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Meeting, June 13-14, 1963, 666 Fifth Avenue, New York, New York

American Institute of Certified Public Accountants. Long Range Objectives Committee

M E E T I N G

of the

LONG-RANGE OBJECTIVES COMMITTEE

of the

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

June 13-14, 1963
666 Fifth Avenue
New York, N. Y.

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THURSDAY MORNING SESSION

June 13, 1963

The Thursday Morning Session of the meeting of the Long-Range Objectives Committee of the American Institute of Certified Public Accountants, held at the offices of the Institute, 666 Fifth Avenue, New York, New York, convened in the Conference Room on Thursday morning, June 13, 1963, at nine-thirty o'clock, Mr. Robert M. Trueblood, Chairman of the Committee, presiding.

There were present:

Members of the Committee

Robert M. Trueblood, Chairman

Clifford V. Heimbucher

David F. Linowes

John L. Carey, Executive Director of the Institute

Also:

Miss Elizabeth Arliss

Guests

Bertrand J. Belda

Leslie Mills

John Peoples

CHAIRMAN TRUEBLOOD: I think you have all had enough material on what the long-rangers are doing to have some concept of how we work. Mostly we have met with individual consultants but we do have a number of panels such as this scheduled and what we do is just to free-wheel completely and try to accomplish two or three things: getting informed views on questions we have asked ourselves; getting challenges from you on some of the things that are already in the record; and, perhaps more importantly, getting from you questions which we should be asking which aren't in the record. But so far as the session goes, it is completely free-wheeling. We don't go down a list of questions. We just talk, no holds barred.

A complete transcript is taken. Today Cliff is taking notes and he will then prepare what we call this working position paper on this session. The transcript is not distributed beyond the Committee but each of you has the opportunity to review the working position paper in draft before it is released. It is not an official document in any way. It is distributed only to those of our members, largely Council members, state executive directors, state officers, and so on, upon request. It is not a finished document. It will not be published, simply because we can't take the time to dress it up for publication, so these are really quite private proceedings and we don't need to worry too much about the niceties of the language.

This session is designed to get the practicing practitioner's point of view. You may or may not realize that we held a two-and-a-half-hour session, I think, at Council meeting, where we invited anybody who wished to come to sit in on the same kind of thing--with a rather different flavor, of course. The transcript of that is available.

[To Mr. Mills] Did you attend that, Les?

MR. MILLS: No, I had another meeting.

CHAIRMAN TRUEBLOOD: Substantively I think relatively little came out of it, but it was a very interesting session.

The reason I mention that is that the transcript of that session will be woven into this session and there will be a single working paper on the practitioner's point of view coming out of the two programs.

[To Mr. Carey] Would you care to comment any further on our method of operation and what we are trying to get at today, Jack?

MR. CAREY: I don't think it is necessary. We have covered fairly well the environmental questions, what the environment may be like in the next ten or fifteen years. Your views on this are welcome, but we haven't got much evidence yet in the record on the areas of professional service and what may develop there and on the problems of education, research, ethics; and the structure of the profession is still pretty much ahead of us, so I sort of hope, as the draftsman of this final report, that we could get into these things pretty heavily today.

CHAIRMAN TRUEBLOOD: Well, with that let's go!

Is there anything particularly on your minds about our method of operation and our approach to trying to work with this problem?

MR. BELDA: I have no questions. It sounds good and I am relieved--I understand I can swear without being official.

MR. LINOWES: As long as you spell it! [Laughter]

MR. MILLS: I must say, Bob, that when I read this I learned--of course, I had read most of it before--I learned more about the Committee and what it is after and what it is doing and it is probably obvious to you, to all of you, that we have got an education job for the membership generally. We can't make them read it unless they want to.

MR. LINOWES: This, I guess we interpret as the two ends, what is completed and the interpretation of it.

MR. MILLS: I wonder whether this isn't like Tom Dewey's book of thirty years ago. We like to buy it, but not necessarily to read it. [Laughter]

CHAIRMAN TRUEBLOOD: Actually, what we plan to do, Les--and we are going to talk tonight about how we will handle the book or the series of monographs--but I think you probably heard in Council that we are going to disband the Committee as soon as this project is done and then, hopefully, set up some sort of a planning committee that can work with the Executive Committee on picking pieces that we will have.

MR. BELDA: I am glad to hear that because I don't think that long-range planning is something that is a one-time shot.

CHAIRMAN TRUEBLOOD: We find, as you well know, that as we go to Council with bits and pieces, if it is set philosophically ahead by eighteen months, it is damn bad [laughter] but that is another kind of problem.

We are hoping to wrap up the panel sessions by the end of the year, Jack, I think. There are four or five more.

MR. CAREY: I hope so.

We hope to get this book, or whatever it is, a summary of the whole thing, done now, I think, by the summer of 1964. There will be a summary of that--highlights--which I hope will be sent to all the members of the Institute. We can't hope that they will all read the book, which is now estimated to be maybe 500 pages, but we are also planning to try to get state societies to devote a day to the book, so somebody will have to read it, or parts of it, to speak from. We are making speeches all of us, even now, about this area and intend to keep it up. And then I am going to do everything I can, as Bob said, to get a very small planning committee, maybe three men, of the best men we can find in the profession, to try to restructure the Institute's entire program in accordance with whatever this thing seems to suggest is sound. What should we give priority to? What kinds of public relations activities? What kinds of ethical problems? What kinds of research? What kinds of publications? And giving effect to whatever conclusions we get out of this exercise.

These men have put in an enormous amount of valuable time at this over a period of years and the ultimate objective must be action and not just a lot of bright ideas.

I hope that will go down to the state societies and we can get some radical changes in the way they look at things and operate out of this as a practical project in my terms.

MR. PEOPLES: Could you give me some idea, John, of just some of the things that you more definitely have in mind that seem almost all wrong in a---

MR. CAREY: Oh no. I think a lot of what is now going on is right.

MR. PEOPLES: Yes, there is no question about that

MR. CAREY: But there are many gaps. Well, just for one example, as an experiment I tried to draft the section on international environment and what it means to us I got 26 pages on that one item and it suggests things that we haven't thought of before that the American Institute ought to be doing in relation with the L.E.C. in Europe and in other countries and this whole idea of reciprocity in international accreditation, maybe how firms, American firms, will have to operate abroad in the light of the trends we have discovered, things that we are not paying any attention to at the moment, so I think we should have a staff specialist on international affairs and the International Relations Committee should have a much more specific program, a much broader one, than it now has.

CHAIRMAN TRUEBLOOD: You see, already, John, the International Committee came out with the proposal that we in effect let foreign students take our CPA exam over here and call themselves International Associate Members of the Institute. Well, obviously, this is a very small piece but I think had it gone through just as it was, it might have had some considerable danger in terms of the way we are thinking.

Could I put it this way: at the meeting of members of Council in Phoenix--and I think we had most of a hundred there, did we not, John?

MR. CAREY: Yes.

CHAIRMAN TRUEBLOOD: Somebody criticized us for not setting our sights on 1975, but on balance I think, with Cliff's help, it sort of came out this way: so long as you have a road map, it makes no difference whether the terminus is 2000 or 1990 or 1975. If you have something that you are sort of trying to follow you are better off than if you take action on individual pieces outside of the greater context. That is all we are trying to do. Does that make sense?

MR. PEOPLES: Yes, I think so. We did somewhat the same thing in our own firm. We didn't put our sights quite so far away as ten years. That doesn't mean that there is anything wrong with twenty-five years, because that encompasses ten, too.

MR. CAREY: I would hope that this would be a road map for firms, too. Probably your firms are away ahead of us, but some of the smaller national firms and some of the larger local firms are beginning to do planning. I have two ? rip plans that I have gotten from local firms--the first time I have ever heard of such a thing--projecting their affairs ten years ahead and they think this could be very useful to them in considering what they may prepare for.

CHAIRMAN TRUEBLOOD: May I suggest that a nice separable subject is management services and the Long-Range Committee has a paper out on the subject. To what extent should this be adjusted or revised, or what have you, in terms of that aspect of our functional approach to the future? Bert!

MR. BELDA: Gee, I am just delighted to be first! [Laughter]

CHAIRMAN TRUEBLOOD: It gives you much freedom.

MR. BELDA: Tell me, is this the time when you want my fifteen-minute sermon?

CHAIRMAN TRUEBLOOD: Yes, fine!

MR. BELDA: Well, I have some notes that I would like to use in this connection. I am also pleased that we can start with something that I am sure will wake up the Committee and panel members so early in the morning.

I have divided my comments into three principal segments. These embrace:

The development of management services by CPAs over the years till the present time;

Second, the qualifications of the CPA and the relationship to the need for his services by industry, commerce and Government;

Three, the prospects for future development of management services in our profession. Of course, number three is the one that I think you are primarily interested in.

Perhaps spending your valuable time on prior experience and current situations may seem to be a little inappropriate, however I think it seems evident that the only sound basis for projecting the future is a clear understanding of the past and the present as it may be correlated to circumstances reflecting these known developments. [or: "affecting these known developments."] However--and this gives me considerable concern--there are too many indications that the attained role and scope of the CPA in management services is not generally known by others, including CPAs themselves, as well as businessmen and business-related professional people.

With that introduction I would like to discuss the past and the present.

Several of my own associates expressed surprise when I reminded them that our own firm's record of rendering management services on a formally recognized basis as distinct from that of auditing pre-dates that of tax consultation by at least five years. Our Systems Department was officially organized in 1908 in order to establish an administrative direction that we considered necessary to render the many specialized services which we now refer to as management services.

While I do not know how long ago similar departments were set up in other major accounting firms, I believe that substantially all national firms have had comparable consulting groups for at least as long as the twenty-two years I have been a CPA.

Even more significant, I think, is the scope and role of the smaller CPA practitioner in the management services field over the past years and into the present and the degree to which smaller firms or solo practitioners assist their clients in the non-auditing and non-tax areas appears to be far more extensive than I think is generally recognized, especially by the accounting and auditing technicians who seem to have received some--or have achieved some prominence in our national and state societies.

My principal basis for this comment is the response to a survey made last year of our smaller accounting firms by the Committee on Management Services. A sampling of 171 such CPAs disclosed that more than half of the respondents render services relating to accounting, costs, credits, mergers, acquisitions, inventory control, production control, organization planning, mechanical office equipment, employee compensation and product pricing; more than a third also render services in the areas of sales forecasting, insurance and data processing.

You may know that the Management Services Committee of the Institute is currently circularizing all the larger CPA firms and representative other firms to determine the present scope and frequency of specialized services offered by these other bases.? I think this is indeed an important fact-finding process that should contribute much needed information concerning the extent to which CPAs now practice in the field of management consulting.

Perhaps our struggles with questions as to the appropriate scope and role of the CPA in rendering management services can be overcome with much less difficulty if the whole profession is aware of these facts.

I can state with considerable confidence that CPAs are now furnishing advisory services in substantially all of the recognized arts and sciences of management excepting law and probably product and equipment design, some of it. These services embrace marketing, including surveys and forecasts; factory layout; psychological testing; acquisitions and mergers; and other areas that some CPAs seem to think are beyond the scope of the accounting profession. This is now being done.

With this comment as a premise--and ignoring at the moment any question as to the propriety of these services--how has this come about? I think this is how:

At the beginning CPAs assisted their clients in establishing accounting systems, associated paper-handling methods, and similar functions directly related to the art of classifying and summarizing business transactions in a ? manner. In substance, in these early days of management services, CPAs generally conformed to the close financial and control functions of the business that some of the current writers on the subject presently feel is the appropriate area and the limited area that CPAs should work in.

However, accounting, the language of business, didn't remain in a static state. The language was constantly expanded as the meanings of the elements changed. Even more important, the assessment of the information that accounting sought to convey became more complex. Those who endeavored to express business transactions and financial positions through the medium of accounting found it was just as important to know the true nature and significance of these actions, transactions and status as were the rules of the language itself.

What I am trying to say here is that in terms of expressing ideas, in terms of conveying thoughts, the rule of performing in the past and future tenses, the regulations regarding the use of numbers, all are important, but it is much more important to know the substance of the ideas that we are trying to talk about. The accountant inevitably finds himself in the position where he has got to know whereof he speaks and how he speaks.

For example, the accountant who was engaged to establish a standard cost system found it necessary to be skilled in the techniques of work measurements, product component specifications, data-processing mechanisms, as well as cost accounting principles in order to accomplish his objective. The need for these skills, that are normally regarded beyond those of the CPA, was recognized and they were, in our firm at least, originally obtained through a cooperative arrangement with other professional consultants, such as industrial engineers. Frankly, this, of course, was unsatisfactory to all concerned, and more particularly to the client. An excellent solution to this problem, not only in my firm but in others as well, is the direct employment by the CPA of qualified people possessing the non-accounting skills essential to performing the entire function.

The addition of talents other than accounting to the management services staff of CPA firms has been a problem for about forty years. It is at least this long a time that our firm has regularly employed such personnel and it is with these supplementary skills that are at its disposal that the CPA firm could and did undertake to perform an engagement such as the standard cost system I just mentioned and he was able to assume the full responsibility for the entire task on a basis that was satisfactory to the client.

Let me go on to other items. The use of industrial engineers for work measurements and the product specifications in the cost system was just the beginning. A rather formidable list of other non-accounting talents has been added to the permanent management services staff of the CPA. In this connection it should be noted that the control function of a business includes the planning and reporting systems, which should be geared to the organizational responsibility and decision-making authority of that business. Planning involves essentially business planning for the future, the lengthy demand for products of the business and the share of markets which might be expected by a given company. Gentlemen, this is the area of skills possessed by the marketing specialist.

The responsibility for the accounting for revenues, expenses and capital expenditures is dependent upon an effective organizational structure. An organization which concerns itself with human relations, with the personal, intellectual and temperamental qualifications of the key managers is the province of the industrial psychologist.

The determination of optimal strategy and effective tactics in planning and development decision rulings--and that applies also and involves scientific measurement and evaluation of a large variety of opposing forces, which is the field of the medical scientist as opposed to the operations research people.

The establishment of the systems needed to supply meaningful information essential to all of these management functions requires today at least the skill of a competent data-processing experience. All of us are aware of the revolution in data-processing mechanisms in the past ten or fifteen years and it is inconceivable to me that a CPA, who can maintain himself thoroughly qualified in the area of income taxes, current auditing,and SEC matters, can at the same time keep himself abreast of the developments in computers and other electronic mechanisms.

Now, these developments in special skills in the management services would be readily related to the financial or accounting control function--again with some suitable limit on management services. However, I don't necessarily subscribe to the proposition that all management services by CPAs need to be directly related to financial control and control elements of the business management.

At this time I would like to emphasize that the growth and expansion of management services by CPAs is not, in my judgment, the result of some design or scheme to extend our area of practice beyond that which our client has actually requested and needs. On the contrary, these services have only kept pace with the natural impositions and the requirements of our clients.

It is always interesting to note that some CPAs render non-accounting management services without really being conscious of it. Some fourteen years ago I wrote an article that was published in the Illinois CPA Magazine and this item discussed the developments and applications of the AICPA orientation and achievement tests which had just been created and in this article I referred to the need for supplemental evaluation of temperament as well as the intellectual and technical appraisals that these tests offered. A partner in a Chicago local CPA firm took me to some task for suggesting the use of psychologists and in the conversation he mentioned the use of a psychologist not only for a recruitment appraisal of staff candidates but also the suggestion that these services might be offered to clients. When I applied this to his own experience in the area of recruitment of accounting personnel for any of his clients he began to practically admit that he had done this a number of times. As a matter of fact, he even mentioned that he had on occasion recruited non-accounting people, such as production and sales people, for some of his clients. In substance, he was performing a recruitment service but he didn't regard it as such, employing professional skills and using all of the sound and effective management tools to render a competent service.

In summary, the scope of services of a management consulting nature offered and actually practiced by a number of CPAs today encompasses a wide variety of business problems, many of which involve skills not ordinarily regarded as being directly associated with the accounting profession. Some CPAs have learned the necessary skills for this work through exposure to similar problems in the course of their auditing and tax work; others have acquired knowledge through some supplementary academic training on the same subjects; still others have hired qualified specialists to perform the non-accounting functions for the management services they do to supplement their own. Which of these methods, or combination, is the best, I don't know.

2 Leaving the matter of expansion of management services now rendered by CPAs, let me comment briefly on the climate for these services.

I have already indicated that the bulk of these developments are really in response to the clients' demands.

I could talk extensively on the problems of business as they have mushroomed in complexity under the pressure of high competition and expanding technological developments and the acceleration of economic pressures in this age of science. However, for this purpose it might be sufficient to say that managements at all levels and in all businesses want and need help. The growth in numbers of unaffiliated consulting firms as well as the expansion of management service capabilities in CPA firms is rather evident testimony of this demand.

I respectfully submit that the CPA is the only recognized professional who has the character, reputation and training to undertake this charge and responsibility of providing the reliable, objective and competent management services so urgently sought by business and Government. I think the reasons for this are fairly obvious but it may be pertinent to cite just a few--after I have a cup of coffee. [Laughter]

[Coffee was being served at this point.]

MR. BELDA: Referring again to the reasons for why I believe that the CPA is uniquely qualified to be the leading force in the consulting field to management, I will list just a few:

First the independent position of the CPA, as expressed in his Code of Ethics and Mode of Practice, provides an ideal basic trait of character to furnish the objectivity and unbiased judgment needed to competently advise management.

Another reason: the solution to most management problems involves the process of analysis. This technique is, of course, one of the core elements of auditing practice. Moreover, the analysis methods used in auditing have been developed with particular application to business transactions and affairs.

Three, management problems in business and in Government also are most often evidenced by money values as related to costs, expenses, capital expenditures, or revenues. The CPA is without a doubt possessed of more evident competence in comprehending of the underlying components and dollar implications of these problems than any other individual I know of.

Four, except for a few general and ineffective pronouncements by a small portion of the unaffiliated management consulting group through their trade organization there is not presently any standard of competence in the consulting field that is comparable to that already possessed by the CPA. Just as an aside on that, it is rather interesting that some of these independent--I wouldn't call them independent--unaffiliated consulting organizations. who seem to raise a question as to the competency of the CPA, have no standards of their own.

Now, these are just a few of the reasons that I thought might be worth while mentioning, which I believe in turn have motivated intelligent, thoughtful managers in business and Government to come to the CPA for help.

My final segment to this monologue is related to the future of management services. With this brief background of review and need and qualifications as a basis, now let us look at the long-range objectives.

As an introduction to these brief comments, I should re-emphasize that the long and successful span of experience in the management consulting field already achieved by many in our profession I think should serve as an excellent foundation for other CPAs to follow.

In addition, I am hopeful that our profession will shortly achieve a much more mature understanding of the importance of the effect of cooperation among its members. I believe that this kind of a development can provide the springboard for technical interchange and referrals among CPAs, which should strengthen the individual CPA and the profession as a whole.

However, there is much to be done in order to bring the standards of practice with regard to competency in the management services field up to a level comparable with that of auditing.

In all of these things the CPA examination must be expanded to include a much more intense coverage of management problems and their solutions. I would suggest that this field should be covered in at least as much depth as is now devoted to commercial auditing.

These needs, together with those of other fields of practice. such as in taxes, may encourage us to reconsider the advisability of establishing various specialized academies within the profession.

With regard to the scope and extent of services, I don't presently know what limits we may reach. As a matter of fact, I have a strong antipathy to the idea of specific limitation by regulation. I should, of course, make it clear that I certainly concur with and agree with our present rule pertaining to compatibility of services that we now have.

Another aside, gentlemen: CPAs are being asked and are answering questions of every sort and character. If they are to answer any of these they have got to answer them wholly, not partially. I don't know whether this has been pointed out but in a little light vein I might say that I have an old tax partner of mine who regards one of his most important contributions to society during the course of his career as the fact that he managed to have prevented four divorces. [Laughter and simultaneous comments]

MR. BELDA: Under the limitation I can foresee a considerable expansion of management services rendered by CPAs Among others I consider it quite likely that the field of applied economics is not far distant from the scope now performed by some CPAs Actuarial science is already included in the areas of services now offered by a few CPA firms

A third area: undoubtedly the whole field of management sciences will continue to grow in importance as a major area of service. Every day that passes sees hunches, guesses, intuitions, and other sensing techniques that were traditional to old-line management, give way to the logical science of mathematics and sound analysis. This development offers tremendous opportunities for management to eliminate loss and waste and to achieve added revenues, also improvement of profits and more efficient production and distribution.

Measurement of the true value of a particular business program continues to be an elusive element. Profitability in an accounting sense is rarely adequate to appraise the degree of better-offness that has or will be achieved by the implementation of a management decision. The qualitative relationships between short-term and long-term profits,for example, continue to confuse management planning and results. It is to this area of research and study that the CPA and the management scientist can and should address their attention.

In conclusion, I regard the management services that the CPA performs to be an accomplished part of our professional capabilities. Although I don't have any official figures, an informal estimate made by members of the Committee on Management Services indicates that there are much more than a thousand full-time specialists now engaged in such practices within the profession. I am confident that these numbers will grow at an accelerating pace, probably exceeding the relative expansion of tax and others.

You may note, gentlemen, that I have made no reference at all to independence. I didn't think it necessary, but I will be open to any questions on that and any other subject.

CHAIRMAN TRUEBLOOD: Who wants to kick off?

MR. MILLS: I suppose we can ask questions, too?

CHAIRMAN TRUEBLOOD: Oh, yes, definitely. Desirably so.

MR. MILLS: Are you going to discuss each one?

CHAIRMAN TRUEBLOOD: Well, it may get kind of mixed up because Bert has a deadline Let's focus on management services for the moment.

MR. PEOPLES: You mentioned that the CPAs are particularly adapted for this type of work. Isn't it probable, though, with the terrific expansion there has been in this field, especially since the War, that in effect CPAs, a lot of CPAs are not doing the work, even though they are employed by CPA firms?

MR. BELDA: You mean, non-CPAs?

MR. PEOPLES: Non-CPAs are doing a good part of the work

MR. BELDA: In our own experience, yes.

MR. PEOPLES: The ultimate end of this must be training our own people. It has been necessary, certainly, to go out and hire people. We find that they are not nearly so competent, though, in preparing working papers, thinking in the analytical way that you have mentioned, and, while at the moment there is a lot of this work being done in the name of CPAs but not by CPAs, I think in the future substantially all of it will be done, so that raises some problems in my mind. Some of these things that are done in management services are so difficult in themselves that it is impossible to qualify in--to get the CPA, say, and at the same time qualify, say, mathematically in operations research.

MR. BELDA: No, they are not that impossible. As a matter of fact, in our firm, and I am sure in many others, we have many dually qualified people.

MR. PEOPLES: I know of no actuary who is a CPA, no

Fellow of an actuarial society or institute who is also a CPA. I think you will see some because personally I think the CPAs may be a little easier to get than the actuaries, for example.

MR. MILLS: Well, but, John, traditionally, over in Scotland there were actuaries before there were CPAs

MR. CAREY: We used to have that problem in the CPA examination when I started in.

MR. BELDA: Apart from actuarial science---

MR. PEOPLES: He is an actuary, I think, in the sense that most of the Scottish societies--there were three of them, in Glasgow, Edinburgh and Aberdeen--and it is also described as "The Society of Accountants and Actuaries" and they always did have questions in it.

MR. MILLS: Leslie Banks was an actuary in the United States and so was Macgregor.

MR. CAREY: But Bert would say that aside from actuarial science---

MR. PEOPLES: As a matter of fact, I am not sure of my points. I put it as a question.

CHAIRMAN TRUEBLOOD: Mr Carey!

MR. CAREY: I just want to underline the point. I think you were about to say "aside from actuarial science," but you do have CPAs who are qualified operations researchers, or qualified production control people.

MR. BELDA: Right. Combined industrial engineers and mechanical engineers--for that matter, civil engineers--who are CPAs. Now, this, I think, will grow and it means, I think, in the management services field that we are going to be looking more and more toward this dual qualification.

CHAIRMAN TRUEBLOOD: Leslie!

MR. MILLS: Your comments raised this point, which is a practical point for us. Most of us take a long-range professional problem and that is, how can you give people like that, who are non-CPAs but who are rendering this top-level service, a degree of partnership status, and if you do, what does it do to the general concept of parnership that should be a partnership of CPAs?

MR. BELDA: Well, in our firm at least--and in this we have actually trailed in this area to other management firms when we have created the status which we call "Principal." Legally this individual continues to be an employee but by his terms of employment status he has all of the rights and privileges of a partner and is so regarded This is our solution and it is a brand new one for us but, as I say, other firms have had this for some time.

MR. MILLS: That is our solution but we are going further. The titles are not important--he can be a director, or what have you--but we are moving towards additional status besides title, which includes a trend to partnership status. Not only for legal reasons but as a practice we don't intend at the moment to certainly have them put in capital or do any voting, but it bothers me a bit. I think it is necessary and they are entitled to it, but it bothers me in that the attempt, obviously, is to give them--at least in some of the companies--the position of a partner but to protect ourselves by saying they are not partners and in doing this, in fairness to them and for our own practice problems, I don't think we have gone too far yet but there may be a tendency to go too far.

For example, you know the Canadians don't seem to have any inhibitions about setting up a corporation to do that work where we do at the moment, and yet generally the public here and in Canada thinks that the accountants are just as ethical as they are here, so it just causes me to suggest another examination of how you do those things.

CHAIRMAN TRUEBLOOD: We have, of course, done the same thing and maybe gone further than you, because so far as the public is concerned I think none of our principals are legally partners--if I can use "legally" legally.

MR. BELDA: Well, our principals actually make a contribution---

MR. CAREY: Ours do, too.

MR. BELDA: [continuing]...but this is regarded as debt rather than equity.

MR. CAREY: May I---

CHAIRMAN TRUEBLOOD: Yes. I want to press back to the training situation here. Are you going on to a new subject?

MR. CAREY: I am going to extend this one. This problem is in terms of the entire Institute membership and I don't see how the philosophy that you are talking about can be adopted by smaller firms. It takes a large firm, a fairly large firm at least, to extend these services over the whole range.

I don't think there is any point in having any argument here about scope. I don't think there is any real problem, in effect, because I don't think there is any possibility of an enforced limitation on scope and I don't think it is desirable even if it were possible because people have to expand and things have to grow and there is no rigidity here as there is in the practice of law in the tax area, which is an entirely different legal position.

What I am trying to get at is, as to scope, to what areas can we claim that the CPAs as a whole are competent to perform. I don't see for the next twenty-five years that we could ever in a public relations campaign suggest that the membership of the Institute is competent in the area of actuarial science or operations research. I think here we are not trying to limit anybody but we have got to get somewhere what we consider the common core and then we have got to introduce it into the educational system and into the CPA examination, but this is a problem. What is the common core? Can you help us there? What do you think we ought to suggest, for example, should be taught at the basic professional accounting levels at the school that prepares a man for at least the minimal competence in your area?

MR. BELDA: Well, I can perhaps speak relatively a little more objectively than I can speak absolutely. I would like to take all of your comments into pieces, if I may.

If we go into competence in areas of practice, I don't know what I can suggest beyond some means of objective or subjective testing, but I think we must realize that a large number of people in our profession, particularly the smaller people, profess some knowledge to their clients which may or may not be quite what the rest of us would regard as competence. I can imagine--in fact I have seen situations of this kind where a small practitioner gets involved with a registration statement and frankly he knows about as much--has about as much technical knowledge and know-how about this as he might have if he approached an operations research problem and yet he holds himself out to do this sort of work.

Right along those lines--if I can find my grades over here [getting out papers]--I would like to dwell on this just a moment because we have had some interesting confusion. I appreciate that sometimes semantics enter into this area, but of these small practitioners, for example, 37 out of 171 said that they render service in operations research, or 21.6 per cent.

A gentleman down at the University of Texas is currently making a special study of the subject and when he saw the results of this sort of thing he just thought it inconceivable. He said, "I doubt if there are more than twelve accounting firms, if that many, that have competence in operations research--at least as I understand it."

MR. CAREY: These guys didn't know what operations research meant.

MR. BELDA: Perhaps not, perhaps not. And then, too, you must realize that there are degrees. Maybe they are competent in operations research. I can remember long ago, about twenty years ago, my company made a study of antimony standard in Laredo, Texas, and we had an algebraic equation that I think was twenty-one pages long, in which we took seven variable elements and equated them and I just barely got through trigonometry and I don't remember a thing about it in terms of my own personal competence in mathematics, but today, as a matter of fact, we refer to this as an O.R. stage. It was a complicated mathematical equation.

And people who are concerned with the profitability of a saleman's, or a customer's have a series of elements that they must take into consideration. It isn't a major problem but it is the kind of a problem where various opposing factors, as I call them, are balanced, weighed, and an optimal solution is reached.

Now, I don't suggest that these people that profess operations research--even if they know what it is--can necessarily do all of the work necessary--are qualified and competent people in terms of what TIMS or ORSA might regard as being such, but this is true of an audit. A fellow who does write out work for local gas stations might accept an audit for a bank.

CHAIRMAN TRUEBLOOD: Well, let's--I have you on the list. I want to pursue this particular phase of it. Let's go back. I agree with, I think, everything you said about the extension of qualification within the firm and within the profession, but let's go back to the basic qualification of the CPA. I think you said this, and I certainly would agree, is basically oriented to the accounting discipline, which is a very, very narrow tool in terms of our whole perspective.

Let's move over to the management scientist, for example, and counting as one of their tools I might oversimplify it and say that mathematics is the base of their--so that duality here is no problem. Right?

MR. BELDA: Right.

CHAIRMAN TRUEBLOOD: In terms of the exam, training, or what have you, the duality is no problem.

But move over to the industrial psychologist, now. Do you literally mean that in time he would be a dual kind of guy, or would he always be a specialist?

MR. BELDA: I see no reason why these are incompatible at all. The fact of the matter is, it is interesting to observe and we have deliberately endeavored to recruit those people who have specialties--undergraduate degrees,perhaps, in business administration, or graduate degrees in psychology, in order to---

MR. CAREY: I think that is okay, but would industrial psychology be in the CPA exam?

MR. BELDA: Right now I can't imagine that.

MR. CAREY: I can't either.

MR. BELDA: It isn't part of the basic core.

CHAIRMAN TRUEBLOOD: The CPA would still be the basic qualification, with a considerable extension of its scope, but the differing specialties, in terms of disciplines such as psychology, would still be a specialty superimposed upon the basic broadened qualifications. Is this your view?

MR. BELDA: I think that is a pretty fair statement of my view and yet I don't know--if we are talking about 1975 I am not so sure. I would think--I think--and it comes back to my recent statement--that to do a good job, to do a complete job in these areas of control, of planning, we must be prepared to use the kind of talents that are necessary and desirable to accomplish this.

One thing leads to another--and I didn't discuss this yet, but I thought somebody might ask about it, and that is--and there has been some comment about it--the difference between in-house and out-of-house competence and holding out of services. You have an industrial engineer on the staff who is used for work measurement purposes. Well, now, I don't know if any of you are familiar with work measurements but a good time study man, for example, begins his work by saying, "Is the job necessary? Is it being performed on the proper equipment?

Is the work flow to and from the work station being handled effectively? Can the task be combined with another?" And so on. "Is the individual workman competent and capable?" All these questions should precede the actual time study and measurement technique of leveling factors and other elements that work into the determination of what an operation should require.

Now, with this kind of analysis, assuming that the answer to any one of these questions is in the negative, does the industrial engineer stop and say, "I am with an accounting firm and I cannot proceed beyond my basic task of work measurement."? Or does he say, "Look with a different layout and a different piece of equipment we can do a better job."? The
3 answer is rather obvious, I think.

CHAIRMAN TRUEBLOOD: But I can see a certain duality and compatibility among certain things, like the ORSA people, the TIMS people and the industrial engineers, but now you yourself say, "Well, psychology is a little bit different." Now, what else is a little bit different?

MR. PEOPLES: Would it be--for example, you say that the man should be psychologically fit for the job. He also should be physically fit for the job. Should we practice medicine as part of that? I am just tossing this out as a thought. I just wonder if psychology really isn't so far in left field that it hasn't much to do with the CPA.

We may have psychologists on our staff,I don't know. [Laughter and general simultaneous comments]

Let me say that physical fitness is just as important as mental fitness and where do we draw the line?

CHAIRMAN TRUEBLOOD: What I am trying to do is to press Bert, as you are, I think--

If you carry your argument to its logical capacity then would you say that the CPA should be examined in and presumably competent in any area in which any businessman might ask any questions?

MR. PEOPLE: I was twitting one of my friends in another firm about some particular things that they were taking on, "Well," he said, "we are doing practically everything bar the tax rate." [Laughter]

MR. MILLS: Bob!

CHAIRMAN TRUEBLOOD: Yes? Les!

MR. MILLS: I was going to make some comment myself on this. I think what we really do is that there is a basic core of educational experience that qualifies you as a CPA. From then on you can speak still as a CPA, the prestige and all that, on other matters, providing you are qualified.

Now, if you take it in reverse, here you are getting a certificate of the necessary experience and maybe even a membership in the Institute, but that is only the beginning. You still may know so little about psychology and human nature that you can't work with people, so you are no good. You may know nothing about economics, so if you do nothing but juggle figures and don't understand them, you are just no good at all. If you are good--and the better you are, the broader your experience is, that came either by other education not essential to the CPA, or by practice or by anything else--so I think there is something along this line.

MR. CAREY: Does what he is saying apply equally to the tax area?

MR. MILLS: Sure, except there is a kind of specialization corollary, but it does raise this, like ? said--maybe it is oversimplifying but I think you can take from our Ethical Rules of General Practice that an accounting firm shouldn't sign any report or give any advice which the partners themselves are not capable of doing, so we are in sort of a dilemma if we don't happen to have any CPA who is qualified, or was, to submit a report made by very qualified lawyers.

MR. BELDA: I think I could perhaps partly answer that by another analogy with taxes. Our firm, and I am sure yours, has a number of people who are attorneys, yet they don't practice law. We use this particular skill and knowledge, which happens to be very valuable, an ideal background among others, for tax counsel and tax activities. We regard our psychologists in about the same category. We feel that they are important, valuable adjuncts to the total practice of business counsel and advice, but we don't practice psychology.

CHAIRMAN TRUEBLOOD: Dave!

MR. LINOWES: Well, it is along this same line and I have had to test on the point of using--for example, it has been shown many times in the past that accounting is a long-legged business and when we say that we don't really leave any room whatsoever for the economist, the ? ,or anybody else, and I am just wondering whether or not we are justified in trying to usurp for ourselves this broad area and I say that for this reason: it just so happens that we are the best developed professional organization and profession. That might be a compliment to Jack Parry, it may be a compliment to the far-seeing accounting of a previous generation, but nevertheless we are the best developed. Just because we are, does that give us the right to feel that we are entitled to every area of work that touches on business, or should we not be broad enough to recognize that there are such areas requiring true scientific training, which none of us have, frankly? CPAs don't get real scientific training as a base. Should it really be a type of scientist who should be taken into these broad areas, the mathematician rather than the accountant, who is on the periphery?

And you more or less extrapolated from the little practitioner in your comments, saying that, well, accountants have always done management service work but never called it that and larger firms should therefore begin to specialize and hire highly trained, capable experts in these areas. That doesn't concern me as applicable for the reason that very often physicians--making this analogous to other professions--will discuss morals with patients because it may be related, yet we don't say he is a theologian and minister and therefore should--only he should not practice theology.

I find it disturbing for purposes of the discussion to feel that we have a right to spread ourselves over this entire area,especially when we realize that people like Peter Drucker I don't believe would ever want to claim himself to be a CPA or would ever want to be part of the CPA profession, yet if anybody would have a right, shall I say, by virtue of his capability and his writings, it would seem to me that he should speak for business management more than most outstanding CPAs.

MR. BELDA: I think you have got an interesting point, but it isn't claiming a right so much that I am concerned with, it is meeting a need that exists that I am most addressing my thought to and comments. I will confess that there are some areas in your charge that I might have overlooked in my original comments, but let me re-stress that we are in a position--when I say "we," our country and the world is in a situation today where there isn't any other recognized group who can shoulder this responsibility. There aren't enough Peter Druckers to handle this kind of work and some place, somehow--it is just like ten years ago somebody inquiring about a man to head up the design and installation of a complicated computer and the specifications being that he must have fifteen years experience with this type of equipment. There just isn't such an animal.

I don't think we can escape it. As a matter of fact--well, I will just let that statement stand. And if we can escape it, we must do something about it, do more than we are doing, particularly in the area of training, competence and development. Much of this has been, as many other relatively new--at least, the scientific aspects of business, perhaps, are new in their definition if not in their practice--there must be adequate fulfillment of this. Some of it is trial and error and this is costly and expensive. I am sure that the accounting, and the CPA, the concept of income and all of these things proceeded much along these lines. In a sense I think the position of management consulting in the field of professional practice in possibly sixty years is comparable to the CPA profession of the CPA sixty or seventy years ago. Someone has to drop the ball. I don't know how the original CPAs became qualified other than they understood some of the writings that were in the nature of ? . In fact, I think our first practice in systems was the installation of double-entry bookkeeping systems. How was this learned?

It is a shame, perhaps, that we cannot create a new professional man and there is some attempt being made at this, but the fact that a man has a graduate degree from Harvard Business School doesn't make him as qualified a man, in my judgment, to be a business counselor as a CPA.

MR. LINOWES: What if he was a graduate of Yale? [Laughter]

MR. MILLS: I want the record to show that if this discussion goes on I will discard [remainder drowned in laughter] but I want to say this: I think maybe we are over-complicating this or maybe misdirecting it and I would like to say--when I get a chance--that with respect to policy that we can do planning on it and broaden our perspective, but let me put it this way: if a prominent attorney--let's say that Roswell Magill, recognized for going about in Government service, wants to speak to a Congressional committee on the state of the economy--which he did, as a matter of fact--he gets introduced as a prominent attorney, a member of a large firm and a man who is well known and then he speaks with authority and is listened to respectfully by the group as an authority on the economic situation. I see no reason why an accountant, who has had his education and training, who has proven himself, he may be introduced as a partner of his firm, and he talks on how to manage people and how to do this and do that, and he ought to be listened to as an authority. His basic qualification is that he is a CPA and he is a success in his profession. So I am concerned at the self-imposed limitations that we seem to be putting on ourselves--and we don't have to--he doesn't have to get up and say, "I am a member of a law firm, I am also a psychocologist, I am also a personnel expert." He is a success in his profession and there I think that for long-range a person who can say that he is a CPA and has a career of success as a CPA should, to an informed person, be looked on as more qualified than an attorney, because an attorney could be a great success in his profession if he keeps himself narrowly as an attorney, he could be a great success and still be an estate tax specialist, an attorney like Magill, or Foshay, or any of these people that are well known as accountants, like the ones I have mentioned.

MR. BELDA: I am interested in that comment because I have often said that the attorney is the only man who csn practice medicine without a doctor's degree. [Laughter]

CHAIRMAN TRUEBLOOD: But, Leslie, go back a little bit--and the other professions are as concerned about this as we are in their own way--does this not, however, get back to the fundamentals of training the whole man and broadening his initial view and casting some reflection upon our present training?

MR. MILLS: I think that is on page 9. [Laughter] It does, very much.

MR. CAREY: I made a feeble effort to stop the argument about its scope. I didn't get anywhere. [Laughter] Because I knew it could go on all day and I don't think it is necessary in this context.

Could I ask a couple of short questions?

CHAIRMAN TRUEBLOOD: Go ahead.

MR. CAREY: I think that short answers would be possible.

You mentioned very casually a couple of things. One was cooperation in the profession. Let's go back on the small firm. There are 12,000 of them, there are only eight of you, and we have got to speak for them all. Do you think it is practicable for this prettty broad scope of service to be rendered to small businessses through referrals? If a small firm has a general understanding of the management problem, the organizational, the technical, can he bring in your specialists on a consulting basis to render the service or does he have to manage with other people and build up his own organization?

MR. BELDA: We are well aware of this. This is exactly what the Committee, the Committee on Management Services is endeavoring to provide in sensing the field.

I can predict other things but the outcome of this I am just not in a position to say. I hopeful---

MR. CAREY: You think we should work at it.

MR. BELDA: Oh, by all means--and we are working at it.

MR. CAREY: Good. Then in 1975 we might be able to say as the Institute and the Institute might be able to say as a spokesman that broadly the profession is prepared to help business in these areas. Now, if I am a local firm with only three partners I know where I can get the help. This is the point.

MR. BELDA: Yes.

MR. CAREY: Okay.

Now, may I go on?

CHAIRMAN TRUEBLOOD: Go ahead.

MR. PEOPLES: Do you really think, though, that that is the way it is going to work out?

MR. CAREY: I don't know.

MR. PEOPLES: I think it is fine if it did, but what do you do if in effect this large firm renders some rather superior service and the other people say, "Well, we would like to extend our field. Of course, it is true we can't extend it without talking neighborly."?

MR. CAREY: Well, that's my problem.

MR. PEOPLES: For example, we had a registration statement once and finally the people said to us, "Well, we would like you as our regular lawyers."

And we said, "We can't do that."

So they said, "If we don't take you, we are going to take somebody else." And they did take somebody else.

MR. CAREY: That is my problem as a local practitioner.

MR. PEOPLES: I mean, it is fair to say this is going to work this way, but---

MR. CAREY: I say, that is my problem as the local practitioner. I wouldn't call you in unless I was sure I could hold a client in the first place.

MR. PEOPLES: That's right.

MR. CAREY: So that is where he made a mistake.

MR. PEOPLES: As a practical matter I don't think there would---

MR. CAREY: He wasn't competent enough to---

MR. PEOPLES: But how does he become competent enough in some of these fields? I mean, if one had to say it needs several partners at least to do the thing, what do you do? I think if I were the small practitioner and not competent I wouldn't call anybody in. I wouldn't even---

MR. CAREY: That is exactly what they do. [Laughter]

MR. LINOWES: It is the competence aspect. It is not--in fact I know an instance where just the reverse happened, where a national firm was called in--and it happened to my firm, former firm--and after they came in and did their specialized work for which we called them in, he said, "I will never have the national firm in again. I mean, I just couldn't get the kind of attention I wanted. I mean, we love you." And he kept referring work to us. So I think it depends on the quality of the work and if there isn't competence then by all means the incompetency should be shoved out to one side and let nature take its course.

MR. HEIMBUCHER: You recommend that the small man should call in an incompetent large firm? [Laughter]

MR. LINOWES: No. They happened to be a very competent large firm but they did not get the type of personal service and understanding of problems that a different firm has. It was the personnel there rather than the firm and I think that is true in all of this work.

MR. CAREY: There was another little side remark in the very beginning about the professional recognition extended to the auditors.

Do you have a feeling--I suspect it is prevalent among the people who are in your field or work--that maybe the management services of CPAs haven't yet been accepted even inside the profession and maybe inside their own firms possibly as full-fledged professional people. I have a feeling that tax men sometimes feel that way too. Is that right?

CHAIRMAN TRUEBLOOD: About management services or about themselves?

MR. CAREY: No, about themselves, that there is a little splitting off, that the auditor, the CPA, is still the dominant fellow and that the management service man and the tax man is regarded as a kind of a peripheral part of the firm or---

MR. MILLS: Well, in large firms that is so because large firms are so disciplined in accounting and auditing, although the tax area is usually more profitable on an hourly basis, but I don't feel that down-grading is concerned.

MR. CAREY: Do you feel that there will be a tendency toward integration by inter-staff training and that the thing eventually will be a unit? It seems to me now like a kind of a three-pronged service that the firms are offering. It doesn't seem to me quite right somehow.

MR. PEOPLES: It is integrated a good deal more in the tax field, I think, than it is in the management services.

MR. CAREY: But the goal should be---

MR. BELDA: I think so, but that certainly is the way we are working.

CHAIRMAN TRUEBLOOD: I don't know, John, what you mean.

MR. CAREY: Well, I mean that every boy who comes into the firm ought to have a period of training in all the areas.

MR. MILLS: You are only talking about training?

MR. CAREY: Yes.

MR. MILLS: What about your practice?

MR. CAREY: About education and training, so that he has a relatively---

MR. PEOPLES: Would it be every boy? I mean, if he is to study everything he must think this end of it is more important than the auditing function because it is the greater one.

MR. CAREY: Let's say everyone who is going to be a partner --let us put it that way--sooner or later would get a working knowledge of the other areas.

MR. BELDA: May I just make a comment or two on that point? I think it is a good one.

I think that we are moving more and more toward integration in one sense but at the same time there is more and more specialization, which tends to defeat this particular aim, in our particular activity, where we always see to it that the auditor, the chief, the executive partner, is closely allied with the project that these management services people are concerned with, but at the same time the greater specialization is such that the auditor, as I tried to indicate, finds himself more and more at sea in comprehending the specifics, the technicalities, of the job. Now, he can look at it from the standpoint of a broad business judgment, but that is where he is limited.

If there is a comparable problem, I would suggest that, at least in Cleveland, the best men that we have hired in the last few years on our audit staff are all men, substantially all are men who came to us as management services candidates. These are men who very often are not accounting majors. Some of them have graduate degrees in accounting with engineering or mathematics as undergraduates, or vice versa; some are history majors, who are just good people, bright people; but the restrictions and the requirements of the state with regard to sitting for the CPA exam, particularly in Ohio, where I believe it is now a specified number of hours in accounting, is limiting our opportunities to attract these people, and the interesting part of it is that fully a third of those that were hired in this particular capacity four years ago, and it was thought that four or five years on the audit staff would be their training program for a management services staff, have already indicated they want to remain as auditors, which they like. We didn't think they ever would.

I am not concerned about that. We need good men of all kinds in all areas. In fact, one of them wants to get into taxes.

MR. MILLS: Send him over! [Laughter]

MR. BELDA: But we have got a problem in this educational requirement in the CPA exam.

CHAIRMAN TRUEBLOOD: May I ask another quickie having to do with the specialization we talked about? You presume specialization, Jack asks about referrals, philosophically you are with us in what we have said. Now, what about specialization amongst firms? That is, do you predict that we may have even the smaller, or conceivably the sole practitioner identifying himself as a specialist?

MR. BELDA: I think that is entirely conceivable. I don't think it is very likely. I wouldn't say it is probable to any great extent. Of course, there have been some examples of that.

CHAIRMAN TRUEBLOOD: We have had it on an industry basis.

MR. BELDA: Right, and I think Mackenzie was the one we got it from.

MR. CAREY: Well, that wasn't originally---

MR. BELDA: But this is an exception rather than a---

CHAIRMAN TRUEBLOOD: You don't think it will build up that way?

MR. BELDA: I wish I could say yes, but I don't think so.

CHAIRMAN TRUEBLOOD: And why do you say no?

MR. BELDA: Because I don't think these smaller firms generally equip themselves with the competency in the management services area and strive to this particular objective.

MR. CAREY: Well, you could take a guy like Gene Brown, who has worked for a firm, gone to Harvard, he is tops, he is young and you can conceive of him as going out into practice alone and offering his services to other firms.

MR. BELDA: Well, this is being done, but unfortunately I think it is being done more by non-CPAs, who are in a small community.

CHAIRMAN TRUEBLOOD: I was thinking, for example, of this kind of thing: let us say you have a CPA with a competent management science approach to something or other, maybe several things. Let us say he decided to build around himself a group of ORSA types and deliberately stayed out of the auditing field. Now, this would mean that you could then have referrals, as it were, amongst and between smaller firms rather than the behemoths, which would probably improve our referrals.

MR. BELDA: There are some of these already, such as you suggest. In fact, our replies indicate in some instances where practitioners never do anything but taxes or never do anything but the sort of thing you are talking about and they would be delighted to act as a referee. However, the prospect for immediate development in this field without some real overt act to promote it, I don't know is too promising.

CHAIRMAN TRUEBLOOD: Should we promote it as a positive referral, do you think?

MR. BELDA: I think it sounds very good.

MR. CAREY: This leads to your other allusion to academies. Do you feel that the Institute ought to develop organized efforts for specialists either just for their exchange of view as in sessions or for the qualification of specialists, as in accounting.

MR. BELDA: I would like to see that done.

MR. CAREY: Both?

MR. BELDA: Yes. The thing that I would like to see, however, is that there be a core qualification for the CPA with added test measurements of competency to qualify in other fields.

CHAIRMAN TRUEBLOOD: Agreed.

I was about to declare a five-minute break, Les.

MR. MILLS: May I make one more point?

This specialization point leads to a question as to the action of the states in recognizing another state's CPA. Specifically we had that difficulty in our firm when we had a CPA from out of state come to New York because when he made his application in New York for reciprocity, I guess it was, and the work described that he was doing was tax work, they rejected one case on the basis that they would give reciprocity if you have experience in a general accounting firm. Well, our people always have, almost always have, so that case was just a question of straightening it out.

The point is that a CPA in New Jersey or Connecticut, for example, if he does nothing but tax work and I would presume one of your specialties, and tries to get reciprocity in New York, they will bounce it if you make an honest description of your job.

MR. BELDA: We have the same difficulty.

MR. PEOPLES: Fifteen years, I guess, of course---

MR. MILLS: I am thinking of the younger fellows.

MR. CAREY: I think the state requirements have to be overhauled somehow and the test should be the general core of basic qualification we are talking about, corresponding to the educational pattern of the future and this emphasis on the application of generally accepted auditing standards for so many years, I don't think that can stand up.

4 CHAIRMAN TRUEBLOOD: Just a few years ago California got the new law passed.

MR. LINOWES: [Several inaudible words] ...requiring a four-year policy with regard to the CPA exams, but unfortunately it has some of these requirements. It requires a major in accounting, but, of course, I regard this as a good step forward anyway. We can change the major later.

MR. CAREY: That's right. So long as the law doesn't specify any subjects.

CHAIRMAN TRUEBLOOD: One o'clock is a long time. I think we will break here for five minutes.

[The meeting recessed briefly.]

CHAIRMAN TRUEBLOOD: We won't wait for Jack. He is tied up on the telephone.

I think we will take just a little more time concentrating on management services and then ask Les Mills to make his preliminary statement.

Cliff, we ended up with your hand up.

MR. HEIMBUCHER: Yes, I would like to just go back to a comment you made in your initial presentation there, to the effect that many CPAs are performing certain management services without even knowing it and I think by implication maybe you said that the client didn't even know that the service he was asking for and receiving in some cases was what we call management services, and this is somewhat borne out by a recent study which you may or may not have seen, an opinion survey that Elmer Roper made for the Institute on public opinion with regard to CPA services and one of their conclusions was that CPAs are very highly regarded and I asked all kinds of questions, which confirms your statement that the client comes and asks questions on many, many subjects and regards the CPA as being very intelligent but usually just in a very limited field and when asked a question of where they go to look for management personnel, to recruit management personnel, and they were asked, "Would you go to a CPA firm or to a CPA?" they would say, "Oh no, we would go out and find a management consultant."

I wonder what comments you would have on that and how you would go about correcting this situation?

MR. BELDA: Well, my comment is simply to confirm what you have already said. I think that I could at least if not quote paraphrase a reply that I thought was interesting in this survey of the Committee on Management Services. One practitioner, after listing at least half of the general areas of management services as being of a nature that he regularly performs for his clients, later on in the questionnaire went on to say that he didn't believe in CPA firms rendering management services.

And I think, among other things, we need a better exhortation of the profession to recognize what they are in fact doing and if for no other reason, if the profession itself is to realize fat fees for that service, but, again, the smaller practitioner particularly, I would suggest--I am not sure that I can talk for any proportion of them as individuals, but certainly between taxes and management services--and if you will excuse me, I consider taxes really as a part of management services, at least with similar flavor and aptitudes but different skills--this comprises, I would suggest, a very important if not the bulk of revenue that most small practitioners achieve. It is surprising to me to see the extent and, from what personal knowledge I have, the very little auditing done by the small practitioner, in the classic sense at least. So this isn't something which is really foreign.

I don't know on what basis he may charge his fee. It might be on a retainer variety under which he renders a considerable amount of differing services over the course of a period of time, but I would like very much if we could, shall we say, upgrade his work in terms of what he calls it for the benefit of the whole profession.

MR. HEIMBUCHER: Do you think that there would be any advantage in trying to encourage the smaller firms, or to try to reach them in such a way as to do the management services work on a somewhat more formal basis and encourage them to give written reports instead of oral reports, and this kind of thing. Would this help, do you think?

MR. BELDA: I think it would. On the other hand, I think you must be responsive to what the client needs and expects from his close relationship with his CPA, but I think it should move in that direction, yes.

There are other reasons for it. Among those I might mention is that it is pretty certain that the CPA in his consulting capacity understands what he is about to do and achieves a solution to whatever problem is presented to him in a manner that the client comprehends as well. I sometimes feel the approach to their own viewpoints is harmful and that there is something lost in the transmission of the memory of what has transpired or what actually has been expended.

It is part of the job, of course, of selling the public and specifically the client on the value of the services rendered. I think these things help to do that and sometimes I think it is to the interest of the client to get some sort of odd copy, if you will, of what consideration was given to the problem and what the final solution or solutions might have been. I think this should be a much more formal development because I feel there should be formal development in terms of competency in these areas.

CHAIRMAN TRUEBLOOD: Now, before we go on, are there any other questions of immediacy?

[There was no response.]

CHAIRMAN TRUEBLOOD: Before we go on, Bert, would you put in the record this other thing?

MR. BELDA: Yes, I am going to do that.

While I again express the pleasure and the privilege of discussing these subjects with the Committee and Panel, I think we must recognize that management services, by its definition and its nature, is possibly one of the more nebulous areas and even possibly more a controversial area in the accounting profession. I would like to suggest to the Committee that it seriously consider obtaining the views and ideas of other practitioners in this field before it comes to its conclusions. I have no reservations about anything that I have said but at the same time I think you should find it very worth while and I would be somewhat concerned if your exposure to practitioners on an oral basis, a specific basis, such as we have today, would be limited to the comments I have made. I would like to see you expand the interrogation.

MR. LINOWES: Do I infer from what you say that there might be others of top stature in the profession who might take a view different from what you have expressed today?

MR. BELDA: They might, yes.

MR. LINOWES: Are you aware of any? In other words, can you give us a hint as to names that might take a different position?

MR. BELDA: Yes, I would suggest that Mr. Trenten, of Arthur Andersen would give a different viewpoint. I could think of other people that you might wish to talk to: Gordon Murray, of Haskins & Sells; Herman Heiser, of Lybrand; Henry Gunters, of Price Waterhouse; and I think possibly also you might consider a somewhat smaller firm and I can't think of anybody better that the Chairman of the Committee on Management Services---

CHAIRMAN TRUEBLOOD: George Olive.

MR. BELDA: George Olive.

CHAIRMAN TRUEBLOOD: I was going to ask you this question. Would a formal exposure to the Committee as such be helpful, or--maybe I should ask the second question first: is it your feeling that your views on management services are essentially ahead of those of the Committee taken as a whole?

MR. BELDA: I would suspect so, but I would like to qualify that by saying that the membership of the Management Services Committee is--I think the majority of the membership comes from the smaller firms.

CHAIRMAN TRUEBLOOD: I see.

MR. BELDA: And I suspect that if there is a reason for it, this might be one of them, but I think it would be worth while. If you don't interrogate or meet with these people you ought to at least get some reaction in informal notes or memoranda that you could peruse and decide.

CHAIRMAN TRUEBLOOD: Let me remind you of this: the Long-Range predecessor Committee to this--I guess Herman Bevis was then Chairman--put out a paper in the Journal and the objective which came from it, which is a somewhat more guarded position than yours, but I don't think essentially so.

MR. HEIMBUCHER: They are not incompatible in any way.

CHAIRMAN TRUEBLOOD: They are not incompatible in any way, but at that time we had, let me see--was Jack Seidman on the Committee at that point?

MR. CAREY: No.

CHAIRMAN TRUEBLOOD: Not initially. We did consult with three or four people before the paper went out, in the way you suggest, and it was exposed to counsel and discussed on the floor and did pass, so this is not a vacuum kind of thing. I mean, you are not this old consultant, except to the point that you are going beyond that position.

MR. HEIMBUCHER: He is being much more specific, though.

CHAIRMAN TRUEBLOOD: Yes, more specific, more positive.

MR. MILLS: Bill!

CHAIRMAN TRUEBLOOD: Yes, Les?

MR. MILLS: I was going to ask a question but maybe you ought to make an observation which is a precursor to what I have been saying.

I think part of this difficulty that the Committee may be getting into, especially with the smaller firms, is, as you indicated, somewhat a semantics problem. I have spent much more of my professional life in what, by my own standards, is a small firm than I have in a large one and small firms, in many cases, get so close to their clients that, as we all know, we have the ethics of ownership and interest and while that may be solved, I think the answer is the only answer possible. There is no way in which we could or would want to try to suggest that they be more remote from their clients. Some of the small firms and some of the medium-sized firms are practically a part of the management of their clients and it is entirely proper and they give good service.

Now, these fellows, as you indicated, have certainly been doing functions that in your firm would be in your department, but maybe the idea of writing these fellows and saying, "Now, are you doing any of these management services?"--which, of course, they are, but they hadn't thought of it that way--I think they might get a bit scared if they thought, "Well, heavens, I am doing something that is now sort of departmentalized and I don't have this department." He doesn't need one. The fellow is living with his major clients and he is giving them management services and I think, as you have indicated, that this is entirely proper and necessary to their auditing functions and he shouldn't have any inhibitions.

MR. BELDA: You might be interested, just on that score: we also had those people interrogated as to whether or not they had a management services specialist.

CHAIRMAN TRUEBLOOD: A management services specialist?

MR. MILLS: It could be the senior partner.

MR. BELDA: Forty-eight per cent did.

MR. MILLS: Or it could be a partner in a small firm who spends more than half of his time on one client.

CHAIRMAN TRUEBLOOD: Well, let us go on to---

MR. HEIMBUCHER: Could I ask, on that point, could we ask this question on independence? I know you said--and we have had a lot of discussion on this--but one specific thing I would be interested in hearing. I should preface it by saying that I have no concern about independence but a lot of people do in this area and the specific question is most often asked: in a case where you have been called in for management services, such as the revision of a cost system or any kind of system,for example, and then at the end of the year your auditing department comes in and audits that plant and in their opinion this system isn't performing well, are they independent--are they qualified to express an opinion on that?

MR. BELDA: I would say yes. That is a quick answer. Again the Management Services Committee has addressed itself to that particular question and I thought Gordon Murray and his Subcommittee did an excellent job of discussing the aspects of this particular question and it was passed on to the Ethics Committee. The Ethics Committee in turn has recently issued its judgment as to the tax arm and its concern with its aspects. In fact, my own point of view was in the sense that this particular question doesn't merit an answer, but we recognize that my views on this are not necessarily the other man's.

Essentially the answer was that the important thing is role rather than scope. If our role is that of an adviser, we feel that the attitude and the framework of independence can be maintained and well served throughout the profession.

MR. PEOPLES: Mr. Gilbert has asked this question, of course, more than once, particularlyly---

CHAIRMAN TRUEBLOOD: Who?

MR. PEOPLES: Gilbert. Lewis Gilbert.

CHAIRMAN TRUEBLOOD: Oh, Lewis Gilbert.

MR. PEOPLES: Lewis Gilbert has asked this quite frequently and it is our opinion that in most cases the wrong answer has been given.

CHAIRMAN TRUEBLOOD: Exactly.

MR. PEOPLES: Because, of course, in most cases it is one of the larger firms that can say it is an entirely different group, but I think the whole thing revolves around the fact that we do not make management decisions.

CHAIRMAN TRUEBLOOD: That's right.

MR. BELDA: In fact, one of my own partners here in New York was asked that and Gilbert got up and jumped right over him because he dealt with this fellow in a defensive and apologetic viewpoint. The fact of the matter is he was entirely wrong.

CHAIRMAN TRUEBLOOD: Where was that?

MR. CAREY: It was in the annual meeting of stockholders.

MR. PEOPLES: Reynolds Wrap. My own partners have done the same thing.

MR. BELDA: He said, "No, we don't do anything but give financial advice."--and at that particular moment we were installing a maintenance control system. Maybe that is financial advice.

CHAIRMAN TRUEBLOOD: I should like to get into the records of this meeting the report of the Management Services Subcommittee.

[To Mr. Belda] What did you say--Murray? Who did it?

MR. BELDA: Gordon Murray.

CHAIRMAN TRUEBLOOD: Because, as I recollect,the present position of the Ethics Committee is not very philosophic.

MR. CAREY: Just last Thursday the Ethics Committee approved a release on independence which says that in the tax and management services field, in effect, so long as the function of the clients retains the decision-making there is no question about independence.

CHAIRMAN TRUEBLOOD: But there is no elaboration?

MR. CAREY: No.

MR. BELDA: Well, as a matter of procedure, Jack, would it not be best to either ask the Management Services Committee as a group for that information? I can certainly see no reason why informally you can't have a copy of that, but I don't know what our---

CHAIRMAN TRUEBLOOD: We can get it through the regular staff procedure, can't we?

MR. BELDA: I think that would be the best way. I just have a second draft with me here.

CHAIRMAN TRUEBLOOD: We can get it from the record of the staff assistant, whoever it is.

MR. BELDA: Henry de Vos.

CHAIRMAN TRUEBLOOD: Okay.

I guess Jack is having trouble in the rear, so we had better go ahead. [Laughter and simultaneous comments]

I think you [we?] had better go ahead or we are going to have--Les!

MR. MILLS: I approached this in a different way and I took Mr. Carey's instructions rather literally, his invitation to make comments on the whole package of material here and some of it is duplication, but I will state it again, that I got the impression that while the consultants sometimes take a fairly broad view as to our scope and our capabilities and functions, that the material developed by the Committee itself on this group of specifics seemed to be thick with analyses and cautions to the general effect that accountants should stay within rather narrow confines in their professional practice and their service to the business community and to the economy.

I thought there was an unnecessary emphasis on the attest function because to me it leads to an attempt to equate with the attest function our services other than the primary one of expressing opinions on financial statement for management and for the public and when this emphasis is applied to tax and management service activities it requires unnecessary and unfortunate straining and casts doubt on whether the accountant should be doing this kind of work at all. The same difficulty is encountered when the concept of independence, of which we are all so proud, is considered in connection with these special services--and I give you one example: Mr. Foshay's discussion--page 31 for a reference--takes up the independence problem in connection with management counseling and tax return preparation and I consider that to be rather an unfortunate approach that one can take. On the other hand, much of the consultant's material in these colored things [indicating booklets] emphasizes the great opportunity for the accountant to grow and a way for him to guide the accounting in its development.

I think on balance we may be trying to sell the concept that accountants have a great and growing influence on business and social development and at the same time, as a profession, seeking unnecessarily to restrict our scope or to create difficulties which the public does not see and which may not actually be in the public interest--and I would like to cover some of the comments on tax practice later.

Now, while I was getting ready for this I remembered reading recently an article by a Scotch accountant and I dug it out--it was in the Australian Journal--I cut it out partly to prove I read some other books! I was a little surprised to find it was a paper presented at the Eighth International Congress [laughter] but there were a couple of paragraphs there that kind of press this point.

MR. CAREY: Was it James Stewart?

MR. MILLS: Yes. So you all remember it and I hardly need to read it, but he gave the example when he was an apprentice it was impressed on him that an accountant's concern was with the past and not with the future. Then he went on to say: "This attitude implies an apparently deliberate rejection by accountants of the role of guides and leaders and the acceptance of a lower and purely mechanical role as purveyors of figures." He goes on to say, "We seem to be trying to avoid having anything to say in the future." which I consider not very sound. So anyway, that is in the right of anybody.

Going back to Mr. Foshay, I note that he suggests that the accounting function is closely related to management counseling and tax return preparation and on this basis I would infer that he thinks they are proper services, but it seemed to me quite unnecessary to go on, as he does, to infer that we can do this work only if it is as a part of an integrated service and that we should not permit ourselves to be employed by a client on a regular basis. This is all in his report. He specifically states, "We should not permit ourselves to be placed in the position of making market forecasts." which he considers to be a job for the management consultant. He also suggests, "We should not advise a client as to whether or not to purchase another company, although we can produce an accounting report for the information of the client."

What I am coming to is--and I am glad to find that you agree with me--that many of our people are well qualified to develop information for markets and make the forecast and certainly with people who are rendering accounting service to a client, the client won't understand that it is in the public interest for us to give all kinds of information and yet decline to have an opinion on what he can do with it.

Now, I know that this is contrary to some of the rules which are generally accepted but this is my reaction. All of this seems quite unnecessarily restricted to me. Perhaps we are influenced in this connection by our close relationship with the attorneys. They have persuaded the public that legal services must be monopolized by the organized profession in the public interest and therefore it is not in the public interest for a non-lawyer to render those services. I really don't desire to argue the point and I think it is in the general public interest, but I see no reason why it should be applied to other functions which have a professional character. To be specific, I think that a well-rounded accountant must, among other things, be at least a practical economist--and this point is made in some of the material--but surely it is too limited to consider that accountants--and by that I mean CPAs--are sufficiently trained to produce useful information but not to interpret the information.

I have an example here and maybe I can take the time--some of these thoughts occurred to me before I got the assignment from Jack. I give an example that the difficulty we are having now in the great political debate on how to manage the economy, the tax debate, the tax cut and the tax system, is because the debate is based on an application of a theory that is well founded, the facts which are accepted by the theorist without knowledge of their soundness. What I have in mind by that is that it has bothered me,and I have talked to friends of mine who are recognized economists, that unlike accountants in this great debate in this Congress and last Congress and in the future, in this great debate you can tell in advance what the leading economists will say and they ought to be a bit ashamed of this. You can tell what the CIO economists are going to say as to the tax cut and where it should go; you can tell what the NAM economist will do; you can tell what Walter Heller will do; and you couldn't write it as well but you know what Arthur Burns will say. But they are developing theories applied to facts, historical facts and forecasts, and they are in effect dealing with material that we are capable of producing and they are making a forecast on material without understanding the background. Really what I am saying is that there are many accountants, in my opinion, who could start off with a better understanding of the facts, a better appraisal of them, and maybe make a better forecast for the future. Of course, you understand that when you read about this you are not talking on that basis. The debate is between whether the economy will be best served by a tax cut that flows to productive equipment or one that flows to consumption, but actually you are dealing with facts that we could develop.

So I say that an accountant who is trained in the manner suggested in the Committee's material for the future should have no inhibitions and no professional rules forbidding him to express opinion on these matters as an individual accountant and indeed in the future for a professional accounting organization, and surely our reputation for objectivity would add much prestige and authority to a publicly expressed opinion on such matters.

I should note for the record that I find comfort for these observations on page 26 of Dr. Sellerman's discussion. I would like also to make clear that I wasn't developing this to make a point of view from this material because quite some weeks before Jack called me I wrote a memorandum for our own people and in it--I won't read the whole thing--it is not that good--but my message was in effect that I thought accountants ought to be at least knowledgeable in the economic field. As I say, I didn't--I say that I don't mean we should characterize ourselves publicly as CPAs and professional economists but I do believe that if you take economy--that is, economic science--as a theoretical science of the laws of production and wealth as the manager of money, that we belong in that and we should have opinions on it. We should be at least understanding of it--which would bring up the educational problem that we have discussed.

So my suggestion is that this Committee should seek ways to extend its functions far beyond the attest function and to remove prohibitions and inhibitions against speaking, as accountants, on economics and business matters on the basis that being a CPA can carry with it competence in these expanded areas--and this ties in with some of the discussion before.

I should say, too, that this doesn't mean, as some people seem to think, that having a CPA degree makes you expert in all things, because the public will never buy that. I want them to buy the idea, however, that being a CPA gives you a kind of a built-in competence to develop in these other areas.

Now, let me make some observations on the tax practice of accounting because I have spent some time on that. Let me comment first on what I consider the nature of the Federal tax system, because that is the basic part of our tax structure. Recent Commissioners of Internal Revenue, particularly the present incumbent, are fond of describing our Federal tax structure as a self-assessment system. They note that an overwhelming amount of the income tax is collected on the basis of self-assessment of tax liability by the majority of citizens, so there is only about 3 per cent of the revenues collected by the Internal Revenue Service by direct consultation with taxpayers. Actually, the present Commissioner, in private and with a drink, is perfectly willing to concede that this is in part a misleading statement. With the advent of withholding twenty years ago and the development of an estimating tax procedure generally based on last year's tax liability, the fact is that by far the greatest amount of revenue from the income tax is collected by employers and payees and by estimates based upon past facts and it is fair to say that our present Federal tax system is based on a self-declaration of the amount of taxable income with only a small margin of the tax being really voluntarily paid. The increasing ability, or at least the increasing public impression that the ability exists for the Government to verify the amount of income declared as taxable, continues to narrow the proportion of income tax revenues which are truly self-assessed.

The position of the accountant as a representative of the taxpayers in our economy I think is quite secure, despite ? employees of the legal profession. I think it is quite secure in many ways. We do so much that lawyers are sometimes astonished when they get an estimate of the revenue accountants have from pure tax work other than tax return preparation. I would just make a guess in this Committee room that the accountants' revenue from tax service other than returns for our organized profession is probably $100 million a year. There is nothing like that in the law. But beyond that, our position is getting more secure, in my opinion, because as the law gets more confined, more and more responsibility is given to the Commissioner and the Service and the Treasury, which means more and more is administration, and we are secure in administration. There is more and more litigation, which is clearly the field for the lawyer, but for litigation in tax practice the number of cases, dollars and everything else, is getting much, much less relatively.

So I start off with the feeling that despite the continuing flurries our position is secure and the future of the accountant in tax practice is one of continued growth, relatively and absolutely. That leads me to an appraisal of the responsibilities of the accountant in tax practice and his relationship to taxpayer clients and to the Government. There is much talk in the literature, including some before this Committee, of the independence of the accountant in tax practice, of the relationship of his activities to the attest function and of his public responsibilities to the Government. The Internal Revenue Service, recognizing that the determination of taxable income is basically concerned with accounting precepts, has seized upon the attest function and the accountants' professional approach to independence to promote the idea that the accountant has the responsibility to arrive at an independent determination of taxable income as a sort of middleman, or arbiter, between the taxpayer and the Government. I personally think this is an unrealistic approach, considering the nature of our tax system and the necessary attitudes taken by the Government and the taxpayer.

The Internal Revenue Service is the one Government agency that has periodic significant close contact with the greatest number of our citizens. After Defense, Agriculture and I suppose, the Post Office, it is the greatest employer in the Government. It experiences the problems of any large organization, including business companies, that it is easy to set broad policy but it is difficult to have this policy applied in practice.

You may remember a few years ago one of our great corporations got tried in the press for putting something over on the Government in procurement and the actual defense was that they had a policy and it wasn't followed in the field--and they were criticized. The public thinks that they were playing fast and loose. I think sophisticated people would understand the situation, that they did have a policy but you can't always get a policy from Detroit or San Francisco or New York down to the field.

The Internal Revenue Service has that problem multiplied fourfold, but in addition I think the Service at top level not only hasn't found a way to get its policy put into effect but concerning its policy it is unrealistic as to field operations.

I am not trying to be merely cynical and negative. Maybe I am overselling the point. Actually, I think the public view of the tax system and the role of taxpayers and their advisers, as I am stating it, is much more realistic and actually sounder in principle than that stated at the top Treasury level and by some in our own profession.

The public engages accountants and others to prepare tax returns and to represent them in tax controversies purely and simply as advocates. I think the public is entirely right in this appraisal. To me it follows in tax practice, as in any other proceeding with the Government, such as a controversy involving costs of contracts or application of any law which directly brings citizens into conflict with the Government, that the position of the taxpayer and of the Government is necessarily an adversary one. The Government certainly treats its citizens in this respect when a controversy arises and I think honestly that the citizen is entitled to and should take the same attitude himself.

I am not suggesting, again, that this situation has developed as a necessary form of the system. I think quite firmly that this is the right and proper way in which both parties can arrive at a reasonable result. One must recognize that the present Tax Law and the tax law of the foreseeable future cannot and will not answer all questions simply and clearly. There are built-in conflicts of opinion and self-interest and ultimate equity must be based upon the ability of both parties to put their best foot forward as advocates. It may be regrettable that the accountant kind of puts himself between the two parties instead of in a position of his own with his own compromises, but I think this is only a recognition of the actual circumstances which make the present situation what it is. In fact, I wouldn't want to change it if it were possible.

I can give you examples that might help dramatize the fact--illustrate it, not dramatize it. One is a very current problem that our clients have with the Internal Revenue Service right now. The Service, imbued with the idea that they can run a public accounting practice, too, have adopted a formal procedure just this year of having its examining officers review corporate minutes and audit working papers of public accountants and they say that they do this and they want to do this because they want to make quality audits of the type and character made by our profession. I say they fail to understand our professional functions and their own functions. The files of a competent CPA will have a memorandum on difficult tax issues and an analysis of determinations which suggest different positions as to tax effect. These may include a review of conflicting rulings and judicial decisions. The problem in this case is not the same as the audit working paper problem when you have a note of things to do and things that you haven't verified and these should be thrown away, to have a clean set of working papers, but no accountant should be forced or induced to throw away memoranda which is the background of his arriving at professional opinion.

Now, what does the Service do with this material?--because they have been using it. What is done in actual practice is to use the accountant's analysis to develop a case for the contrary position which the CPA decided in his professional judgment was correct in tax principle.

There are a great many other examples. It comes up all the time in the corporate reorganization field. Many more are going to come up with these new provisions, particularly in the foreign field and I think it just illustrates the difficulty we get in if we try to give the concept that the accountant is between and is as remote from the client as he is from the Government.

Let us give another example, Mr. Carey having come back. This isn't in here but suppose the American Institute was being examined by their CPAs and the CPAs did--as they probably should every now and then--have a look to see whether they are still entitled to their tax examption and there would be a memorandum on that. Now, suppose the Service comes in to examine the Institute and they demand the working papers, why should they get the analysis of the CPAs for their clients as to whether the exemption is still in force? Presumably the professional opinion of the Institute CPA is that it is still valid and I think that that should be the end of it.

MR. CAREY: Can they command the working papers?

MR. MILLS: Yes, they have the power, there is no question about it, and they are doing it now.

MR. CAREY: Even if no fraud is alleged?

MR. MILLS: Absolutely. They say--and some of your partners are quite unhappy about it--they do it on the grounds that their job is to examine the tax return and they are entitled to all relevant information and you can't really say on their basis--and sometimes with the support of our literature--that a public accountant "should be thoroughly informed on his client," so they say, "We should be thoroughly informed on the affairs of the company," and they go to corporate minutes. They get frivolous about it. I know cases where the corporate minutes have shown that there was a discussion with the management and the management of another company as to whether they should merge and they decided not to do it and the Government in o ne particular case sent a memorandum through the channels to go to the other company to see what they thought of it, just to see if there was anything of interest--but I don't want to get away from our main point and I think in an advocacy situation we ought to now resist the thought which seemed so intriguing at first that the Internal Revenue Service audit function ought to learn from us, because they are learning without understanding their function.

Now, if I may take another couple of minutes on this same frame of reference--on two frames of reference which are commonly raised with respect to the public accountants:

The first is independence. This is all in tax practice. Can the accountant's concept of being independent be reconciled with what I consider his proper responsibility to a client in tax practice? To me the question is, independent of whom? The accountant's function in tax practice is to represent the taxpayer who hired him and let me say again that the entire concept of Government in dealing with its citizens under our tax system is that the citizen must look after himself and present his determination of taxable income as best he can under the law.

I do not think that the accountant's position is at all analogous to that when he is hired by a client to express his opinion on financial statements. In this case he is expressing his opinion not only to the client but to the regulatory agency, to stockholders, to creditors and to the public--most importantly to the public. The public looks on the accountant as one who has an independent opinion on financial statements under accounting concepts, principles and procedures which are developed by our profession and for which we are responsible. This is not at all the position when the accountant is determining taxable income for self-assessment purposes or representing a taxpayer in an adversary proceeding administratively in connection with a tax controversy as to what the proper taxable income is under income tax concepts. To me the independence function is illusionary in tax practice since the responsibilities involved are entirely different.

The second precept to be discussed is our ethics, or moral responsibility. Here I think in some degree we can equate our responsibility very directly with that adopted by the legal profession in tax practice. Admittedly the lawyer is an advocate for his client and there has been no public outcry that his responsibility is other than to his client. However, the lawyer is required to be honest and forthright and the attorneys have developed a detailed Code of Ethics which in substance is no more than the moral code that we accountants have and do follow.

Thus I believe the accountant's responsibility in tax practice is a moral matter. It is to avoid misstatements, either directly or by implication or by omission and to avoid misleading statements or presentations which, while technically correct might obscure the position he is actually presenting. It is on this basis that I previously stated my own opinion that the existing Code of Ethics of our profession is perfectly adequate to control our positions and practices in the tax field, although, of course, interpretations of the program under way is well worth thought, but I see no conflict between appearing as an ardent, outright advocate for a client in tax practice and our responsibility not to deceive. I think--I say again I think the conflict is between analogizing the accountant's responsibility in tax work with that which is the outgrowth of the attest function in preparing financial statements.

I had a couple of other comments that were on matters we have already discussed. Shall I go ahead with those?

CHAIRMAN TRUEBLOOD: Go ahead.

MR. MILLS: One was on the education, which I read with a great deal of interest--we have discussed that already--but in tax practice particularly with respect to education my own experience has been that a good tax accountant must first and foremost be a good public accountant. In the practice of my own firm we find quite selfishly that we can best serve our clients and ourselves by requiring that our accountants assigned to tax work have an adequate period of training in the accounting and auditing fields. Our policy is that we don't transfer a man to our Tax Department until he has had two or three years experience in our general accounting and auditing staff. We are quite selfish about this since we find that such men can render better services to our clients than those who devote themselves entirely to tax work without a background of accounting.

Now, I say quickly that we have exceptions but this is our policy and we follow it.

Let me interject, too, that some years ago I hired a Government [prominent?] attorney who had enough background, education background, to become a CPA and I never had so many divergent uniformly favorable recommendations. He was good in everything. And after a year and a half I had to let him go. He didn't have the accounting background, he took too darned long on things, he couldn't handle a lot of engagements. That would stress that he didn't have the training. He had the efucation and all he had to do was study and get the CPA, which was--we have a rather firm policy. We don't have anybody on our staff who is a lawyer and not a CPA except where we can cope with people who have the qualifications in the educational sense and who are permitted to become appointed.

Many young men entering the accounting field get the impression that the possession of a law degree is almost essential to being a good tax accountant. Part of this attitude stems from the conflict between the accountants and the lawyers, which I think is frequently overemphasized, and possibly some of these men feel, or have felt, that some day the accounting profession's tax work will pass to the lawyers and they should be ready to act as lawyers. My own experience is that this is not only not necessary--that is, to become a lawyer--but is positively harmful because while in some degree they perform the same professional service in the tax field, the disciplines of the lawyers and the accountants are entirely different and I think that the AICPA might give some thought to having an analysis of that because it has been my experience that it is the discipline that is involved and not the degree, not actually the education. It is the understanding and the approach.

Now, we also have discussed specialization. I read in my notes here that accountants will not be real accountants if they specialize entirely in taxes. It would be an ideal to have all tax accountants competent in all areas of accounting and auditing but that is an unattainable ideal. In fact, I see an increasing specialization in the tax field itself and I don't see any major conflict of principle in this because I see an increasing specialization in the whole accounting field. It doesn't mean that the firms must get larger, but it does mean that if you go into a branch of our professional work that you have to be competent and in some cases a smaller organization won't have all the competence and I don't think--I don't expect that very many of them will be foolish enough to take on work that they can't do. If the work is worth doing, they will become competent.

But I think our basic problem is to see that accountants before they enter the profession have an adequate training in the entire technical field of accounting but first I think they should have before--and I think this is what you said before--I think they should have an adequate education in the general sense and in particular in the humanities,and in their technical education I would like to see a program where there was a broad requirement in the curriculum for a broad scope of accounting and the next step, the third step, would be in the training in the firm when you go to work, when the man goes to work. He should have, as I say, for the tax field, two to three years of experience and then specialize.

When I wrote this I realized that in effect I was asking for a reconsideration or re-establishment of the apprentice system, which has a great deal to be said for it.

And finally I had a comment on my review of the international discussion here. It seems clear to me that the United States accounting profession has a growing responsibility in the international field. To me this means that we must be more careful than ever to avoid getting ourselves caught in abstract rules and differentiations between what we can do professionally and what we must not do even if qualified as individuals. Other countries are likely to have a broader, or certainly a different view of what the accountant can and should do and I think rather than to try to narrow our perspective for them we should broaden our own to fit their problems and concepts.

That is the end of my notes.

CHAIRMAN TRUEBLOOD: Very good.

MR. CAREY: What examples of narrowing influences do you have in mind?

MR. MILLS: Well, the discussion this morning, Jack, that accountants should develop facts but not make any business decisions--naturally not make decisions, but not give business advice to clients on what they should do on some of the information developed. Frankly, I think accountants can and should, when they are competent, give market advice. When an accountant works with a client and makes an audit of another company the client wants to buy and makes a market analysis and gets accounting information, I just don't think the client will understand, or else he will show up like the big book here [indicating] saying, "These darned accountants, they throw figures at me but they have no understanding of what I should do with them."

MR. CAREY: I agree with you and I don't think there are very many who would disagree.

MR. MILLS: Well, Mr. Foshay said---

CHAIRMAN TRUEBLOOD: I think just before you came in, John, Les made a point that we tended to have an attitude of setting up limitations in this presentation whereas he was happy to see in most cases it went the other way in profile.

I should point out, Les, as you may be aware, that these presentations go in to Council for a vote [laughter] and this is a great big difference.

MR. PEOPLES: On this question of advocacy the British have taken a rather different viewpoint, haven't they, and yet strangely enough they haven't been challenged at all by the lawyers for inability to do a thorough job for their clients. In a sense they are almost an arm of the Government as they are set up because the Government hasn't the people to do the job that is done here.

MR. MILLS: I don't think it is just for that reason, though, John. I think that we have been accepted by the public as having ? .

Let me take another---

MR. PEOPLES: I agree. At one time I think they were ahead of us but I think they have slipped somewhat behind.

MR. CAREY: You are referring to tax practice?

MR. PEOPLES: I am referring to tax practice.

MR. CAREY: You mentioned the word "advocacy."

I would like Les to develop the English thing, with which he is fully familiar. If I understand it correctly from my English friends, their approach to the tax return is very different from ours. They do consider themselves a kind of arm of the Government and their reputations rest largely on sustaining that role.

MR. PEOPLES: Well, actually, so far as the smaller firms go--in fact the quite small firms are in it for no other reason than to prepare tax returns and I believe an opinion has to go with it.

MR. MILLS: Well, I---

MR. PEOPLES: I just wanted to say two or three more words. The Government polices it in the sense that if it finds them giving misleading information to the Government they no longer will accept any--so they are virtually out of business, so that is the way they control it there.

MR. MILLS: If the Chairman wants I can send him some material about this--you don't mind if I talk about the British system? [Laughter]

This question about the British system I think is somewhat misunderstood and a few years ago I asked our London office to send me a memorandum on it, which incidentally I gave to the Commission. Actually, they don't have a true assessment system such as we have. Let's take a business organization. Our business corporations submit a return and that is the basis of it. The British corporation does not submit a return in the sense that that return is going to be used to compute the tax and may be looked at and may be not. The normal procedure, as they tell me, John, is that when the time comes for the Inland Revenue to look at these returns, they go to the chartered accountants, who then develop with them the necessary details and supporting schedules. In other words, the first submission does not purport to be a return for self-assessment. It is then the normal practice that these are developed with the Inland Revenue inspector and the chartered accountant and they arrive at a conclusion which would be pretty much what our corporations would have submitted in the first place and arguments will develop then and they will be discussed and usually settled administratively. So it is not the same kind of a proceeding where our corporations submit something, sign it, we sign it, and both parties say, "In our opinion and to the best of our knowledge and belief" this is it.

CHAIRMAN TRUEBLOOD: I may be oversimplifying this, but is it correct that in effect they make the determination but all non-controversial stuff is just straightforward and then in effect the C.A. must specify or point out or what have you the areas which are negotiable or are controversial for and preliminary to this settlement conference?

MR. MILLS: Well, I don't know that he would put it as boldly as that. It is my understanding that he would say, "These are things that you ought to start arguing about." but my understanding is that at the time of the meeting between the chartered accountant and the inspector the chartered accountant will produce additional information on items which should be audited or reviewed which were not in the first submission. No doubt these are the items which are controversial.

CHAIRMAN TRUEBLOOD: But there is a compulsion on the C.A. to make disclosure one way or another at that time?

MR. MILLS: Yes, and in effect I gather that when the initial information is submitted it is submitted with an advance understanding between the taxpayer and the Inland Revenue that when the time comes for examination the chartered accountant stands ready to develop the additional information and fill in the holes.

CHAIRMAN TRUEBLOOD: This is rather different from our system, in that we have no obligation to disclose a questionable item in the first juncture.

MR. MILLS: Very much so.

CHAIRMAN TRUEBLOOD: We have no---

MR. MILLS: I am not buying the idea of disclosing questionable items. We have an initial obligation to give adequate information in the return, which is not in accordance with their practice. They just don't give all the information, such as compensation, etcetera. That comes up in development and discussions with the chartered accountant. However, I should say, too, that some of the thoughts on the British system are not as clear in practice as they were before because the British used to be much more--the Inland Revenue--much more flexible and--let me put it another way--they now dig in more deeply than they did. If they take a more adversary position they can get more revenue, so expense accounts, for example, are no longer accepted as they used to be.

CHAIRMAN TRUEBLOOD: Are you saying that essentially their system is not greatly different than ours, but it is the method by which they operate and work back and forth?

MR. MILLS: Yes, I suppose that is part of it, but, you see, the Inland Revenue is completely Civil Service, which ours isn't, and it is much more secure and has much more authority. Litigation is not easy to start in the United Kingdom, as I understand it, because you have to have a real issue to be litigated.

CHAIRMAN TRUEBLOOD: Jack, do you want to pursue this?

MR. CAREY: No, I think I have got almost all I wanted. I just wanted to pin down the point for the record. I am strongly of the impression that the British chartered accountant considers himself to have a greater responsibility for disclosure than the American CPA has.

MR. MILLS: Yes, I think that is true.

MR. PEOPLES: My knowledge is thirty years old, so I don't know what goes on today, but certainly that was the case thirty years ago.

MR. MILLS: That is so still.

CHAIRMAN TRUEBLOOD: Dave!

MR. LINOWES: While you were talking I was sitting here putting myself in the shoes of a lawyer and I couldn't help wondering why should not the lawyers hire CPAs and take over the whole job of tax practice? It is true that historically taxes was a simple matter. It was arithmetic and it fell to the bookkeeper--it fell to us as a hangover--there were no customs, no court rulings, it was almost basic arithmetic, but today practically every point that you make seems to argue for falling within the discipline of the lawyer and his training and his work. A lawyer must research, he must follow rulings and precedents, which accountants need not do--I am making this comparative--he must advocate, which accountants need not do, the advocacy; he need not concern himself with independence, which is a thorn in our side; all of his data is privileged, which is another concern which you expressed here in the event that they want to examine working papers; so it seems to me if we could divorce ourselves from being so closely aligned to our own profession that logically it would almost evolve that the lawyer should hire CPAs on their staff rather than the reverse. This is especially so when we recognize that the basic conventional function of the accountant is his audit report and preparing financial statements and lawyers can use these.

Do you not agree that this seems to be the normal evolution?

MR. MILLS: Dave, I didn't do a good job, because every point you made--every point you got from me is contrary to what I was trying to say.

MR. LINOWES: I know that, but that is the interpretation I got sitting here as a lawyer. [Laughter]

MR. MILLS: Most lawyers don't consider that their files are privileged on backing up a tax return. This is not privileged, but that is a minor point. But I say the accountant is an advocate within certain reasonably well understood rules, ethical rules, as is a lawyer, but he is an advocate.

The Code, the Internal Revenue Code, is basically an accounting document. Only the more extreme lawyers of the Otterburg Larburg type say that all tax work is law because taxes are imposed by law. We don't do that. The Internal Revenue Code is basically an accounting document. It has many special provisions which interpret the accounting aspects and [if?] we don't agree with them. There are other special provisions which knowingly vary from accounting, but the principal provision there is that the taxpayer shall determine his income in accordance with the generally accepted accounting methods and principles used on the books provided that in the opinion of the Government, the sovereign, it fairly states his income.

Now, we could use different words--and I didn't give their words--but it is exactly the same thing. It must use accounting practices, acceptable ones, which are consistent, and the result must be a fair statement of income.

Now, all the other clauses and reorganizations and the special provisions and the loss of deductions reflect accounting policy, Congressional policy, or are interpretations, but it is still basic accounting.

Now, one of our principal controls is not so much the Congress as the courts because lawyers love precedents, as you just said, and lawyers think in most of their practice that if they can get a previous decision from a sufficiently high judicial body on an answer on similar circumstances, that is it.

One of the things I do regularly when one of the fellows who does the work in my office comes in to me with a problem or a memorandum is to give him hell politely if I find that he has been analyzing a tax problem on the basis of precedents and I tell him that the tax problem, the determination of tazable income is basically the determination of income under accounting concepts and as a tax man he has got to know how these have been interpreted and not on some occasions not follow what is good accounting if you find that there is a great length of ruling or what have you that says you have got to do it another way, but it irritates me to have somebody in effect study at a per diem rate a lot of decisions and balance them up and say, "On balance the weight is this way or that way." because the answer ought to be accounting--and it is. And this isn't just talk on a general principle on my part because by and large--most issues haven't been litigated and by and large the answer that the Government accepts is the accounting answer and it has got to be a fair statement.

But you run into litigation and you find that a precedent was sound in the past accountingwise and is no longer sound, so it is quite difficult to change.

We had a very dramatic case--

[To Chairman Trueblood] It was one of your clients. Can I mention Fruehof?

CHAIRMAN TRUEBLOOD: Yes.

MR. MILLS: Fruehof is a case where the company was following an accounting practice many years ago which was acceptable then and it ain't acceptable now. Isn't that right?

CHAIRMAN TRUEBLOOD: Yes.

MR. MILLS: It just isn't acceptable and the Government is tangling with it. They are kind of hoist with their own petard. They are saying, "You can't do this, Mr. Taxpayer, because what you are doing is not good accounting." And the company's defense, as I understand, in part is, "But it was then." The lawyers, of course, can't handle that kind of philosophy, but they had better learn.

So all of your points, maybe, were antagonistic, but none of them covers my concept.

MR. CAREY: While we are talking about lawyers, Les, I was quite startled to have you say that you thought the CPAs' tax practice was perfectly secure from the lawyers. As we stand now, it hangs completely on the will of the Secretary of the Treasury. Isn't it possible, right or wrong, good or bad for the public interest, that sufficient political pressure from the bar on the Secretary of the Treasury might simply destroy this practice?

MR. MILLS: Jack, I say no. I don't mean to minimize the dangers we have and the problem we will continue to have but in my opinion the Treasury Department, as a continuing agency of the Government, cannot remove the non-lawyers from the field because they cannot operate their tax system if they do that. It can't be done.

Now, there is no doubt you might get some real legalistic lawyer become Secretary of the Treasury and he would turn Circular 230 around or do something like that, but he will be an incredibly bad Secretary of the Treasury if he does it.

MR. CAREY: And in your opinion it would be reversed because we would have to reverse it?

MR. MILLS: Yes.

MR. CAREY: Because the thing wouldn't work?

MR. MILLS: It wouldn't work. They could not work their tax system without the non-lawyers and among the non-lawyers the organized CPA, I think, is growing in strength.

CHAIRMAN TRUEBLOOD: You say this with great conviction but daily we have fears and crises and problems.

MR. CAREY: We will continue to, but I think he is right.

CHAIRMAN TRUEBLOOD: You just say this is the affair of the day, that in principle '75 or '85 will be as it is?

MR. MILLS: I am really firmly convinced of this.

MR. CAREY: Except for this--could we get into the record your views on the probability of a simplification of the tax law that will make the services of the CPA less necessary?

MR. MILLS: Well, I wish I had views, firm views, on that. Professional advisers have for years and years been arguing for the need for simplicity. They have been pointing out that the law is too complicated, that it is breeding a larger and larger group of overpaid professional people who would better serve the economy if they did something more useful. Maybe it is because I am getting closer to retirement but I am beginning to feel fairly strongly now that the law cannot be really made simpler unless the rate structure is changed. Put it another way: I am afraid that the actual technical complications of the law are built in by our economic system, that you cannot have an income tax law that is less complicated than our ways of doing business and our whole economic structure.

Most of the most complicated provisions are based upon a desire to do equity among taxpayers and between taxpayer groups, or a desire to help those being penalized or a desire to correct provisions or interpretations which permit some of the groups to get what looks like an unfair advantage.

I think, however, simplicity can come and a reduction in our practice in the long-range future if the Congress meets the issue of a major tax other than an income tax.

CHAIRMAN TRUEBLOOD: By abandonment?

MR. MILLS: Pardon me?

CHAIRMAN TRUEBLOOD: By abandonment?

MR. MILLS: Abandonment of what?

CHAIRMAN TRUEBLOOD: Income tax.

MR. MILLS: No, I don't think there is any reasonable chance of that because our progressive tax is practically a part of our Constitution and our social system now. It doesn't have to be a sales tax, but you see, you are dealing with the impact of taxes on business, you are dealing with a lot of problems on which the economists and the accountants disagree, including whether the corporation tax is passed on or not. That is part of the great debate.

MR. CAREY: You think it is?

MR. MILLS: I think it sometimes is and generally it is not, but we are dealing with the use of the tax system as an economic tool of the Government. Mr. Keynes--Lord Keynes started that when he pointed out that the entire structure of the Government can be used to control. You are dealing with the matter of the use of deficits in promotion of business and the effect of surpluses as a retrogressive aspect of business, so that income tax has to stay, in my opinion, as an economic weapon, or a control weapon, of the Administration, but the income tax system is getting to be a little creaky in the sense that there is a constant intrusion of averaging techniques in it and this is Congressional policy, but thirty years ago there weren't any averaging techniques. Now business income generally is on an eight-year spread--a nine-year spread. You take a loss back five years and you have got an eight-year spread. So that the income tax now is so much a part of our revenue needs that the averaging feature is beginning to push the economists into the need for another tax that will not be subject to such fluctuations, the point being that if we had a 1932 year in 1963, part of the problem would be that we wouldn't get any revenue in '63, but we wouldn't get any in '64 and '65--and worse, we would have to give back $50 million in cash, and we don't have it. So that is one of the things that is pushing the objective people into consideration of another tax, a transactions tax. The difficulty, however--and this is where I think an accountant can speak--one of the difficulties in inventing a tax with the present and foreseeable Administration in, is that the new tax might be used to reduce the dependence on income tax, then new spending will develop and the income tax will come back with new strength.

CHAIRMAN TRUEBLOOD: Do you foresee---

MR. LINOWES: You are expecting a continuing Democratic Administration, I take it?

MR. CAREY: You mean new Government sepnding?

MR. MILLS: Yes, new Government spending.

MR. CAREY: Not consumer spending?

MR. MILLS: No, no. Government and their agencies.

CHAIRMAN TRUEBLOOD: Bert, you wanted to say something?

MR. BELDA: I just wanted to add a comment or two.

I would like to applaud Mr. Mills' comments generally and reiterate again that income tax, which is the principal area of our tax activity, is based on income and that income is an accounting problem and not a legal problem, in my judgment at least. I echo that remark.

And then I would like to report--and I didn't in my discussion--perhaps the remarks I made are self-evident, either in endorsement or conflict with some of the monographs you already have, but I was quite surprised at the attitude of the attorney throughout the discussion of these areas and in fact part of my reason for suggesting points of view on my subject is simply that I think you could find another attorney who would think quite differently than the gentleman used here in terms of what the accountant should or should not do. I think it appropriate to ask other professions as to where we should go. I endorse the idea, but I sometimes feel that we--well, it is just like asking Andy Barr whether we ought to be in management services, and I think Andy Barr is one of the most respected accountants I know, but I don't think he knows beans about management services.

CHAIRMAN TRUEBLOOD: Getting back to Mr. Foshay is what I was pressing a little bit before. Sure, philosophically I agree with Leslie's view and it is delightful, but---

MR. MILLS: You do not agree with my view?

CHAIRMAN TRUEBLOOD: I do, but we live in a world of many people, many professions, many segments, and our view is not going to prevail only because we want it to prevail.

MR. BELDA: But wanting it to prevail, Bob, I think, is the first step forward, and I think we have got to do a much better job in the area of public relations and understanding amongst ourselves as to what we do and how we do it.

I like Mr. Mills' comments about the question of accountants remaining in the income tax field. It is just like--much stronger, as a matter of fact, than my own reply to a question concerning whether or not CPAs ought to advance themselves into the management services field. We can't withdraw from it. It is economically and socially, I think, without feasibility. It is just unthinkable.

MR. CAREY: I can't grasp the reconciliation. I don't think Les tried to reconcile what he says about the position of the CPA in tax practice as an advocate--a word I detest---

MR. MILLS: I will remember that! [Laughter]

MR. CAREY: [continuing]...but Bert hangs his hat on this reputation for independence that the profession has built up through its auditing practice, which makes it all the more reliable in management services. It is a great public image.

I can't see how one man in practice as a CPA can do both tax work and auditing, if your philosophy prevails, because if I am an advocate for my client in the area that touches his pocketbook most immediately, I don't see how I can dissociate myself from my viewpoint---

CHAIRMAN TRUEBLOOD: He is an independent advocate.

MR. CAREY: [continuing]...and be the public servant in making full disclosures, and one thing and another, for the financial statement. It seems to be physhologically almost schizophrenic. How can you do that?

MR. BELDA: I am sure Mr. Mills has some, but I would like to refer to an analogy I have used on some occasions. It so happens my earliest business efforts were with a title company and while I guess today a large portion of the guarantee and the transfer of real estate involvement is handled by special corporations who are in this business on the basis of an insurance factor, but essentially their work is that of law, but a large number of real estate transactions occur on the strength of a legal opinion rendered by an attorney, who I think admits and holds himself up to be an advocate. However, when he renders a legal opinion as to the title of a piece of real estate, this man hangs his reputation on it and regardless of whether he does it for a client or who he might do it for he has the responsibility which the attorneys seem to think that they can continue to do without any problem at all.

Let me say again that I think this emphasis on independence is an important one. I desire it, I glory in it, but I think it must be understood as to how and in what manner and where it applies and I think we can be advocates and we are advocates at the same time, as you put it, Bob.

CHAIRMAN TRUEBLOOD: Well, I put it in this way: being independent but not disinterested accountants.

MR. MILLS: Jack, I know you don't think I am a very practical person but I think you might have a look at what kind of issues would raise the problem and I hope--I am sure you understood that I was talking about accountants who were, as a professional matter--who had integrity. They were honest and they had integrity to the point that they will not deceive by resting on technicalities and they will not, as I say, give a wrong impression in the way they present things.

MR. CAREY: By definition an advocate can do that.

MR. MILLS: Well, not in my understanding.

CHAIRMAN TRUEBLOOD: What I am wondering is whether we are really using the word in the same sense.

Advocate, frankly, Jack, to me means something a little bit closer than Les's definition, because I think of advocate in the sense of a lawyer who proceeds to save a man even though he knows he is guilty.

MR. MILLS: Well, I don't think the lawyers will admit that either. They will say if they know the man is guilty that their job is to make sure that he gets a fair trial and is proved guilty by the courts and the jury. That is different. So let's drop the advocate. He ought to have integrity but he ought to devote himself to the interests of his client and not the Government in the same degree. He has an interest and obligation to the Government in that he has to be honest, he has to be sincere and he has to be forthright and all that and make disclosures, but, you see, the issue comes up, Jack, I imagine, basically in connection with tax returns or tax controversies with business corporations. I personally make a separation as to tax work for individuals and business because we are giving opinions on business v. the Government.

Now, if you consider the actual facts, a tax return for a business organization is supposed to conform to the Tax Law, but the return itself, or rather the examination, gives the financial accounts according to the books, so there isn't much room for a CPA to say, "I will be as independent as can be on the books for the stockholders and the SEC and take an entirely different position on accounting matters on the return." because the two things are together, so the least you would have would be disclosure, so he is dealing with items which are in my book generally outside the accountant--and let me interject that I have spent twenty-five years wishing that we had never invented the word "tax accounting" and put all our controversy with the lawyers on the basis of what we do as accounting and therefore it is none of their business.

And what we do in a reorganization matter, which I consider we are competent to do, is not accounting at all and many times we have all strained to say that we are doing accounting, this is accounting and that is accounting. It is not accounting at all, it is law, but it is law within our province. It is just as much law as me knowing that if somebody passed a traffic light they violated something, but that is beside the point.

The issues of a different opinion on financial accounts for a tax return and a financial account to the public are pretty well disclosed and the differences which the accountant can take on behalf of his client are really beyond the functions he performs as the signer of a financial statement. No doubt there are circumstances where you might find a difference. An accountant might take a position on a reorganization or an acquisition as to how to handle the surplus and whether there is a pooling of interest, and so on, but that is a bit esoteric for the tax field and generally that doesn't come up. An accountant should have an opinion as to whether the transaction was tax free or not, and that doesn't show up.

MR. CAREY: People write down inventories in small businesses to save taxes. The accountant has gone along with it knowingly. He certifies the financial statement for a bank. He can't change the figures for the reason you have just mentioned. Now, when he hears you talk he thinks he is okay, but he doesn't understand you because you told him that he can be an advocate and to him that means something of much wider scope than you intend.

MR. MILLS: Jack, I think the accounting literature needs more definitive and more well concerted discussions on materialities and immaterialities in the accounting fiels and in the tax field, but as you state the bald problem that if an inventory is incorrectly stated in accordance with the accounting concepts of the Tax Law and other accounting concepts, that an accountant is violating the long-existing Code of Ethics by signing this return unless he protects himself with a materiality concept and that is why I say we need a materiality concept developed for taxes. Now, we only have our own opinion but too many of our members are flexible in their opinions. We are going to have some real ethical problems in this regard in 1963 tax returns and it is giving me great concern because I personally take the position that there is in fact a materiality concept in the Tax Law because the Commissioner's office has to agree to that, but you can't say it officially. They can't say that you may not capitalize any additions up to $50 because it is not material, because there is no provision in the law for that to be practiced, but I also feel that taxpayers and accountants ought to rest on materiality with respect to items such as the one I have given as an example, but they should not rest on it when the public policy and public interest are involved. Let me illustrate quickly:

I think any of us here would sign the accounts of a client if we knew that in expenses was $100 to the Democratic National Committee and $50 to the Republican National Committee. We would probably sign the accounts of a corporation, but if we know that as a fact, we cannot and should not sign a tax return with that hundred or even one dollar because it is just against public policy and against the statute to take a deduction for that, and it is a major problem because when I talk to people on this in this vein they say, "Well, that is stupid. Are we going to sit down and dig out all those things?'

And I say, "Well, you don't, but you tell us in discussion."

If you know it is there and you are making the return and signing it, you must see to it that that is out, because that is a violation of all known codes. If we have knowledge--and incidentally, the practical problem as to whether I personally have knowledge of what someone in the audit staff has, that is a problem that is difficult to cope with.

The reason I say that the thing is going to be a major problem in 1963 is that these expense account rules may be changed, but they are going to create a problem which I see as an ethical one because we, as accountants, are going to know that some of our clients have unallowable business expenses. There are legitimate business expenses on everybody's books, including the Commissioner's, that are going to be deducted. Now, what are we going to do with that in a large corporation? Suppose in one of our large clients--I say "large" because it brings in materiality--that we are given the information for the return and we are asked to review it and sign it and we find that there is no item for unallowable business deductions. Now, I talk to some accountants and they say, "Well, if they don't tell you about it, you don't do anything."

And I say, "Well, I don't agree with it."

So they say, "Oh, what we will do, we will ask the comptroller if there are any and if he says there are none, then we are through."

I don't agree with that either, because the facts of life are that you can't run a large corporation under this present law without having some unallowable deductions.

I raised this with a business executive recently and he told me with some chagrin that his company is somewhat decentralized and when the club dues thing came up--and, as you know, for country clubs particularly it is unlikely that there is going to be 100 per cent deduction for dues--he told me that they didn't have any idea of how much they were involved in this because they are decentralized, so their comptroller wrote out and got all the information and found they had 450 country clubs to which they were paying dues, so I said to him, "What are you going to do with your tax return?"

And he said, "Well, as far as I am concerned, if they report in some personal or not deductible, we will take that out."

So I said, "Suppose they all report in that it is all business?"

And he said, "Well, that is what they say."

We wouldn't sign a return like that because I don't have to know about any particular club, I just know 450 country clubs means that there is some non-deductible, and that is the point I am making, that '63 will be a very difficult year for the application of this ethical problem.

CHAIRMAN TRUEBLOOD: You call that a policy problem too in the sense that it is statutory and therefore public policy is involved?

MR. MILLS: No, I was using public policy as to an item which could be frivolous in amount but is clearly a bribe, for example, especially to a politician.

MR. LINOWES: Doesn't that again get away from what we are basically trying to do as accountants with figures when we state that in our opinion and taken as a whole the statements generally reflect the financial condition and that there would be no doubt in our mind about allowing some minor items to stay in financial statements? When you get down to the technical phases of it, the very fine line, you are giving the technical legal phrases, are you not, not merely the accounting end of it?

MR. MILLS: Not at all. It is the legal interpretation of the statute, but I don't say that the interpretation of the statute is necessarily legal work in any normal concept.

I would like to make sure that these observations I have been making on deductions and detailed items are not confined to tax work. I think we all agreed that you can say that if it is immaterial in amount you know there are some things in there, although I question that we should have too much freedom on that, but accountants sometimes, quite properly and very helpfully, will help their clients on determining and developing cost figures for Government contracts, for example, and there I think our responsibility as to the material problem is greater than it is in public consumption because we are expressing an opinion on accounts as a whole, but if you are developing something for, say, a fee determination or a cost-plus or a price-minus, or whatever concept they use, I think you must recognize that there are specific rules that your customer imposes on you which cannot be sloughed off on the basis that they are not very important, because as a technical matter certainly you are not forced to take this business so I think morally, and probably legally, you accept their rules in some of the areas anyway before you take the business and if their rules call for disregarding a certain item I think the accountant has the responsibility to see that they are excluded regardless of materiality.

CHAIRMAN TRUEBLOOD: But do you take the same position as you do on factors, that if you are pursuing a Re negotiation case or a cost-plus determination that you are acting by your terms or by your definition?

MR. MILLS: I can see the boss will make me change it. I say definitely that you are working for and a representative of your client and your responsibility is your own to yourself. Your responsibility to yourself is to have integrity, to be honest and then ? proceed, but it is not to try to consider what you would do if you were a judge and there were real issues.

CHAIRMAN TRUEBLOOD: But then in all of these areas in addition to taxes you would take a consistent position in that we should not put ourselves professionally in the role of being a determiner for the Government?

MR. MILLS: Right, unless both parties asked you to do it.

CHAIRMAN TRUEBLOOD: I was thinking of extending our services in the sense of having our determinations accepted as a matter of practice in these areas. Now you are suggesting an arbiter role or---

MR. MILLS: I feel it is not realistic and I know Mr. Carey wrote an article in the Arizona ? in 1936.

MR. CAREY: '36? I am afraid that is not valid.

CHAIRMAN TRUEBLOOD: He changed his mind.

[Simultaneous comments and laughter]

MR. PEOPLES: Purely as a matter of make-work, though, and after all we are all interested in receiving better fees at all times, would we be better off as a professional accepting the responsibility that Caplin is always trying to put on us?

MR. MILLS: In my opinion we would not be better of financially or as a prestige matter, because I don't think it will work. It would just cause confusion and if you want to talk about money and competition, it would enhance the competition that we already have and give them a great advantage. I don't think we are ready for it and I actually don't think we will ever be ready for it.

MR. CAREY: I don't get it. If you prepared the return under the standards you have just recited--integrity, your peace of mind, professionalism, disclosure of the material or statutorily required facts--if I were the Commissioner I would take your return without audit. What would be the harm in that?

MR. MILLS: Jack, in fact the Commissioner's people will take a return with little or no audit from certain firms that, based on their own experience, they trust and they plan to publish the list.

MR. CAREY: Why would it be wrong for us to move toward formalizing this arrangement?

MR. MILLS: Because I don't think it can be applied across the profession. I don't think there is any way in which the Commissioner could say from his experience that he will take the returns somewhere else and then not one by Price Waterhouse because his experience with Price Waterhouse has been that they are pretty sharp.

MR. CAREY: Not even by 1985?

MR. MILLS: I don't believe so. I don't think it fits into the free economic system.

MR. PEOPLES: In our own firm I have differences with our tax partners. They all take your position and I take an entirely different viewpoint. I think that if you are capable of certifying and you are honestly trying to do a job, you could save the Government a lot of money and you could do a proper job and you could increase your fees. I feel very strongly about it, and partly because I grew up for ten or twelve years in the British system.

MR. CAREY: You would have tax ...?... ?

MR. PEOPLES: Absolutely, but again maybe I was talking about something I know nothing about, because I think every one of our tax partners in New York opposes this. Maybe they know nothing about auditing, they have been in taxes so long. Sometimes I have that opinion.

MR. HEIMBUCHER: Isn't there another factor here? You made a distinction a little while back between what you called business returns and I assume by that you really mean clients where you also make an audit and where you have much of this information already. Then you went on to point out that you felt there was a little different situation in regard to materiality where you were reviewing a particular specific kind of problem, such as a cost-plus contract, for example, but isn't it true that much of the tax work, particularly for individuals and to a lesser extent for businesses, is done where no audit is performed or where perhaps financial statements are prepared but without audit, and wouldn't you have a great problem trying to change our present responsibility for tax returns in this area because admittedly we could go to expressing an opinion on tax returns where there has been an audit and particularly if we enlarged the scope of the audit to the extent of catching the items which would be immaterial for general audit purposes but which become material for tax purposes, but wouldn't the taxpayers like us then to extend that to these individual taxpayers in other areas where we do not perform an audit?

MR. MILLS: No. The basis of my remark you first talked about was not the impression you got. I was taking the position that we, as professional accountants, can have an opinion of the income of the business entity. I didn't mean to suggest that I was dealing only with those firms in which the tax returns prepared are audited, because I think that all of our concepts of generally accepted accounting principles and practices, all of our techniques, are devoted to the business enterprise. It is very seldom that any of us expresses a professional opinion of the attest type on an individual because it is not the kind of work we do, and when we do do it, as we sometimes might for an estate matter or something like that, we fill it with qualifications and I doubt whether we ever, or very often, actually have an audit and put an opinion on an individual and besides the Tax Law as to individuals not in business is not as much an accounting document as it is with business enterprises. Individuals, of course, have accounting methods, cash, and so on, cash and accrual, but they don't get involved in the instalment and the inventory problems, and so on, if they are not in business, so it is more or less a specific thing. It is like making a sales tax. So I say that really you cannot put the attest function on the tax return of an individual.

CHAIRMAN TRUEBLOOD: I am going to break here. I have been so interested I have gotten lax. We have fifteen minutes before lunch.

Now, John [to Mr. Peoples], whatever remarks you are going to make I would like to have before Bert goes, but does that give you enough time?

MR. PEOPLES: That will be more than adequate. [Laughter]

I think the trouble in talking about ethics, it is like the original code of ethics, the Ten Commandments, it consists so much of "Thou shalt not." Practically it is all "Thou shalt not." It is pretty difficult to look forward and see what more shalt nots we will have in the next twenty-five years.

My talk will probably be five minutes at the most. Some of the other speakers I think have already touched on it because they know more about the subject than I do. I will just read this:

As presumably my specialized knowledge is in "ethics"--parenthetically, it certainly is not in taxation or management services--I have taken a look back to see what has happened in this field in the last twenty-five years, knowing that this Committee is interested in where we will be in the next twenty-five years, so the night I worked on this I knew very conveniently where I could find the 1938 Annual Report of the American Institute. [Laughter]

A comparison of the rules of professional conduct adopted in 1938 with the Code of Ethics now in force shows much similarity but also some differences.

The points of similarity after twenty-five years relate to:

Designation of firms as members of the Institute;

Two, sharing of fees;

Three, engaging in incompatible business;

Four, signing reports unless examined by the member, employee, or a member of the Institute;

Five, solicitation;

Six, offering employment to an employee of a fellow member;

Seven, contingent fees;

Eight, advertising attainments though in the intervening years the so-called "card" is no longer permitted;

Nine, practicing incorporate form;

Ten, failure to direct attention to misstatements or omission of essential rules.

In fact, of the thirteen rules in force in 1938 all but two are still in force, at times in a somewhat modified form. The two rules no longer appearing in the Code are--and they are rather peculiar rules, or it would seem that way today:

> That no member shall take part in an effort to secure the enactment or amendment of any law affecting the profession without giving immediate notice to the secretary of the Institute.

Is there anything about that today?

MR. CAREY: That was stricken.

MR. PEOPLES: And then the other one, which is a rather specialized one:

> A member shall not be an officer, director, teacher, etcetera, of any university, college or school which conducts its operations by methods discreditable to the profession.

You have probably forgotten that there was such a thing in there.

MR. CAREY: No, I remember it well. It was directed at a gentleman, a specific one.

MR. PEOPLES: It was written for one. [Laughter]

The 1938 rules made no mention whatever of independence, which, then as now, was the cornerstone of the profession. Nor was there any rule that a member shall not violate the confidential relationship between himself and his client. Perhaps the 1938 framers felt that this would be stating the obvious. Possibly because the Committee on Auditing Procedure did not come into being until the following year, we find no rule in 1938 as to expressing opinions or the labeling of statements as unaudited where this is the case. Lastly, no mention was made of competitive bidding.

So much for the progress in the past twenty-five years. What of the future in the field of ethics and the enforcement of the rules?

Primarily any code of ethics should be for the protection of the public. We all agree that that is the case, I think. I don't think there is too much justification if it were only for the protection of ourselves, though there is legitimate reason for rules to protect members from each other provided the public is not injured in the process. The public expects us to be competent in our chosen field and independent. For this reason I consider the Articles on "Technical Standards" and "Independence" as the most important rules in the Code.

Having concluded that independence is a state of mind, we have leaned backwards, and rightly so, in formulating the new rule which becomes effective on January 1, 1964, with retroactive effect in certain aspects to 1963. If the facts are known, the rule on independence is relatively easy to police. Technical standards are in a different category and it is doubtful if at present we have the machinery to effectively enforce the rule by suspension of members in even the more obvious cases.

The Childree case involving the Olen Company is an example of the difficulty of procedure. Under the proposed new By-Law a member could be suspended if under criminal indictment, but here the criminal indictment has been dismissed. As a member of the Subcommittee on Cases I had thought that we might ask Mr. Childree to appear before the Committee. However, counsel for Childree had advised him to say nothing about the case except in court and our own counsel feels that failure to furnish information in such circumstances could not be regarded as an act discreditable to the profession.

Eventually the SEC or the courts will come up with an opinion which may or may not exonerate Childree. Should we rely on outside sources to make up our minds? At times the legal wording of an SEC decision appears harsh but unless we accept it or reject it out of hand, making our own appraisal might well involved hundreds of hours in detailed study of working papers. The members of the Ethics Committee just cannot afford the time and usually we take the easy course of relying on the decision of the state society, which obviously is no better fitted to determine the merits of the case. Personslly I would prefer to rely on some one of the caliber of, say, Dick Lytle to make a thorough investigation. However, there are no Dick Lytles available for such work. At times I wonder "Should there be?" Certainly such a situation, if not effectively dealt with, harms the profession more than a member obtaining an extra listing in a telephone directory where he has no office. Much of our time in the Ethics Committee is spent on these things. I don't think the public cares whether there is one listing or ten listings. Certainly it doesn't harm you in any way in what basically we are setting out to do, to render independent opinion.

Earlier I have said that a code of ethics should be primarily for the protection of the public. In some respects I wonder if the rule on competitive bidding was designed for the protection of the public or of the members. Now, I may say in the report that I have here I was outvoted fourteen to one so it is entirely my own opinion. I think I have got one convert since then. [Laughter]

MR. MILLS: Jack, that sounds like an uneven split. [Laughter]

MR. PEOPLES: Let me just go on with this:

I say this despite the fact that I was chairman of the Subcommittee that drafted the numbered opinion which has not yet seen the light of day, largely because of the Attorney General's position in California.

I strongly feel that a rule restricting competitive bidding is desira le where third parties are involved. They are involved, or there is always the possibility that they will be involved, where opinion reports are rendered. Can we make the same argument in the case of management services where the client, having all the facts, including price, can make his own decision and no one is involved but himself? One of my partners in management services feels that if a client is foolish enough to look for a dime store job there is no reason why he should not be accommodated if someone is foolish enough to supply the service.

The new rule on independence does not settle all the problems in this field. Some people would restrict us solely to the attest function--and here I am oversimplifying something that you have developed .

As to management services, I look on this as an extension of the recommendations we have made for years as the result of our examination, applicable to particular fields and carried out by specialists. I don't see a great deal of difference between the management letter that they have written for years saying that if you would do this or do that, you would improve this or you would improve that, except that in the management services done by people we are a good deal more competent than the average senior accountant is, who lacks the information. The recommendations are not decisions. Management makes the latter and as long as they do so our independence is not impaired.

And I have one here that you will probably take issue with, Les:

Lawyers have suggested that it is difficult for us to express an independent opinion on financial statements where we also prepare the tax returns. We rightly disagree with this contention, but is our argument equally valid in all circumstances where a contingent fee is involved?

I think we dropped the contingent fees in the cases reporting to the SEC, or maybe we never had them in that case, but I certainly think that for all--I know we have little or nothing in the way of contingent fees today and it is probably something we should perhaps outrightly prohibit.

MR. MILLS: You mean for tax work?

MR. PEOPLES: For tax work.

I think this is all that I have to say on the subject so far as--I do feel very strongly on this competitive bidding so far as management services. Not only, to my mind, is any restriction serving the public--I don't think it is--but secondly, they have also the problem of competing with other people who have no such rules, but I don't think that is the main reason. If it helps the public, then I think it is perfectly all right, but I just don't think it does.

CHAIRMAN TRUEBLOOD: Do you want to talk to that quickly? We can go on a little longer.

MR. BELDA: Yes. I just wanted to be sure that I understand you properly. You are opposed to the rule on competitive bidding. Is that correct?

MR. PEOPLES: I am opposed to it except--now, of course, it doesn't enter into tax work. I just think it is impossible to sit down and say, "Well, what will you prepare our tax return for?" So many things are involved.

CHAIRMAN TRUEBLOOD: As I understood it, you supported it on the attest function but would take it out of both tax and management services. Is that right?

MR. PEOPLES: I suppose you can really make a good argument here that where third parties are involved it shouldn't be a question of buying the thing as cheaply as you can get it. I didn't make an argument the other way but I can see a real purpose there. It is something else that is essentially, I think, like selling some other kind of service or material. People may be knowledgeable or they may not be knowledgeable, they may be fooled or they may not be fooled, but they have to exercise their judgment at all times in anything they buy or do. If it does not involve a third party I just can't see the same cause for it.

Personally I think that if the Attorney General or someone else comes along, we would be in a much stronger position if we were able to demonstrate that in effect we have made a distinction between these things and that it was not entirely for our own protection, we were very largely thinking of the public.

CHAIRMAN TRUEBLOOD: Bert!

MR. BELDA: Well, I think there is considerable merit to what you say, John. As a matter of fact, our own Committee has discussed this California situation and we think it is impossible even to--as I understand it, it has got to the point where even to your own client, if you say, "Now, look, the production control system is just out of whack and we have just finished an audit and you have had a tremendous inventory shortage and loss and we think you ought to do something about it."

And he says, "Well, will you--can you handle this?"

And we say, "Yes."

And he says, "Well, what do you think it is going to run?"

And we say, "Well, we don't answer that particular question."

"Oh gee. Give me a ball park."

MR. PEOPLES: The Committee means--aren't you overly cautious there if he is your client?

MR. BELDA: As I understand,the California proposal as it presently stands would prohibit quoting fees even as to days or per diem rates or totals.

MR. PEOPLES: There is nothing in the Institute's proposed [several simultaneous comments], though there is some question as to what he should pay.

CHAIRMAN TRUEBLOOD: Yes.

MR. BELDA: And also I think that the same general atmosphere is in Texas. [taxes?] That is my recollection.

MR. CAREY: The question is, what is competitive? In a situation like this you have no reason to believe he is asking anybody else for prices.

MR. BELDA: Yet--well, but suppose he says that there are other people who can do this kind of work as well. In fact, I have this question every day. I say, "Yes,there are." Oh, I suppose it is only good prudence to take a look at some of the qualifications of other people.

MR. PEOPLES: Suppose he says, "Maybe I had better ask Booz Allen"---

MR. BELDA: Exactly. Exactly.

CHAIRMAN TRUEBLOOD: Well, we can continue at lunch and it is now one.

[Announcement regarding arrangements for luncheon]

[The meeting was recessed for luncheon at one o'clock.]

THURSDAY AFTERNOON SESSION

June 13, 1963

The meeting reconvened on Thursday afternoon, June 13, 1963, at two-thirty o'clock, Chairman Trueblood presiding, with the same attendances as at the morning session with the exception of Mr. Belda, who was not present at the afternoon session.

CHAIRMAN TRUEBLOOD: It is wide open now.

MR. LINOWES: I have a question.

John made some comments about the ethical aspects [several inaudible words]. He made no reference to what he thought we were going to do in terms of what the public might expect of the CPA in the event that he comes upon an immoral or illegal act which has been performed by the client or his employees, during the course of his audit, which has nothing to do with auditing.

I would be very much interested in your reactions and [several inaudible words]. Should we disclose it? Should we bring it to the proper authorities or should we close our eyes to it?

MR. PEOPLES: I suppose my first reaction is we should close our eyes to it.

MR. MILLS: How does this come to his attention?

MR. LINOWES: It comes to his attention while he is making the audit. It may be something in connection with floating the business that for some reason is exposed in the papers, some collusion, or through any source, any of a dozen sources. Nevertheless it seems that the auditor is the only outsider who really gets into the heart of a business organization. He is in a position to come across---

MR. MILLS: You mean the accountant? This does not---

MR. LINOWES: The auditor, in which the auditor is not involved.

MR. PEOPLES: He is not involved. It is either a business expense or--it certainly has nothing to do with him, but he certainly does realize that the tax law of the United States---

MR. MILLS: And you might find out by looking at the expense account that the appropriate executive was keeping 350----

[General simultaneous comments and laughter]

MR. PEOPLES: Well, I don't think that is---

MR. MILLS: You are trying to make the accountant an informer.

MR. LINOWES: Well, do we have a moral--I am asking this in the form of a question--do we have an ethical responsibility in this case?

MR. PEOPLES: Well, I don't know that as a group we have and yet we couldn't do it any other way than as a group. Certainly I suppose anyone who sees a crime committed has some responsibility. In most cases they walk away from it rather than be involved.

CHAIRMAN TRUEBLOOD: What is the responsibility of a lawyer in a position like this?

MR. MILLS: I don't think there is any. I think John has changed the circumstances. When he said if he saw a crime committed he had in mind that if you find evidence that a crime has been committed in the past. Now, I don't know whether a general application goes any farther than that, but I don't think the accountant, if it doesn't involve his work, is any more obligated.

MR. LINOWES: No, excepting does he have a responsibility to top management? How does he---

MR. CAREY: Or to stockholders.

MR. LINOWES: If he is elected by the stockholders, which is the public. Once you make disclosure to the stockholders you are really an informer.

MR. PEOPLES: Well, I think he has a responsibility certainly to top management. As a matter of fact, I think in a few of these cases of conflict of interest actually the accountants have been asked to direct their attention to that. I think it is another thing if it goes to stockholders. I mean, there are things that we tell top management that we don't tell to stockholders, just because we believe in part that whatever we have recommended in effect, that isn't the best way to carry it out. I don't think he has--at least, my present thinking, and I haven't thought about this deeply at all--I don't think he has a responsibility to people other than those who hired him.

CHAIRMAN TRUEBLOOD: Say the stockholders have elected him?

MR. PEOPLES: The stockholders--that is very true. If the stockholders have elected him, then I think he has to turn over in his own mind, just the same as today on any supplementary report we do not make it a part of our opinion report simply because we believe--partly because we believe it would do more harm than good and the wrong impression might be created. In effect, if you want to accomplish something you sometimes have to think about the way you will go about accomplishing it.

MR. LINOWES: You are putting yourself in the place of a judge.

MR. PEOPLES: Haven't we all done that? For example, I mean, in an REA report I believe you are expected to put in any recommendations you have made or any criticisms that you have made of the system, but outside of something that is actually written into the law and the requirements I don't know of any case where we are going outside of top management--and we are going to top management, I believe, on it because I believe in most cases we address these management comments to the president of the company. Possibly we might address them to a financial vice president where obviously he was sufficiently removed not to be affected by them.

CHAIRMAN TRUEBLOOD: You would include the Board in top management, depending upon the circumstances?

MR. PEOPLES: In certain circumstances, yes. Again sometimes there is a question, would more be accomplished by going to the Board?

CHAIRMAN TRUEBLOOD: Let's carry it one step further. Say that you do find something gross--I don't know what is a good example--let's say it is a conflict of interest, a serious conflict of interest, you go to top management and stand over the Board and get nowhere, having been elected by the stockholders, then what would you do? Or what should we do?

MR. PEOPLES: I take it that this has nothing to do with the fairness of presentation, because obviously---

CHAIRMAN TRUEBLOOD: Yes, obviously if it had we wouldn't be in that circumstance.

MR. PEOPLES: Of course, it is rather difficult because I can't think of a single case that has arisen in the thirty or forty years that I have been in it. I don't think-- I can think of one case where the chairman of a company was obviously **simply** borrowing from the company. This was one that involved Bill Bleck. He was a chartered accountant there and he simply went to him and said, "Now, there is no business reason for this," which was a difficult thing because I suppose that the chairman could almost as readily have used his influence to have us thrown out because of not doing a good job--I mean, the reason would have been something different. He told him that he could see no business reason at all for this and in the circumstances he suggested to him that this thing should stop or that he might be compelled to feel that it was something he should report to the Board. It is one of the very few things I can recall that happened. I may say that it stopped and there was no ill feeling about it at all. As a matter of fact, I think the chairman thought rather more of us for it, but he could just as readily have thought differently about it.

MR. CAREY: You mentioned the REA, John. I spoke of that this morning in connection with the question Les was discussing about attesting tax returns or being in between the Government and the taxpayer. It seems to me there is a kind of general movement in the Federal Government to use CPAs in lieu of their own examining staffs. I mean, this REA situation is the compliance examination and the questionnaire apart from the financial. Now, I think this changes the status of the CPA just a little bit because he is acting for the Government in a sense as well as for the client and I wonder if maybe there isn't a parallel here in the tax situation that some day might converge--the Federal Power Commission is using firms to develop cost data, isn't it?

MR. PEOPLES: There has been a suggestion certainly on that. As a matter of fact, I think there has been an agreement on that and some work has actually been done and I think, among other things, I know some of our partners have a feeling that these regulatory commissions should be in effect sitting as judges, not gathering the material.

For example, we think that if every bank had outside public accountants and simply leave it to both the insurance commissioners and the banking authorities as regulatory authorities, that the material could be gathered better on which to make their decisions and gathered cheaper.

MR. CAREY: Well, if you did it, then, John, do you think you would be in a slightly different position than you are now?

MR. PEOPLES: I think you are.

MR. CAREY: Because you are bound by law and regulations?

MR. PEOPLES: Yes, I think you are.

MR. MILLS: Would John's basic point of view include the term of reference of the Chrysler type conflict of interest? It has been suggested from many quarters as to whether we have additional responsibilities there, where the chief executive was found to have financial interests in a supplier. Wasn't that about it?

MR. CAREY: That's right.

MR. MIKLS: Do you think we have any ethical responsibility if we in the course of our work find that out but we don't have any inhibitions as to signing the accounts? Do you remember the situation?

MR. PEOPLES: Yes, oh yes. I remember it quite well. Actually, it probably didn't affect the financial position at all.

MR. CAREY: No.

MR. MILLS: No.

MR. PEOPLES: It certainly didn't affect it significantly. Yes, I think we do. It is a difficult task but I think we would have a responsibility.

CHAIRMAN TRUEBLOOD: I agree with you .

MR. MILLS: To whom? To the stockholders or to the public too? In other words, should we accountants see to it that the Board and the stockholders know about it or should we take the next step and see to it that our public report mentions it?

MR. PEOPLES: No, I wouldn't even go as far as you. I think our responsibility is to the Board.

MR.MILLS: Yes, but the Board might be involved and what then is our responsibility?

CHAIRMAN TRUEBLOOD: Well, that would be--excuse me.

MR. PEOPLES: I was going to say the Board is not involved as a whole, though.

CHAIRMAN TRUEBLOOD: That was the step situation that I suggested, that if you find these things you have a responsibility to make them disclose and correct it, and if not, you then go to the stockholders.

MR. MILLS: I don't know the answer. I really don't have an opinion on it.

MR. CAREY: I don't know either, but it seems to me you are getting a little bit away from the financial position and results of operations. It would seem to me that maybe fifteen years ago nobody would have thought there was anything wrong with this situation. This is a question of the public standard of morality. The conflict of interest actually was only potentially, if I read the case right. Nobody ever proved that he had done anything he wouldn't have otherwise done.

CHAIRMAN TRUEBLOOD: Nobody ever proved that they paid any more or less than they otherwise would have.

MR. CAREY: That being a fact, how could the CPA say this was immoral. What standard is there for deciding?

MR. MILLS: Jack, I think that this is bringing up the fact that standards of morality vary with the times.

MR. CAREY: So they do. Your mores change.

MR. PEOPLES: We are going pretty far afield on the thing and I could visualize that you would certainly report certain things to the Board but it would be a bit difficult going to the stockholders as a whole because you might very well damage the company and I think on matters like this that you have got to leave it to the Board. The Board might very well say--well, let's say it was a conflict of interest--I agree with John here that it is rather difficult, maybe even on a point of a conflict of interest--but suppose you had whatever the situation was, the Board might very well in their wisdom say, "We don't mind this very much actually. This is a wonderful president we have got and we are certainly not going to argue with him on this rather trifling thing. It is not important." What in the world would you ever go to the stockholders on it for, let alone the public?

CHAIRMAN TRUEBLOOD: Suppose it were not trifling?

MR. MILLS: Suppose--forgetting the trifling--suppose somebody like John Gilbert raised it at a stockholders' meeting and it was explained that the Board knew all about it and the accountant knew all about it but the stockholders hadn't been told, I should think you might give a public image that your company was giving lip service to independence but they were subservient to the Board's interest.

MR. PEOPLES: Well, we had a rather difficult case once of some kiting by the president and maybe we took a rather easy way out of it. We wrote a letter to the Board and sent enough copies to the president and asked him to write and confirm that he had delivered this to the members. I may tell you we also withdrew from the engagement. I don't know whether we should have gone further, whether we should have mailed the letter ourselves. We had very serious thoughts as to whether we should have mailed the letter to the Board.

His excuse for kiting was in effect that he was borrowing money to help the company over a rather difficult hump and he had some arguments in his favor, but it obviously wasn't something that you could condone, so we took the slightly corny way out by simply--not by simply--by resigning from the engagement in addition to putting it up to him to deliver these letters.

MR. MILLS: John, let me ask you a question. Suppose some other accountant got that engagement and they called you up and---

MR. PEOPLES: Some other accountant did take it.

MR. MILLS: If they called you up and asked you whether you had any information which you thought would be of interest to them in the new engagement, would you feel that you had a right to and an obligation to disclose this among the reasons for resigning?

MR. PEOPLES: Well, it is rather peculiar, you know. First of all, let me say that I believe [laughter]--I believe we took it from another firm without asking and there may well have been something going on before--not that we have any knowledge. When we gave up this job evidently two other firms were approached. One of them wrote to us and we said that for good and sufficient reasons we did not want to be associated with the job and didn't say anything more. The other one did not write to us and the other one did the work.

MR. CAREY: Do you think we have exhausted this question of moral responsibility?

CHAIRMAN TRUEBLOOD: No. The specific, yes, but I wanted to get back to something John said this morning and to me this is the kind of thing we should be concerned with in relation to ethics, ethical practice and our ethical policing. John said this morning that 50 per cent of the work of the Ethics Committee had to do with the niceties and I happen to feel this very, very strongly. I think it just diminishes us and we put ourselves in an unseemly posture by making proud statements about "Thou shalt not bid" when we all do it every day, and "Thou shalt not advertise" when we all do it every day, and I think we have a choice. We find out what ethics is and do something about it or we forget it.

MR. CAREY: I would like to have the record show I don't agree by silence on what you said. [Laughter]

MR. HEIMBUCHER: I don't agree either.

MR. LINOWES: May I ask a related question so that you can explain it. What if you filed a tax return and signed it and after it was filed you learned that there had been actually a substantial omission of income that the client did not inform you of and the client didn't care to have you file an amended return. Now, there is certain a question of ethics and it relates to the original question I asked in connection with morals. Do you feel it necessary for you to report that other fact?

MR. PEOPLES: I don't think I would have too much difficulty on that one.

MR. LINOWES: Would you report it to the proper authorities?

MR. PEOPLES: Yes, I think so. You are certainly directly concerned, having signed it, having signed the dura, or whatever it is.

MR. MILLS: There is a committee of the Institute working on this kind of problem. I will give you my answer at the moment. I think that the first thing you must do is to inform the client in such a manner that there is a record of it that he should file an amended return. Now, my own firm's position is that we take the next step and see to it that he does or else we withdraw from the engagement, but I feel no obligation to inform the Treasury Department because if we cease to have a professional position with that firm and we have made our position clear, that's it, but I don't want to be an informer for the Internal Revenue Service.

I find the Circular 230, which is the official position, is just about what I said. You should withdraw from the engagement and I believe that is pretty much the development of the position that we are in. Maybe it should go farther.

MR. CAREY: Correct. The Treasury doesn't expect you to inform them.

MR. MILLS: They don't expect you to.

CHAIRMAN TRUEBLOOD: Okay.

MR. HEIMBUCHER: I had a question. We had exactly that very same situation just a month ago. Fortunately our client was cooperative and filed the amended return.

CHAIRMAN TRUEBLOOD: Will you let us go ahead of you,, Jack?

MR. CAREY: Sure.

MR. MILLS: I had a couple of points on what John said this morning. One is that I think myself that when John was talking about the public interest in this not bidding competitively on non-audit engagements, I look on it as broader than I think John indicated.

As I understand, John--I may be quite wrong--you said you didn't see much public interest in trying to prohibit competitive bidding in non-audit work like MAS because that is a matter of competition. Well, I think myself that we have to be concerned with the over-all posture of the profession and we have decided that competitive bidding is not a professional position or a professional practice and therefore you think there is not much public interest. I think there is because it will to me damage our over-all reputation, assuming for the moment--which I think is correct--that it is not good professional ethics to engage in competitive bidding. I think also, more specifically, there is a public interest in preventing competitive bidding even in tax work because it can damage an accountant, which is not good for us, if you bid competitively and probably below cost to get certain kinds of work because--and accounting firms frequently do that--so that they can get into the company and presumably they would make it up later, but I disagree with that.

I would also like to make a comment on the contingent fee method you mentioned. We are opposed to contingent fees. In tax work I think the ability of a client or a taxpayer to get services on a contingent fee basis in some circumstances is very definitely in the public interest because in many cases the taxpayer cannot afford to maintain his position, which may turn out to be correct, if he has to pay the fee for the services regardless of the result. I might say that since the

Treasury rules are very specific that no accountant or lawyer may enter into a contingent fee basis without first informing the Treasury in writing, I think on balance the public interest is served in some cases by permitting a taxpayer and an accountant to enter into such an agreement, because the Government knows and the other party--I used to call them the antagonist--knows and I think the whole pattern works out to the best interest of the public. Otherwise many taxpayers are not able to get a proper hearing before a forum on tax work.

Now, to my own knowledge, my firm has not, certainly in recent years, ever gone into a contingency arrangement, so I am speaking for myself.

MR. CAREY: We have here again a definition of terms. It has always seemed to me that it is perfectly appropriate for a CPA to take on a tax matter with the knowledge that he might not get paid. Payment is contingent on the taxpayer being able to afford it, which, in a sense, is success, but that doesn't mean that he gets 50 per cent of the amount he recovered, or 30 per cent of the amount he recovered. That is the kind of contingent fee that I think has something rather unpleasant about it. He gets overpaid ten times, maybe, if he wins and he takes the chance of getting nothing if he loses. This is an incentive to him to do things that he maybe wouldn't normally want to do, but he has such a stake in the thing--like this blooming Becker case in New York, where they forwarded a $600,000 assessment, they had a 50 per cent arrangement, I think, so they were practically able to retire if they won their case. It makes me uncomfortable. I think they ought to get well paid for their work if the client---

CHAIRMAN TRUEBLOOD: Is either covered by 230?

MR. MILLS: Any tax proceeding before the Service or the Treasury Department requires a statement by the preparer or the lawyer or the--anybody--as to the existence and the details.

CHAIRMAN TRUEBLOODP And both of Jack's examples would be a contingency of that kind.

MR. PEOPLES: I have a feeling that an accountant should not be directly financially interested in the amount of profits if he is also attesting. Either that should be too high or it should be too low.

MR. MILLS: You are attesting, I am not.

MR. PEOPLES: I am assuming that--I believe I said in certain circumstances. I think there are other circumstances where it might be, though I must say that I would much prefer the basis of going to the client and saying, "Well, now, you realize that this has been a rather unusually good job that has been done for you. Our fee at the usual rate is $20,000. Personally, if you asked us to fix the fee we would say it is worth a little nearer $100,000 in the circumstances." But when you directly tie it up with what the amount of the profit is I certainly would leave it to the circumstances where you have an interest in seeing that the profits are too low.

MR. MILLS: John, a very common situation in the last ten years, which has brought a lot of contingent fee arrangements with lawyers and accountants is a controversy before the Surrogate and almost always the Tax Courts on excess profits taxes for the Korean period and World War II period, where there is a purely accounting function of determining base period income and, as I understand it, a great many cases involve a contingent fee basis because it is very difficult to overturn in a Tax Court an administrative determination. The amounts are almost all large and many companies simply could not afford the thousands and thousands of dollars involved in presenting the case and my position on it is that if the taxpayer is unable or unwilling to risk the money and the professional adviser is willing to risk the time, that a contingent fee basis is well within the public interest provided the court knows about it, because the court then has in mind that they are dealing with an adviser who has a stake and they recognize that the taxpayer has a stake too and in many cases the facts are that it is the only way he can get service.

CHAIRMAN TRUEBLOOD: Jack, do you want to ask John something?

MR. CAREY: John touched a button with me before lunch on this question of enforcement. It made me extremely uncomfortable that the gentleman involved in the Olen Green case has been a member of the Institute in good standing after having been publicly proclaimed, with some documentation,as having utterly failed to meet our auditing standards and the Ethics Committee is evidently helpless and the Executive Council to do anything about it because the man has got civil rights. It seems to me that there is something wrong about this.

One of the things that Mr. Foshay impressed me with, among many others, was his description of the way the Association of the Bar of the City of New York proceeded in dealing with complaints. They have a full-time paid staff of lawyers, investigators--I am not sure whether there are two or four---

MR. HEIMBUCHER: Somebody told me six, but that is---

MR. CAREY: Maybe there were six. They do nothing else but investigate complaints from whatever source they come. They talk to the lawyers involved, they get what documentation they can, they are expert sleuths. They bring up the evidence through the Bar Association Committee as a screening first before the respondent is summoned and if they don't think there is a prima facie case he is never summoned. When he is summoned he is given a rather formal hearing before the Ethics Committee, which is before the Trial Board--the Trial Board in this case being the court, of course, where they eventually take him if they think he is wrong.

I wonder whether you think that we should plan a budget for this kind of operation. Normally, this should be done on a local basis, but I don't believe that there are many state societies that at the moment could afford it and the Institute might be able to afford it.

MR. PEOPLES: I had thought a little bit about this and I wondered if it made any difference--because I suppose almost anything lawyers do in a sense is privileged--I wondered if we did do such a thing and called people in and if we suspended them it might be held against them in a court case, or even if the courts obtained our records just on the off
9 chance that we had done something--not the court, his own lawyer--are we in a different position from the lawyers? Can we protect our findings, or would it be of interest to some other party just to find out what conclusions we had come to, even if we had held them in abeyance? I don't know.

MR. CAREY: I don't know either and I am disappointed to hear you say that Bradley in Advisory Committee is holding that we couldn't expel a member for refusing to answer our questions or at a hearing. It seems to me that this is a kind of club. We are not a certifying agency of the Government and Bradley has always told me in the past that we could throw a man out if we didn't like the color of his hair so long as that was in our rules and that he had joined knowing that he was subject to that kind of judgment.

MR. PEOPLES: Very definitely that is his opinion.

Secondly, assuming it had been a different opinion, there wasn't anyone on the Ethics Committee prepared to devote the time to really make a reasonable finding.

MR. CAREY: I don't blame them.

CHAIRMAN TRUEBLOOD: This gets us over into another area--if I may divert this a little bit because I was fascinated by John's remark of should we have a staff of Dick Lytels.

MR. PEOPLES: Mind you, I just wanted to say something in passing. I think that working on the Ethics Committee--we are not informed frequently, but I think certified public accountants as a group must stand up very well compared with any other profession. I think we do take our responsibilities rather seriously--you have only got to read the newspapers, for instance, to find out how rarely a certified public accountant is involved in any fraud and there is hardly a day you don't find a lawyer of one kind or another tied up in one.

CHAIRMAN TRUEBLOOD: I wanted to switch it around to the structure just a little bit, if you people don't mind, in the sense that we are doing staggering jobs on the Ethics Committee and the APB. Take this Committee, we are volunteer, voluntary help, which is the hard way to make progress fast. I mean, just in terms of the timeliness of it and what have you, must we not think in terms of more paid staff in all of these areas, ethics and so on, full-time staff, because you remember part of Foshay's compliance, then, had to do not only with paid staff but committees and subcommittees that met regularly every day of the week, so that the violators or the potential violators or the complainers could come in and ask questions and get things settled on a daily basis.

MR. CAREY: Not the same men every day of the week.

CHAIRMAN TRUEBLOOD: No, but it is all parcelled out, so---

MR. HEIMBUCHER: The committee was large enough so that I think he said on the average each individual met once a week.

CHAIRMAN TRUEBLOOD: This is part of our problem.

MR. PEOPLES: It is very definitely part of our problem. We had a case the other day where there was a man who had--well, first of all he had formed a company and presented a misleading statement to somebody that he wanted to put a lot of money into it. He held out the possibility that they would do very well together. He claimed he put $45,000 in, and he didn't. He also filed a statement with the bank to obtain some loans that he was worth $450,000--he wasn't worth anything like it--and when you look at the file of correspondence, it goes back to 1958. Finally we didn't come to any decision. Maybe we should have earlier but we were waiting for the Utah State Board. The Utah Society had tossed him out in 1960 and there is a little problem of getting the material out of the State Board. Texas, for example, says that this is confidential and shouldn't be revealed to anyone, not even the Ethics Committee of the Institute, all of which, I think, gets around to Bill Doherty, who does a good job inside but Bill is not an investigator by any means.

MR. CAREY: And if he were, he couldn't do what he is doing anyway.

MR. PEOPLES: That's right.

In the State of New York at the time of this public accountant thing, when they issued the license they had a number of investigators--they probably have at all times--people who can go to the premises, talk to the people, and so forth. I must say that we haven't, besides the rather simple one, you know, a slap on the wrist type of one, or, if we want to push it back to the state society. The state society may not know about it, so we would probably write and say, "What are you doing about this?" This is an indirect way of bringing it to their attention. I think that we are the body that can best afford to do this kind of work, but the United States is a big place, you know, and the Bar just takes care of its own particular neighborhood, but we certainly can afford to do it better than almost any of the state societies. I think a good many of the state societies are not prepared to do the job. First of all, they know the chap, he is in the club, you know, and why be harsh about it--that style of thing. On the one hand you can say the people in New York can do a better job. On the other hand, people that don't know him, I think, are more likely to be impartial on it and I just don't think we have the mechanics for properly carrying out the job of the Ethics Committee.

MR. CAREY: You think we should check into this?

MR. PEOPLES: Yes. I think so.

CHAIRMAN TRUEBLOOD: Do you extend this thinking to other significant areas--take APB, for example?

MR. PEOPLES: Oh, I think the APB--again you are a little bit prejudiced by your own thinking. The APB at times I think has got too much help the other way and, as I see it, the APB looks as if it is going to rule a little more into asking the members of the Board to do their own research. I suppose, again--I can speak clearly at a meeting like this, I take it--I remember talking to your partner Bill Werntz and I suppose Bill was feeling a little bit like myself--he knew I had attended one, so he said, "What do you think of the meetings?"

"Oh," I said, "I don't know that they are making a great deal of progress."

And he said, "I don't think some of them just know how to make progress. They are professed but they are not qualified for the job." [Laughter]

This needn't go in the minutes!

I have always had a little bit of a feeling of the APB that--you know, in the old days the Accounting Principles Committee probably didn't--they did a good enough job, there is no doubt about it, but they did their own research and on the APB on the one hand you have the college professors, who haven't a single client, or who rarely have any clients, and they would come up with a few problems they had already had in *Client*

Number One. And then you have the senior partners, who--well, one of their main jobs undoubtedly is to generate income for the firm and, let's say, are not quite so interested, with some exceptions--it depends on who has the firm. No one would argue that ? Spotchek, for example, isn't very much interested in professional opinions, but by and large, partners, a large part of their job is administrative and not devoting their time entirely to wondering about what sort of reporting we are doing on, say, pensions, which we know is done on a cash basis in spite of accrual accounting for several hundred years, and for that reason I thought that this group, the people who did the actual research, were out here [demonstrating]--very hard to get together, and by the last meeting--that was the meeting at Phoenix--I sort of got the impression that perhaps they are going to appoint less of outside researchers and ask the people who are going to come to their meetings to do a little more for themselves, which I think would be more effective, but that is just one person's opinion of the thing.

CHAIRMAN TRUEBLOOD: Notwithstanding this, which involves here what have you, it has been said--or at least John McEachran has told me that ? Walton ? Powell's job was substantially a full-time job, or could have been, or should have been.

MR. PEOPLES: I wouldn't be surprised,but it almost was a full-time job.

CHAIRMAN TRUEBLOOD: It is a very difficult job in terms of the future. As our numbers and our problems get larger, is it realistic to be expecting to call upon this kind of help for free and on appointment from time to time?

MR. CAREY: Well, when you say "Do their own research,"
?
I have a conception, having talked to Muntz at great length and to other people who are on the Board, that professionals ought to gather together. You shouldn't ask the Chairman of the Board or the members of the Board to go out and gather together the facts and the opinions of various people on the problem. I think research in that sense is a job for researchers, but I think they ought to present the Board--Muntz doesn't agree with this--with an objective study of what has happened, what different companies have done, what different writers have said about it, in an organized, orderly way, leading to alternatives, and stop there. I don't think the researchers should make recommendations as to what the answer ought to be. I think that is the cut-off point. Then the duty of the Board should be to read the stuff and to judge whether it is a good job of research or not, whether they think everything has been covered and to think about it hard and to reach a conclusion, but if you leave it to the members of the Board to do that

first step, you will be back where the old Committee on Accounting Procedure was. They will just be speaking from their own experience, prejudice, bias, previous knowledge, because they won't do that kind of research, of getting everything together that there is on the subject and considering it.

MR. PEOPLES: Well, that's very true. On the other hand, when you sit down and simply read what somebody else has said I don't think you ever get into the subject quite so deeply.

MR. MILLS: I agree. I think, Jack, what you are saying is an ideal and maybe it can be made to work, but most committees of the Institute and of other institutions, if they get a good, competent staff man you are likely to find that the staff man starts making policy. Sure, they read his material but generally they want him to prepare the report and form the opinion that will reflect the opinion of the committee and very frequently that is the way it will be after some editing.

CHAIRMAN TRUEBLOOD: Well---

MR. PEOPLES: Maybe it is wrong, but it is the way it turns out in many cases.

CHAIRMAN TRUEBLOOD: We want a little independence on the part of staff, eh?

MR. MILLS: Integrity.

MR. HEIMBUCHER: It hasn't worked that way, you know.

MR. LINOWES: No, it hasn't.

MR. HEIMBUCHER: Isn't this one of the reasons APB has bogged down? Because there they have tried--they had

? on the staff.

MR. MILLS: They have got a Commissioner of Internal Revenue who has had an advisory group for some time and the last one and this one have followed the practice on some issues of having the staff put together what they call position papers.

MR. CAREY: A nice term.

MR. MILLS: Actually some have been quite good in the sense that they show on the one hand and on the other hand and they are written so they can adopt them and I have found in some of my files very good statements of the pros and cons, which will enable a group which only meets every three months to arrive at an opinion.

MR. CAREY: That is what I think the accounting research stands for, because---

MR. MILLS: They have to be objective.

MR. CAREY: [continuing]...rather than draft a position paper.

CHAIRMAN TRUEBLOOD: That's right.

MR. CAREY: Rather than a draft of a policy.

I really think any member of this staff in any area--ethics, taxes auditing, or what not, would do that cheerfully and competently if that is what he was asked to do. On the other hand, if the Committee says, "You write the report because we are too busy, as you think we feel about it," well, he does that, too, and again he is in a sense influencing policy because people are generally lazy and it is a thing we sort of take it that way with minor editing, as you say, and there is a chance he is putting his ideas forward, but you shouldn't blame him for that if that is what he has been asked to do. I have sinned in that direction quite a lot.

MR. MILLS: At lunch I ran into Al Neil, who is Executive Director of CED, and he had some years ago, he had a wonderful staff in that the two staff people were by nature, education and intent pretty much diametrically opposed to the position of CED, and thereby use it, and Joe Peckman, or Joseph, or Gordon, is very much a New Dealer type of accountant--I don't think he had ever seen an honest taxpayer in his life--and he could write things on the tax program and economic program which were well written and very persuasive and it was most helpful to the CED because they would discuss it. They would always disagree with him but what they finally produced was much more persuasive than what they would have produced had they not had Joe as arbiter.

MR. CAREY: That was good stuff.

MR. MILLS: Of course, Joe could take it only for two years and then he quit because he never won anything. [Laughter]

CHAIRMAN TRUEBLOOD: Well, John, it is approaching three-thirty, so I think we had better concentrate on---

MR. PEOPLES: I have about ten more minutes.

MR. CAREY: Do you think it would be useful to raise the question of whether, since the one or two witnesses are together, as to whether you feel, John, that the tax business has an unfortunate effect on accounting ana financial reporting for other purposes?

MR. PEOPLES: I would readily agree that it has. I just don't think you can completely disregard it. There is no doubt that the introduction of an income tax like the SEC has has had some effect on accounting.

MR. CAREY: A bad effect from the point of view of the shareholders' interest--I mean, accounting principles are acopted for tax purposes which aren't necessarily what you think are best for supporting his function.

MR. PEOPLES: Yes, I think so.

MR. CAREY: Should the Institute's objective be, even though it seems hopeless, to provide a set of rules?

MR. PEOPLES: It is just installment accounting. I mean, by and large, it is somewhat difficult to support that. What has that got to do with it? I think I have completed some section where you have got your profit. There are companies that are living on some deal that they had made years before and they will be showing that these are the profits of the current year and they are not the profits of the current year at all. We excuse it on the theory that at times maybe there may be some question of collection, but that is an entirely different problem and is obviously not directly related to the installment you are receiving in any one year. I think that is one example and certainly installment accounting is fairly commonly practiced. I think there must be other things.

MR. CAREY: [To Mr. Mills] Do you agree with him?

MR. MILLS: I would, generally. The income tax necessarily has a terrific influence on accounting practices because it is taking more than half the profits of business enterprises. If we had--if the source of our tax revenues now were what they were one hundred years ago and the state of the accounting profession in the business community was as it is now, accounting would be much more independent, because they would not have to deal with this sharing and we could be more independent in the application of the accrual concept--

pensions would be a good example--and we wouldn't be faced with the maneuvering and the difficult decisions we have had recently in depreciation where tax allowability of depreciation both in amount and as to method and actual determination of useful lives would be made in a clearer atmostphere and would be easier to sell to clients.

I think the business community acceptance of accounting principles as principles is influenced by the tax system. I don't know whether we will ever get it.

MR. CAREY: Do you think the Institute should then make an effort or is it hopeless long-range to try to get enough public opinion marshalled to get the tax rules in accordance with what you think is sound accounting for income?

MR. MILLS: Jack, I have said that that is what we should be doing, but it may be as a practical and realistic approach we should begin to recognize more that the tax rules are set and are not entirely within our control and not even substantially within our control, and divert our attention to making sure that they do not influence the economy solely because of taxes.

CHAIRMAN TRUEBLOOD: Let me take the other side on that. I happen to be one of those who feels that technical rules are a kind of a waste of time and kind of a dull diet, that what we are doing is working for and reporting to the business community. Now, taxes being fifty per cent of the net is a major piece of the business environment and therefore is it wrong that we recognize--or why is it wrong, I should say, that we recognize the impact of taxes on our accounting?

MR. MILLS: I am not trying to--I don't know whether it is wrong or not, Bob, but let me take depreciation as an example. I think the integrity of the accounting principle gets clouded when you find this situation. Within the last five years the Congress finally and the Treasury finally listened enough, we will say, to the business community's complaint that depreciation allowances were inadequate to do something about it both in the law and administratively, but the facts are that a great many companies, with the chartered accountants' acquiescence, have been following pretty much the tax deduction computations on depreciation rather than the amount which they say would have been correct and therefore we want the tax allowances changed and that cannot bring too much credit on the business community and us, especially by people that don't realize the problems that would be created if a company came along and said, "Our depreciation has to be doubled from past rulings regardless of whether we get a tax deduction." So it is quite clear that in most cases companies are following tax depreciation and at the same time they will act through their professional and business groups by saying, "Our depreciation is inadequate."

Now, they can cloud the issue, they can talk about the changing value of the dollar, and so on, but then we get faced with the problem, shall we change now that we get it for taxes? And a great many companies did change and some companies confused the public no end by saying "Ethically and morally we will really have to adopt the same lives for depreciation but we feel complete freedom in adopting different accounting methods." So some firms, including mine, took a firm position saying that there can only be one answer on the estimate of the economic life of an asset but there can be three or four answers on the dollar figure that you bring out for one purpose or for another and that is a mite too much flexibility.

MR. PEOPLES: Certainly if you take replacement depreciation, if the income tax disappeared overnight I am not sure that everyone would adopt it. If on the other hand it was accepted for tax purposes I think almost everyone would adopt it, so here is something that I think would be very much influenced.

MR. MILLS: Some time in the near future there is a strong possibility, in my opinion, of some of the tax rules, including depreciation, of the tax allowances being predicated upon complete acceptance. It has been done in other countries and it is something that the Treasury people don't--the Treasury people don't understand our position. It has been explained to them but they haven't yet developed as to why it is not in the public interest to tax--to get a tax deduction and tax allowance subject to the ? Tax ? Commission in that amount.

MR. PEOPLES: That has been done in ? institutions.

MR. MILLS: And Canada did it with its depreciation.

MR. PEOPLES: And in Germany I suppose it is done to extremes.

MR. MILLS: But you see, they don't have as strict accounting rules for public authorities in Germany and those European countries, so our more advanced state of our market makes the problem more acute.

MR. CAREY: Before he gets away, I have a question-- Can I switch?

CHAIRMAN TRUEBLOOD: Yes, sure.

MR. CAREY: I wanted to ask John if he cared to express any opinion on the great issue of comparability in financial reports to stockholders or on what you call alternative charges or flexibility as a philosophy, recognizing in terms of accounting, and so on.

MR. PEOPLES: Well, you know, Maurice Peloquin's partner wrote an article on that for the New York Journal and sent me a copy--he sent a lot of people a copy of it--and he asked did I think it should be published and I said I couldn't see anything wrong with publishing it, not because I agreed with it--because I hearily disagreed. I said I felt that there were far too many choices left open today and that sometimes I thought Accounting Trends and Techniques was a disadvantage to the profession rather than an advantage because today it is getting very much the case, your clients read it, you read it, you look it up and see who got by with what, and if that is the case then the lowest common denominator prevails.

Now, it takes a man of very strong personality to say, "Well, I don't care what so-and-so does." I think there must have been some pretty strong personalities in the old days, when it developed from what it was--I mean, Colonel Montgomery and old man Sells and these people, and George Omay--when everybody--I mean, the way this profession has expanded there are no George Omays today and I just believe that more rigid rules on this--and I don't know who released that comment in Business Week that Morrie sent around--I am referring to the one that, after being rather tough on Welton ? then went on to say that from now on it might be expected that Accounting Principles Board will take a tough attitude on these things. I think it would be all to the good if it did. You know, today I think we are far more highly regarded by the public than we deserve to be regarded and---

MR. CAREY: We are getting close, though. [Laughter]

MR. PEOPLES: This is one of the disadvantages of publicity, I think.

CHAIRMAN TRUEBLOOD: Well, after all of the investment credit palaver in these various articles, one of my clients decided to do his own survey within his industry in the matter of trends and techniques and this is almost true that every client he asked, every company he asked, had handled the investment credit in a way contrary to the view, the stated view, of its public accountants. [Laughter] This was a group of about twenty in a major business.

MR. PEOPLES: Well, you know, the Institute sent out a little tabulation on the 600-odd companies within <u>Accounting Trends and Techniques</u> and if you just read the first column we came out better than anybody else. [Laughter]

CHAIRMAN TRUEBLOOD: You have two positions, John. [Laughter]

MR. PEOPLES: We had more people who agreed with the

Accounting Principles Board than any other of the "big eight" [laughter] but if you read the second and third we don't stand up quite so well.

CHAIRMAN TRUEBLOOD: Did you have one, Dave?

MR. LINOWES: Yes, I was wondering--just trying to explore some of the problems that we face both with the accounting principles, the Accounting Principles Board, or any principles promulgated by the American Institute, as well as with the ethics, whether one of the problems we have is so basic in that the American Institute really has no teeth. We cannot stop a CPA from practicing his profession, such as the Bar, by bringing action in the courts and get him disbarred. We really have no authority to do that.

MR. PEOPLES: The state societies can do that, though.

MR. LINOWES: No, even state societies cannot do it. It is up to the Board itself.

MR. PEOPLES: I mean---

MR. LINOWES: All they can do is appeal to the Board.

MR. PEOPLES: The Board can do it.

MR. LINOWES: If the Board sees fit. In other words, what I am trying to direct my attention to is this: could this weakness be so great, and are we somewhat overlooking it, that perhaps some of our emphasis in the future should be to try to put more teeth into the--I don't want to use the term "policing" but for want of something else right now--the policing power of the American Institute, so that it can be more effective? Should we try to establish some method of operation with the various Boards of Accountancy so that when we come out with an accounting principle or would come out with a code of ethics they know we are going to back that up with something a little more than a slap on the wrist, or saying "You can't belong to the American Institute any more," and many people will just thumb their noses about it?

MR. PEOPLES: I am not so sure. I have a feeling--and it is only a feeling--that the members of the American Institute are rather proud of their membership.

MR. LINOWES: But the non-members would be interested. How about the non-members?

MR. PEOPLES: The non-members--I don't know what they did on that. We are just meeting here as members of the Institute, I suppose, today, and while that may not seem a great loss of privilege to not be members, if we had firm convictions in the Accounting Principles Board on ethics or anything else, that it would hardly be necessary to go and seek the force of law behind us, I think in 95 per cent of the cases where you had disagreement they would take it almost as law. That is just my opinion. I would be interested in hearing if any other people think that way.

MR. LINOWES: But do you think it would be desirable to give greater publicity to the findings of the Trial Board? This has been a moot question too. I have the feeling that we should, that it would be good for the public to know and it would be an extra sanction on the members to know that if you get fired from this outfit it is going to be in the papers.

MR. PEOPLES: In the Journal?

MR. CAREY: In the newspapers, unless we are forbidden by the Ethics Committee and the Trial Board to release it to the press, but you take a case like the Olen Green case, which received so much publicity, if we should have taken prompt action there and done something about it, or take the---

CHAIRMAN TRUEBLOOD: Billie Sol Estes.

MR. CAREY: Yes, the Billie Sol Estes case, we did take prompt action but we didn't---

MR. PEOPLES: It was the executive [remainder inaudible]

MR. CAREY: It was what?

MR. PEOPLES: It was the executive director really who was the broker there, I think. We felt very strongly that there shouldn't be a moment wasted on that, and quite rightly so.

MR. LINOWES: Should we shoot to try to make our professional organization have a little closer liaison with the State Boards of Accountancy for these purposes?

MR. PEOPLES: I suppose most of the state boards are members of the Institute.

MR. LINOWES: Some state boards, members of the boards, aren't even CPAs in some states.

MR. CAREY: Then you get back to the 53 years state jurisdiction.

[General simultaneous comments]

CHAIRMAN TRUEBLOOD: What about forgetting about the state boards and all that sort of stuff and coming around and having the Institute as an accrediting agency on a firm basis so that it means something more than you have a CPA and you are therefore eligible for membership?

MR. MILLS: Does it not follow that if there is a two-man partnership and one belonged to the Institute that the Institute could take action because of the discreditable acts of the non-member partner?

MR. CAREY: We can now.

MR. MILLS: Yes, I thought you could.

MR. CAREY: That partner is responsible to us for the firm's actions.

CHAIRMAN TRUEBLOOD: Yes, but this is not really the question I am asking. The question I am asking is that in order to increase our influence and increase our stature we might increase our requirements and become an accrediting agency rather than something everybody has an automatic right to join until or unless he does something wrong? We are back to 1936 or '37, but---

MR. PEOPLES: Well, I think when it comes to deciding who is going to join, you would almost accept everybody because at the time they decide to join you know very little about them. They are young, they haven't lived long enough to commit any serious faults---

MR. MILLS: And we need that forty dollars, too.

MR. CAREY: John, I think, said something about accrediting firms, somewhat as---

MR. PEOPLES: I think it might be more practical but difficult to discredit firms rather than to accredit them, because you don't go on the basis of what they might do, you go on the basis of what they have done.

CHAIRMAN TRUEBLOOD: But looking at this very coolly and harshly, which is our business, would your practice change by $10 if all of your partners were removed from membership in the Institute today?

MR. PEOPLES: No, I don't think so and yet we seem very anxious at least to be called certified public accountants.

MR. HEIMBUCHER: Wouldn't it change in the long run, though? It wouldn't be next week or next year.

MR. MILLS: Our revenue would increase substantially, we would have so much more time for clients. [Laughter]

CHAIRMAN TRUEBLOOD: I can say that I have been asked that pretty seriously, this question of ten to twenty years from now, very seriously.

MR. PEOPLES: I really don't think it would make any significant difference.

MR. LINOWES: Why does a firm like yours take such an active part?

MR. PEOPLES: Well, I think there are some firms who take a more active part, I would say. I think for our common good we want to keep standards among a group of people. I mean, as soon as we are left to our own devices--we are certainly much stronger, even the larger firms are stronger if somebody else or a group of other people are doing it the same way.

I might illustrate that by a discussion I had with Bill Werntz one day and this was on the question of these companies who are on the installment basis and include all their receivables as current assets and the tax liability partly current and partly non-current, so I said to Bill, "How did you come to this conclusion?"

Bill said, "I don't agree with my partner at all. I think he is all wrong, but he has apparently convinced himself."

So I said, "Now, Bill, what do I say to a client, a man who says, 'Isn't Touche Ross a pretty good firm?'?"

And he said, "All I can say to you, John, is sometimes somebody says, 'Tell me, isn't Peat Marwick a pretty good firm?'" [Laughter] Touché all right! [Laughter]

I think this is the reason that we take the interest in these things by anybody. We want a common group. We don't want to be left alone out in left field. We know what is right but you can't do what is right on your own if other people are doing something differently and the more we get everybody hewing the line in any particular known question I think the far stronger we are and certainly if the big firms can't go it on their own the small firm has no chance at all. This is why I think agreement on these things--why I so much deplore this disagreement. It is all important, even if you are completely wrong. Agreement I think is important.

It is very true that the opinion is only asked of Peat Marwick Mitchell and Price Waterhouse, but it is equally true that as soon as you are divided in your ideas, then whatever suits a particular client at a particular time is what will prevail.

CHAIRMAN TRUEBLOOD: But this is going to be harder and harder to maintain as we get bigger. We are now 45,000 and we are going to be 75,000 by '70, '75.

MR. CAREY: 125,000 CPAs is the projection I got from the staff for 1970 as against 80,000 today.

CHAIRMAN TRUEBLOOD: You are 80,000 now?

MR. CAREY: Now, if we get, if we maintain a 55 per cent, we are about 70,000.

CHAIRMAN TRUEBLOOD: But you see we are already in the position where we can't call ourselves CPAs, all of us.

MR. PEOPLES: That's right, in particular offices.

CHAIRMAN TRUEBLOOD: Yes, and so we are getting dangerously close, it seems to me, to a point where going alone will attract---

MR. LINOWES: You can't call yourselves CPAs?

CHAIRMAN TRUEBLOOD: Go back to the 53 jurisdiction and verify it.

MR. LINOWES: Oh, oh yes. You can't use that title in those states.

MR. PEOPLES: I think that is a pity. That is probably something we should work on to try to get removed. It seems to me this is only a matter of state jealousy that causes this sort of thing, but again I suppose the State of New York, for example, works on the basis that, "Well, if they don't authorize our people then we in turn won't do anything for them."

MR. CAREY: New York has changed, Massachusetts is changing, if they get their road through.

CHAIRMAN TRUEBLOOD: New York is okay only after the labor which involves about fifteen years of labor.

MR. MILLS: No, no. They will give reciprocity to qualified people in another state even if that state doesn't give reciprocity in New York on the same basis.

MR. CAREY: That is what I mean. They don't insist on reciprocal privilege. They will recognize on their own state standards.

CHAIRMAN TRUEBLOOD: I am confused. I just got mine.

MR. PEOPLES: Well, I got mine in about two weeks in New York.

MR. MILLS: New York State Society sold the Board on that, that it was a desirable objective. Somebody had to take the first move and they felt secure enough to take it.

CHAIRMAN TRUEBLOOD: Having lost the universality of the CPA designation, don't we have to be very careful about finding some basis or means of making the Institute more meaningful to---

MR. HEIMBUCHER: We never had that universality. We are coming closer to it than we have ever been.

MR. LINOWES: That is exactly what I think.

[General simultaneous comments]

MR. MILLS: We were talking before about the need for more staff and more member participation and I wonder if we might not consider this--

And, Jack, I say very quickly that I know the terrible management problem but are we not in our profession developing quite a group of retired or inactive CPAs who could spend more time with the Institute than some of the more active ones and who have a fund of experience and talent--and they are all hard to handle and it would be a management problem, but---

MR. PEOPLES: We can get all of Price Waterhouse on that! [Laughter]

MR. MILLS: You are only two years behind. [Laughter]

I think these people have done a great deal and I wonder if we have done enough with them.

MR. CAREY: This suggestion comes up every now and again and we have on some occasions, at least one I remember recently and I am sure there have been others, developed lists of people who might be available and on inquiring we find, well, they don't want to work full time or they don't want to work at all or they are not in good health or they want to be in Florida three months of the year, or some other condition that makes it very impracticable to use them in any way except on a project-by-project basis, a contractual, perhaps, basis, which I think often is desirable, but as a full-time member of the staff serving the Tax Committee or serving another committee, I can't quite---

MR. MILLS: I know it is difficult but I just have the feeling that some of these fellows would be receptive to some kind of use of their talents.

CHAIRMAN TRUEBLOOD: It is certainly a source of talent and I think we have raised a question that might recoil on you, though. How much do you use your retired partners in your own firms?

MR. MILLS: Too little, because we use them practically not at all.

CHAIRMAN TRUEBLOOD: Because of the same management problems or for other reasons?

MR. MILLS: Well, it is because they retire early, really, and they retire for our own good business reasons, which I found out had to be one thing to state entirely. Many of them have had permanent positions in the firm and when we remove them as partners, which is a matter of general policy, we want them out. They don't attend our partners' meetings where partners' business is discussed, and that's it, so that we don't see them. We have had hardly anything--we had one special one because the fellow was in a foreign country--that kind of thing.

To be specific here, I don't think Jack Ingalls has done anything for the last ? months, not a single thing, management or anything else.

CHAIRMAN TRUEBLOOD: But your point is that he could carry over into professional activity with the same---

MR. MILLS: Somebody like that. I am just raising the question as to whether there isn't some way that this growing group cannot be used. I agree with what Jack said that you can't put people like that on the staff, but they are there, the potential is there. It doesn't matter what he is going to do but if he still has an interest in professional work there is work to do.

CHAIRMAN TRUEBLOOD: I don't argue with the question but there is another point and that is, it would depend in large measure on how significant his work in the Institute is regarded as being. If it is a kind of secondary exercise, that things just sort of have to keep going, you look at it in one way; if you think of it as having a vital impact on the profession, then there is something to say for not putting anybody on any important committee that is over fifty years old to start with because he is on the firing line, he has got a stake in it, he has got a stake in it for some years to come and he is going to think about it. I have a feeling that retired partners at any age quickly lose interest in the future and they regard this as a kind of plaything, something like working for the Community Chest. It is a time-consuming, semi-social---

MR. MILLS: Of course, they could be more independent.

MR. PEOPLES: You take a partner in your position, Leslie, with all the reading that you have got to do in the tax fields you would just think you couldn't keep up with it at all. It gets rusty very soon if you are not active.

MR. MILLS: If I were not active I would like to do something in a special field. I would be relieved of a great deal of reading that would be indicated in some of the fields.

MR. PEOPLES: You would have to be invited, I think, about within a month of retiring almost.

MR. MILLS: Well, you think--we are talking of names now--you take Mark Richardson. I learned recently--and Mark is certainly prestidigious and well-informed--I learned recently that he is taking an appointment as executive director at the Board of Commerce, or something.

MR. CAREY: Chamber of Commerce, Executive Director.

MR. MILLS: There is a man that is going to fit into a fairly full-time job and remain active in the profession, so there are people around who work for the community and this is our community.

MR. PEOPLES: I must run along, I am sorry.

MR. CAREY: Thank you, John, very, very much. You have been a great help.

CHAIRMAN TRUEBLOOD: Thank you very, very much, John. You have been very helpful.

[Mr. Peoples then left the meeting and Mr. Mills also left.]

CHAIRMAN TRUEBLOOD: I thought we would just wrap up the position as we found it today. Could we do that and then go into the administrative arrangements? Would that be all right?

[The reporter was dismissed at three-fifty o'clock.]

FRIDAY MORNING SESSION

June 14, 1963

The meeting reconvened on Friday morning, June 14, 1963, in the Conference Room, at nine-thirty o'clock, Chairman Trueblood presiding. The same members of the Committee and of the Staff were present as on the previous day. The guests at this session were as follows:

Mr. William R. Cross

Mr. Alfred J. Coyle

Mr. G. P. Caterer

CHAIRMAN TRUEBLOOD: I am sure Jack has told you in his letter that this is a very, very informal proceeding. We are simply trying to pick the brains of specialists and experts on a number of subjects and this sort of procedure will go on until roughly the end of the year.

Among the sessions we have had to this time were a meeting with Mr. Carey, of the SEC, and Mr. Caflin, of I.O.S. in Washington, a group of educators in the Midwest, political scientists, and so on and so forth, and then when we get all finished we hope to come up with what will be a good-sized book, which John Carey is taking the primary responsibility for, and which we hope will become some kind of a road map for our successors down the road ten years or ten years plus.

In these meetings it is just a free-for-all. We have no structure, no format, complete give-and-take and to the extent you wish we are glad to have you make any preliminary remarks about us or about your concerns or however you would like to do it, but we don't have a list of questions we are going to ask you and we just get off on a subject and come back to it and work around it and we hope you will be as difficult with us as you can be in the sense that we are trying to get somewhere.

MR. COYLE: Do you want to start with me? I mean---

CHAIRMAN TRUEBLOOD: That will be fine.

MR. CAREY: We hope you will be just as frank as you would like to be.

MR. COYLE: Is Mr. Caterer here with the investment banking?

MR. CAREY: He is a financial analyst.

You are witnesses and, if you like, advocates of your point of view. We are looking for criticisms, comments and suggestions as to the CPA profession. We want to revise our program and activities and propaganda and everything on the strength of what we have learned and will have learned and see whether we can't point to where we ought to be.

You three gentlemen are in a sense consumers of the

CPAs' work in a broad sense from three different points of view, I think, and we would just like to have you present your thoughts and maybe we will ask questions on the basis of what you have said.

So go ahead, Mr. Coyle, you have got the floor.

MR. COYLE: I was so relieved when I heard that I didn't have to make a speech. [Laughter]

MR. CATERER: I quite agree with you.

MR. COYLE: I immediately sat down and began to make notes. [Laughter] Not having a full understanding still of what I am supposed to participate in, I can take a few minutes and throw out on the table some thoughts and if you care to make notes on any one of these we can come back and if I am able to explore it in any greater depth I will. These are just primarily observations as they would affect our relationship as an underwriter with the profession and there may be a lot of them and maybe they are just old hat but they are things that we think about a lot and for the purpose of the discussion I have put my remarks under three categories.

One would be the considerations which apply to us in the terms of the profession.

The second would be the problems of working together with the accounting firms;

And then some comments in terms of the long-term relationship of the professional banker with the accounting firm.

I think under consideration of the first category, the first question that comes to mind is the problem of how do underwriters and a corporate client first get together? This is usually in one of two ways, either the company that is to be financed appears with an accounting firm that they have had for some years, which immediately becomes acceptable to the underwriter, either because of their reputation, professional qualifications, experience, or some other reason, or a company will arrive with an accounting firm they have had for some years and this opens up an interesting question if these people are not experienced in SEC work.

Now, I am limiting my remarks here to public offerings and Securities & Exchange problems, so we hit the problem right on the nose, which is the relationship from our standpoint of the large public accounting firm to the small regional accounting firm not experienced in SEC work and what are our problems when this comes up.

Well, the first thing we are faced with with a firm that is inexperienced, of course, is the very difficult problem of how you handle them, and I will get into that a little later, but the thing we have to think about before we develop a technique on how to handle the problem is the use of an adequate staff to meet a very tight time schedule. These are not necessarily---

MR. CROSS: The staff of the accounting firm?

MR. COYLE: The accounting firm, and obviously a large firm called in can put the horses into the problem and if we are under a limitation on the use of figures by a date line or we are trying to get a market before the Christmas holidays period, or something like that, you have got to be sure that the accounting work will be there on time and that it will be filed, so we have to look at the accounting firm in terms of that.

Secondly--and again these are not in the order of importance, but this is probably the most important--and that is the SEC experience. We have found that some small accounting firms have one or two people who are so well tuned in with the SEC that actually in getting problems resolved they can do a better job for us and for the company than even large firms where they may know everybody on the staff--

By the way, I presume these comments are at the table here. I wouldn't like to---

CHAIRMAN TRUEBLOOD: Yes. A transcript is made for the use of the Committee only. Then the position paper is drafted today by Mr. Linowes and no position paper is released before you each have had a chance to see it.

MR. COYLE: And that will be limited to the Committee anyway? Something could be misinterpreted. I am trying to be objective in analyzing the problem, but depending on how people look at it, it might not appear so objective.

The SEC ability of the accounting firm, of course, is number one, to have the know-how to put together the financial. The other question is their ability to fight through on problems with the Accounting Section of the Commission and, as I point out again, sometimes an expert in a small firm is better able to fight through a problem than a whole staff from a bigger firm.

The next consideration that we have to worry about before we really try to resolve the problem is what about the techniques of the accounting firm--let's say technical companies? Have they got the staff to do the right job on the inventories of, let's call them, component companies of an electronic industry? This has presented problems to us in the past and I know it has to client firms and we rely widely, once we decide, together with the right accounting firm, we do rely widely on their conclusions and it has only in recent years become a problem as to how much do they know when they have to go in and evaluate an inventory that is involved with the state of the art and I think there have been some problems in this area, both with large firms and small firms.

Another problem with the smaller firm--and again I am trying to be objective--is that oftentimes they are too close to management on a very personal basis. They have had a long personal relationship, they may have been involved in business decisions with management, they may also be handling management's personal tax problems--often many times they are--and on occasion you see that the firm has stock or options, or their grandmothers or their uncles or aunts have a relationship on a stock basis with the corporate client, which presents problems. This we have never had happen in a larger firm. So this problem of a historical close relationship with the management of the company is one that is very typical. It is certainly not typical of a large firm but it is on occasion a problem with a smaller accounting firm.

Then there is this very difficult problem to get over and that is the importance of a recognized national accounting firm to other underwriters who are not making investigations of the company that we are but are relying on us and the other experts and it does have an influence in lining up an underwriting dealer group---

MR. CAREY: Syndicating it.

MR. COYLE: Syndicating it, particularly in a very busy period where you have many underwritings and it is a question of how much you can actually get to and how much you can have your research department analyze where you are being asked to be just a participant. I am sure it has influenced many underwriters in not going along where they felt that, "Here, it looks like a nice situation but it is a rather complicated business, we have never heard of the lawyers or the accounting firm and everybody is busy and are we going to say 'yes' to it or are we going to say 'no' to it?" And I think that is a problem. We always feel that it is an element of window-dressing to think about.

It doesn't mean that we wouldn't work with any fine, reputable firm that maybe none of the underwriters have ever even heard of. That wouldn't prevent us from doing the business, but it is a consideration you have to think about when you start to line up an underwriting and dealer group.

Then there is the problem of what happens when trouble develops, questions develop during an analysis of the figures and the preparation of the financial. I don't see that there is too much difference between capable people in a regional or small accounting firm as opposed to having a good team from a large accounting firm, but again it brings up the question of their qualification for technical problems in the registration and it sometimes requires the help of the management engineering staffs of some of the larger accounting firms. I presume that with a tough problem that within an accounting firm they do call in some of their management consulting people. This, of course, is not available to a firm without such a department. It is not for me to say whether this is good or bad but I think business problems do come up even before an actual financing and maybe this is an advantage of a larger firm. I don't know.

Then we have the problem of the year-to-year follow-up, the continuing relationship situation. If the company being underwritten is a good distance away from any of your main offices, if it is a local accounting firm that is used on the job, it may be more difficult for the underwriter representing the public to keep in touch with the progress of the company and get the help of meetings with the accounting firms. If, on the other hand, you are constantly close to the accounting firm because they are working on many underwritings with you, you have more occasion to say, "Well, what is going on out there? Could we set up at luncheon here what your auditors came up with, or what your fellow came up with on the audit last year?" We would never do this, of course, without the permission of the company, but we do try and make it a point to have the company set up a luncheon for us to sit down once a year or so and find out what problems might have been overlooked during the year.

Again the question on the day-to-day relationship is the ability of an accounting firm to find financial personnel of treasurers, comptrollers, assistant comptrollers, and the like. The question: is a large firm with an employment section and contacts all over the country better able to come up with as good an assistant comptroller, who has had experience in a technical type company, is it better able to do that than a regional or smaller firm?

Then there is the problem of crash jobs that may come up as the result of mergers, acquisitions, estate problems, unexpected developments. Is a small firm able to put a team in on a crash basis in anticipation of an acquisition?

On the other side of the coin, since up to now it would seem to indicate that the larger firm has many advantages over the smaller firm from the underwriter's standpoint, this isn't necessarily true. There is an amount of impersonal relationship that develops with the larger firms that can be difficult and can lead to you overlooking things which would not be overlooked if you had a fellow who was really close to management, knew the problems of the company, had been with them for years,and this can be a problem. We have had an awful lot of help from very reliable, very able smaller firms where the senior partner is on the job or one of his associates, he is close to people and he seems to have a better feel for the relationship, perhaps, between us and the public who buys the stock in the company.

The other problem that isn't a problem when a smaller firm comes in is the inflexibility of accounting firms in terms of footnotes and hedges and I haven't noticed it in the last year or two but I have found that this inflexibility becomes a real problem when it is tied to a particular accounting firm's own policy and this is confusing to underwriters because one firm will put in a hedge clause in their opinion and sharp participating underwriters can spot it and may raise a question, whereas another accounting firm, another recognized national firm, would not put in the same hedge clause. Now, it is not for us to resolve this but it can get pretty embarrassing if someone can pull out a similar situation where another fine firm was used and this hedge clause was not put in and this has to do with the use of how far back you will be willing to stick your neck out in terms of figures and some firms will give you a sort of ? comfort letter under a different category than other firms. This, I think, is a matter of internal policy and we have found that the major firms sometimes disagree as to the problems of underwriting and in getting the company to respect us for having perhaps introduced a larger firm to do the SEC work, so we are up to the point of how do you keep your relationship with management if you come to the decision of introducing a national accounting firm that has the experience to do the job for the SEC. This, of course, is on the assumption that the smaller firm is not qualified. It is important to us to continue this relationship with the small firm and we always will urge the smaller firms to take the responsibility for introducing the larger accounting firm experienced in SEC. We will give them four or five suggestions and if they happen to have someone they know, if they have worked with the firm before, we would much rather have the partners in the smaller firm take the credit and get the benefit when it comes to making the selection and inviting them in.

If they continue to resist it and feel that they can get some fellow that we don't think is experienced enough to get through the figure work, there can be problems. It is a matter of us working closely with the major firm so that the smaller firm doesn't feel that it has been eased out of the picture. So what we do is try and make it very clear that it is a one-shot operation, that it only applies to that particular underwriting and that they are not going to find themselves out of the picture.

Now, I will stop here. If this is the type of thing that you would like me to throw on the table, I will get a better idea---

CHAIRMAN TRUEBLOOD: This is fine.

MR. CATERER: How long does your interest normally continue in a company after the initial location, so to speak? You spoke of this year-to-year follow-up.

MR. COYLE: Well, a major corporate underwriting client is a permanent fixture to the underwriting firm or they shouldn't be in business because they are constantly coming back to the well for more finance, so the follow-up is the most important thing from the underwriter's standpoint and the first efforts--that is, for the major company---

MR. CATERER: You don't close the file when this issue is sold?

MR. COYLE: Well, you not only don't but you shouldn't do it. If it is a large issue, a large company, you know they are going to be back. If it is a small company you shouldn't underwrite it unless you think they are going to be bigger and more prosperous in the future, in which case they will need more money, so it is an absolutely closed case. You have got to stay with this company forever. First, your name is forever on the prospectus, you are always identified with it, you can't get rid of it, and you spend more time on the mistakes that you made in trying to help the company out of their problems than you do with the ones that have been successful.

MR. CATERER: If it goes sour in three or four years you don't feel good about that, do you?

MR. COYLE: Your name is attached to it. You may think that stock has been sold and resold over and over but all of a sudden you find that you have got a lot of very unhappy stockholders, so it is very important--in fact, you get to live with the problem only when you get into trouble and at that time you are yelling for the accounting firm and you are yelling for the lawyers and if you are doing medium-sized underwriting you are going to have a certain number where you are going to get into trouble.

CHAIRMAN TRUEBLOOD: This does mean, however, that the one-shot substitution of a larger firm for a smaller firm on a single registration is not a completely satisfactory arrangement.

MR. COYLE: No, because the smaller accounting firm expects to grow, too, and two or three years later you may have to decide then whether they are qualified to do SEC work, where-a s you were sure they were not three years before.

CHAIRMAN TRUEBLOOD: The first time you went around.

MR. CLYLE: If they lose a few of these they will get qualified pretty fast.

MR. CAREY: What would you say roughly is the proportion--we get the impression from some quarters that almost all underwritings go to the national firms, but Queenan, of Haskins & Sells made a survey--maybe you helped them, I don't know--and we found out that in this area, checking maybe half a dozen investment bankers, that the number of small firms utilized was very high indeed.

MR. COYLE: Small accounting firms?

MR. CAREY: Small accounting firms.

Now, do you have any feeling in your mind as to what the ratio would be?

MR. COYLE: It is very high, because most of your underwriting--if you are talking in numbers of underwritings, it is very high. If you are talking in terms of dollar amount---

MR. CAREY: No, no.

MR. COYLE: [continuing]...it would be very low. It is very high because a lot of underwriting firms may not be as particular as to the SEC qualifications of the smaller firm and many of these smaller firms, for the reasons I pointed out, are preferable.

MR. CAREY: I was wondering if you could give me a guess on your own firm whether it is fifty/fifty, seventy-five/twenty-five, or don't you really have any figures on that?

MR. COYLE: Let's leave this out.

CHAIRMAN TRUEBLOOD: [To the reporter] Off the record.

[Comment by Mr. Coyle and brief discussion off the record]

CHAIRMAN TRUEBLOOD: I can give you some statistics:

About 80 per cent plus of the dollars that go through SEC on registrations are from the bigger or national firms, but probably less than 50 per cent of the filings.

MR. CROSS: Actually, you know, the underwriting end is in many ways a lot easier as far as this problem goes than the banking end because they have a problem on the type of a firm it is which they can hit head on because there is a particular situation, a particular job that has to be done. We hit at an angle. We come in and we are suspicious that this firm is not really capable to do the job that they should be doing in a company of this size that has grown at such-and-such a speed and that the accounting firm hasn't developed as fast as the company has. At what point do you put your foot down and say, "You are going to get rid of these fellows. I don't care how good friends they are. We aren't going along unless you do."? You have no evidence to put the case up, but you know it isn't right, and where do you draw this line? I think we have a much more difficult problem than the underwriters do to make this decision on the point that you have to put your foot down.

12 MR. COYLE: Our problem is, I think, relatively simple because we do have the protection of the fact that when it becomes effective it has been through the Accounting Division of the SEC.

MR. CROSS: Yes.

MR. COYLE: Now, this doesn't mean you can get into this problem of maybe mistakes having been made in the evaluation of inventory in a state of the art type of inventory, but we do have a little comfort in the fact that the SEC Accounting Division is supposed to give it a pretty good going over.

MR. CATERER: If I may say so, you are not in quite as competitive a situation as Mr. Cross is either, because his borrower can say, "Okay, I will go over to the Chemical."

CHAIRMAN TRUEBLOOD: Dave, did you want to ask a question?

MR. LINOWES: Yes, but it would be a continuation of the questions. I don't know if he wants to---

CHAIRMAN TRUEBLOOD: Would you like to proceed, Mr. Coyle?

MR. COYLE: I can finish. I have just got a little bit more.

CHAIRMAN TRUEBLOOD: All right, and then we can have questions.

MR. COYLE: So we left it that it is in our best interest, in terms of our relationship with the client, to keep the smaller firm in the picture to the greatest extent we can. It is a moral obligation, particularly if they directed the business to us. This may mean a national firm is in on just the underwritings for the SEC.

Now, a couple of considerations on factors in terms of the longer-range relationship with the accounting firm. I don't know the answer to it. It is no different than the law and a group of lawyers, I suppose, but this could mean that an underwriting firm introduces a lot of substantial business to the accounting firm. This is something we have got to weigh pretty carefully. Reciprocity is a nice thing but you have pretty serious problems of what do we do, for example, with a small accounting firm that constantly brought pieces of underwriting to us because they like the way we handle it, they like the way we handle the management and they felt that we had always looked after their interest. On the other hand, if maybe 50 or 60 per cent of the men not being introduced by us were a national firm--I suppose we are all human and we look for support and help from our friends. I don't know how to define it but it is a consideration.

I think that the accounting firms, both large and small, can do a much better job in educating their clients to the SEC requirement before they even start talking about an underwriting. I don't think this is our job, although we get it most of the time. I think this should begin two or three years before the firm even thinks about raising money probably and selling out.

I think the accounting firm, particularly the larger one, should do a much better job of hand-holding through the difficult periods for the company. I have actually seen cases where they have been moved from a small firm to a large firm and got into trouble and said, "This never would have happened if we had stayed with Bill because Bill knew us and he knew our problems, but every year we have a different team on the job and we don't feel the same relationship and we wish you fellows had never let us get into this kind of a situation." So I think hand-holding by the major firms is a growing problem.

The problem of keeping footnotes simple and clear is always there. This problem of interpretation and flexibility is one we live with, for example, in the leasing industry--we won't get into that one, but six or seven publicly owned companies that you would usually take a look at in terms of an analysis of the leasing companies on a comparable basis, and every one of them carries their figures differently. A lot of talk was going around last year that the Institute might have some basic changes on leasing accounting. I have heard representatives of very prominent firms indicate that the problem of leasing should be handled in footnotes. I understand there are others who feel that there would be a basic danger in legality. This is something I think you have got to iron out within your own Institute because it does make it difficult for the investment banker.

I have discussed the problem of opinion being hedged to different degrees by different firms.

Another area where we have found accounting firms particularly helpful is in the dubility? thing. If you take a new industry with unusual accounting problems such as leasing, I don't care how carefully the underwriter may have done his homework or how well he may understand the problems, it is usually a smaller partner in the corporate department who runs the dubility screening and if a technical problem is raised by a sharp analyst from a participating underwriting firm, it would be very helpful to have a real sharp fellow from the accounting firm there to explain exactly how it works and why this is a semi-riskless type of business, or why you don't have the problems of repossessions, or why this company differs from another company because here one is taking on its resale value at a 6 to 10 per cent rate a year whereas another one is not taking any resale value, and these are areas where we have had a lot of help from small and large firms. I think it will always be an area where they can be helpful.

Use of the management engineering division: We haven't had much occasion and experience with that, but I know that most of the larger firms now have these divisions. I don't know whether we should be educated more about their availability, I don't know whether we would use them if we knew more about them, but they must be there to help clients when they get into business problems, but I have had very rarely occasion to think about it. I do know one variety of firms that will not look at a new company that seems confusing to them without having a specific accounting firm's management consulting department do a report on it. This has become less of a burden in the last ten years than it used to be. You see, a lot more underwriting is being done with new type companies without this management engineering survey, but it is still a prerequisite of certain underwriters.

MR. CAREY: Is that a sort of evaluation opinion?

MR. COYLE: Management, techniques, markets, products, competition. It used to be pretty excessive. When I was first in this business it was always the company's problem that after you got the fellow all warmed up to be your client for an underwriting, how do you introduce the fact that you want him to spend $20,000 to get a report, so it seems to have gone out of style a little bit in some firms.

And the problem of the annoyance that develops between management and accounting firms when something sticky comes up and I think sometimes the accounting firm doesn't know how sticky it gets because you have some young fellow on the job who knows exactly what he is supposed to say and he may say something that represents a change of twenty years on the part of the guy that built the company and you get into what we call the whipper-snapper problem. [Laughter]

The only way I think an accounting firm can help the underwriter in terms of keeping him informed about problems and changes in the company is to be close enough to management that he can convince management that they ought to call on the underwriters for one of these yearly reviews. You can't expect them to be a detective for you and eyes and ears and everything else, but if their relationship is correct and warm and close with the client and they spot something, they can point out that there is a public responsibility here. "You are a publicly owned company, you had better have lunch with the underwriter and we will sit in and explain the problem." And do it in a helpful way rather then a critical way. I think the accounting firms could be more helpful in this area. They spot things and they are scared to say anything because, "Well, we are just professionals." Well, if they are close enough to management to have their confidence in making changes in things that have been done for twenty years they ought to be close enough to convince them they should sit down with the underwriters and talk about it.

MR. CAREY: This is one of the points, I think, where the smaller firm may have a little advantage.

MR. COYLE: Yes, it has a major advantage.

In terms of long-range planning, we find many companies where the lawyers seem to have a tremendous influence on the long-range planning. I should think the accounting firm, particularly the one that has the management consulting section, should have an awful lot more to say than almost anyone else in the long-range planning. It is a good way for them to introduce their selling the management consulting division into the problem. They don't have to come in on a critical basis, they could come in and sell themselves on the basis of doing a long-range planning study and if out of this comes something that is constructive for management they have got themselves a client and probably done the client a favor and helped everybody. So long-range planning, from the standpoint of the major firm with the management consulting division I think is something to be developed.

Finally, from our standpoint in the relationship with the accounting industry we have tried to develop it further. Some of you may be familiar with the Forum that we had last year. The impact of that was so far beyond anything we had anticipated that we are going to continue it. We are still putting out hundreds of copies every once in a while. Some firm--I don't know what they use them for but we continue to make them available.

MR. CAREY: I thought I detected your quote from Herman Bevis on leases. [Laughter]

MR. COYLE: Well, it came up yesterday. It came up at lunch on Tuesday because we were discussing leasing abroad with our major steel manufacturers and they said, "Well, we understood that this whole leasing accounting problem is under review." I know I just press up the balance sheet approach and, as any good leasing salesman will tell you, when companies like U. S. Steel and General Motors lease, they are not doing it for just a balance sheet, so the discussion developed on Mr. Bevis's comment about giving the footnote approach and it was news to this particular company, a major company. They thought that it was still under review and maybe it is---

MR. CAREY: It is.

MR. COYLE: [continuing]...but it seemed to everyone there at that meeting to be a very realistic approach. At least, that was my reaction to it.

MR. CAREY: Has it been brought to your attention-- you mentioned a financial that the smaller firm often has. We have got a rule of ethics going into effect in January that forbids it for all our members. No more stock, either directly or family, no more sitting on the Board of Directors. It was kind of a struggle because some people hated to give up the things that they already had, but this is a hard and fast clean-cut rule now.

MR. COYLE: Why wouldn't you let them sit on the Board? Was that because of the fear that they might not remain independent?

MR. CAREY: Yes.

MR. COYLE: Do you let them sit in as an invited member?

MR. CAREY: Oh, sure.

MR. COYLE: Through the whole meeting?

MR. CAREY: Oh surely, so long as they are not voting for the management, in effect.

MR. COYLE: And no stockholding in the company?

MR. CAREY: Not one share. Not one share.

MR. LINOWES: Of course, that has been the SEC position for some time.

MR. CAREY: That is why the big firms gave it up, but the small firms, some of them--a lot of them wouldn't have any anyway, but it was mixed up, you couldn't tell, so this question, I hope, is settled, for one thing.

MR. COYLE: It doesn't--I am through, by the way, with any remarks I have to make. Id doesn't settle the problem of if a man can have an interest, indirect or otherwise.

MR. HEIMBUCHER: The rule is quite clear, neither direct nor indirect, any partner or member of his family.

MR. LINOWES: That is what the SEC voted for.

MR. CAREY: We decided we couldn't live with a double standard, big firms, little firms, and we thought it was hurting the little firms,because of the things you said, so we think it is in their best interest.

CHAIRMAN TRUEBLOOD: I just wanted to make it completely clear that this applies to all of our members, whether or not there is SEC involvement. This is a flat zero rule.

MR. CAREY: Some of our smaller firms are trying to develop group relationships with other local firms in other parts of the country, consordiums they call them in England, but I don't know what we call them over here--associated firms. Would this make some difference in their favor to you if there was a local firm of good reputation that knew its business and knew about SEC but said, "Now, we have arrangements with San Francisco and Philadelphia and Chicago and other such firms like ourselves." Does that strengthen that in your eyes?

MR. COYLE: Off the record.

[Off the record]

MR. CAREY: We are thinking of what we can recommend to the local firms to strengthen their position competitively with the bigger ones. Lots of companies are going public in the next ten years, I presume some of them fairly small, and this is a serious problem with us. We have got 12,000 firms represented in this membership and there are only eight in the so-called "big eight" and we get a lot of bitterness developing because the smaller ones are levered out, so I am kind of groping for what can be done. We know they have got to be competent, we know they have got to be trustworthy and we know they have got to be independent, we know they have got to be able to work with the SEC. That having been done, will a geographical tie-in be another point that is plus?

MR. COYLE: I don't think it would.

MR. CAREY: You don't care for that one?

MR. COYLE: Let me ask this: if one had a qualified fellow he would service the members of this company within a region, wouldn't he?

MR. CROSS: Well, at the present time you have organizations where you may have a relatively small firm as the primary accounting firm on a company's books but they don't have offices where they have other plants and they will even take one of the "big eight" and they will work out a deal with them where they will do the local work where they don't have offices. Isn't this done a lot at the present time?

CHAIRMAN TRUEBLOOD: Yes. Jack was going one step further in the sense of having a loose association or relationship amongst, let us say, thirty local or individual firms in thirty different locations, but let me ask Mr. Coyle about another relationship in which we often find ourselves.

A smaller firm, given a registration problem, may call us in as a technical consultant on the registration, not doing the audit, but advising them, consulting them, working with them through this trial and tribulation. Does this, in your view--have you experienced this kind of an arrangement?

MR. COYLE: We may have and not known about it.

MR. CATERER: Is this a business arrangement? Is there a fee involved?

CHAIRMAN TRUEBLOOD: Oh sure. We charge the local firm or the client our usual fees but we don't take audit responsibility. We consult with them as a specialist, as it were.

MR. COYLE: I think this may happen in the smaller underwriting firms. If we felt that they had to get that technical help we would say, "All right, let's get a competent fellow for all this technical hocus pocus. Let's get the name right on there and find out what they have done."

CHAIRMAN TRUEBLOOD: So again it is an arrangement which really helps you in terms of your concern. Dave!

MR. LINOWES: Reference has been made here several times to the so-called"big eight" and you keep referring to the large national firms in terms of preference, which I can understand. There is, however, a group of firms that is more or less regional, or at least not one of the very large ones, and we find--and as a result also do not have the kind of geographical distribution that you referred to that the larger firms have all over the country. Do you find that your preference for a substantial firm retained on an underwriting extends to this in-between-sized firm that is thoroughly responsible both professionally and financially, or is it just limited to the eight larger firms?

MR. COYLE: Absolutely not, and I would like to have all my remarks in terms of national firms be changed to "qualified," whether regional, medium size, or even small. If they are known to us and other underwriters as professionals, we may be talking about a "big forty" or a "big fifty" or a "big thirty" and in none of my remarks did I mean a "big eight" or a "big ten," because I would guess that we have worked with thirty different accounting firms that came under our definition of being qualified, well-known professionals of fine reputation. The differential that I make is between the two- or three-man shop as opposed to the well organized, diversified regional or national firm.

MR. LINOWES: May I--excuse me. I just wanted to pursue this same point a little further. The firm that does not have geographical distribution--very often the so-called highly reputable, highly regarded larger firms do not have local office set-ups. Now, would you feel--or how do you feel about such firms engaging other firms to do their on-site work, but still taking full responsibility? Do you feel it is a substantial weakness in the relationship with this firm if they do not have offices on site near the client?

MR. COYLE: No, I don't think it is a weakness at all. Let me give a hypothetical case:

Suppose we have a company in Seattle, Washington. We don't have an office in Seattle, Washington but we may have an investment banking firm developed out there. They use it, but we have not heard of the accounting firm. We would check through our banks and other people out there and find that this was the most reputable and probably the most active firm in Seattle in the accounting area and we would only ask one question, "Have they been through a few registrations?" If they have been, we would say, "Fine. We have checked them and any other underwriter would feel free to check them. They are the outstanding firm in Seattle and this happens to be a Seattle company. That's fine with us." Their reputation is there.

MR. LINOWES: I just wanted to ask one other point and then I have several questions:

You referred to having a management engineering department come in and look over the management set-up of these firms. Do you feel that such an evaluation from an independent auditing firm affects its independence in terms of more reliance on these figures as presented?

And a related question is: Would you prefer a CPA firm, management engineering firm, over a management consulting firm, say Arthur D. Little, or vice versa?

MR. COYLE: Well, I made the comment that I thought this use of management engineering firms would be the source of this phasing out, not phasing out just because they are getting more careless, but because the corporate departments are getting more qualified people to do their own analytical work. I have never had occasion to review or base an underwriting decision on a report done by a management consulting firm belonging to an accounting organization, so I can't answer that. We wouldn't recommend one. We probably wouldn't recommend anyone. If it happened to be, let's say, a metal processing company, there are certain management consulting firms that are experts in the metal and mining area and we much prefer to have the expert do it, although we would probably end up having to do it ourselves, but I think if you needed one that badly I don't think we would usually think in terms of the accounting firm.

MR. LINOWES: Do you object to the CPA firms getting involved in this management evaluation?

MR. COYLE: In terms of what you fellows might feel was loss of income?

MR. LINOWES: Loss of income, and perhaps capability.

MR. COYLE: No, I think if it was a national firm, we would assume that it was okay. It wouldn't affect us plus or minus. We would love to read it but we wouldn't probably ask for it.

MR. CATERER: I am not at all an authority in this field but it would seem to me that in the pursuit of this auditing function that it is almost inevitable that some ideas would come out as to management processes and to some extent ability and I should think it might be used somehow. I don't know about the other complications that emerge, but I am sure there is useful information there.

MR. CROSS: I am interested in Mr. Coyle's remark about phasing out. As a matter of fact it is my general impression that it is just the opposite of that in the over-all industry. I think you are getting managements bringing in more and more consultants of various sorts and kinds. Granted I think that you are going more and more into the specialty area rather than the general, but I think there are certain phases, especially where it deals with the accounting end of management where it is logical, or most logical, for accounting firms to do this management consultant work and I think many of the firms that do nothing but management consulting work overlap into the accounting end but my feeling is that this business is one of the most expanding areas in the accounting field and I am interested that in the underwriting field this has been an area of retrenchment.

[General simultaneous comments]

MR. COYLE: This might be different. Maybe other underwriting firms are doing it. The only basis for this opinion is that it seems to me some years ago when you were invited to participate as an underwriter you many more times had made available to you a management consulting firm's report and you just get the red herring today in an underwriter's study. I could be wrong, but as a condition to the underwriting it has certainly been our experience.

MR. HEIMBUCHER: You made a point a little while back that sometimes when you have some doubts one of the difficult problems is to get a prospective client to spend $20,000 for a survey. Who would this usually be by? Would it be by the accounting firm or would it be by a specialist firm or would it be sometimes the one and sometimes the other?

MR. COYLE: We have not had a close enough relationship with the department within an accounting firm to probably even think of them. We are just beginning to get educated that some of the major firms even have these departments, so up till now it would not be, but again I say if it was a metal company we would get--or my guess is that we would think there were people more qualified who are specialists in that field than someone within an accounting firm. We just haven't been convinced yet of what those capabilities are.

Let me see if I understand you: if we felt that one was needed it would probably be on the assumption that it was a technical field we didn't understand.

MR. HEIMBUCHER: A special field.

MR. COYLE: A special field, probably technical, and it might be to do with the state of the art or it might be to do with client relationships, in which case we would probably go to the expert in that field and the chances are that that would be a division of a major firm.

CHAIRMAN TRUEBLOOD: I think what Mr. Coyle is talking about is management evaluation over-all in this kind of report as distinguished from consulting.

MR. HEIMBUCHER: Yes. There is one other question I would like to ask on this matter of--I am concerned about this trend for the future and you mentioned that the number of qualified firms that you have dealt with, CPA firms, it might be thirty or some such number. Do you detect any trend? Is this number increasing or decreasing--and I mean apart from your own growth, just thinking in terms of whether--I realize that some of the smaller firms are improving themselves and they become acceptable after a while. Others are probably lost in the sense of numbers because they merge with national firms, but on balance, on the whole, would you say the number of qualified firms is increasing or decreasing?

13 MR. COYLE: Increasing.

MR. HEIMBUCHER: Increasing.

CHAIRMAN TRUEBLOOD: There is a relationship among many of the remarks to be made by the panelists this morning and we do have some time stipulation, so can I ask you, Mr. Cross, if you---

MR. CATERER: May I ask one question before Mr. Cross starts?

CHAIRMAN TRUEBLOOD: Yes.

MR. CATERER: It is on something Mr. Coyle said on a different subject that got my attention quite sharply.

[To Mr. Coyle] You mentioned that it seemed to you that lawyers seemed to have a lot to say about long-range planning and you question whether they have the type of professional man--professionally the best advisers on that. When you say that are you thinking in terms of the smaller companies where the lawyer is a sort of family counselor type or is it true for the larger companies as well and if so what does the lawyer do for them in terms of long-range planning?

MR. COYLE: Well, I think--I don't want to take more than a minute---

CHAIRMAN TRUEBLOOD: Go ahead.

MR. COYLE: I think it begins with the relationship to a family--it might be in the large companies, too--it begins probably with estate planning, and that gets you into a diversification program and an acquisition program or a broader product line in order to get a bigger market for the stocks so you have more diversification of holders and you have got a better estate plan.

MR. CATERER: I see what you mean. The stock is bought at one point of contact and it sort of flowers from then on.

MR. COYLE: I know a specific company where the lawyers convinced the management they should get into an acquisition program because the acquisition program would make the company large enough to be listed so that they will now have a market that will make more sense with the IRS and the first thing you know the lawyers find an acquisition for them.

CHAIRMAN TRUEBLOOD: Is this lawyer on the Board, just for example?

MR. COYLE: Yes.

CHAIRMAN TRUEBLOOD: Mr. Cross, would you care to make some general comments at this point and get everything on the table also?

MR. CROSS: I will be glad to make some general comments. I feel a little embarrassed to make any at all after reading the papers which Mr. Carey was kind enough to send over to me. I feel that obviously you know more about this whole subject that I could possibly give you any assistance on, but for what it may be worth I will try and make a few comments, but they will be very brief.

Actually, in reading over the reports that you have made so far I do think that there is a difference in perhaps the three of us here, although it is somewhat similar to one or two that haven't apparently been completed yet, that most of the studies that have been made so far have been where you have brought in outside people. They have been made with people who are not using the direct assets which you are producing or that the accountants are producing, and therefore perhaps the three of us will look at this from a slightly different angle than some of the other people that you have talked to, so perhaps we contribute a little bit---

CHAIRMAN TRUEBLOOD: That was the idea. [Laughter]

MR. CROSS: The biggest single thing that I can see in this accounting field, looking toward the future, is the tremendous growth, which has been emphasized in your other reports, but I certainly feel that from everything that one can see everybody is going to be more and more a part of the accounting industry. This was brought home to me a couple of weeks ago when I returned from a three weeks' trip to Europe with my wife on a business trip and then tried to split down the expenses, which were hers and those that were mine. [Laughter] In fact I think I ought to get a CPA's degree.

But we in the banking industry are dependent completely upon the accounting industry for practically all the decisions we make and I think that as you look ahead we become more and more dependent upon them as the laws become more complicated. I think that inevitably the Government is going to be spending at least as much money as they are spending now and you can operate at deficits for a while but sooner or later your taxes are going to have to--the total income of the Government is going to have to be increased and as this happens the laws, I am sure, are going to become more and more complicated and there are going to be people who are going to find ways to get around it and decrease their taxes more and more as the over-all tax take is increased and I think that the accountants therefore are going to have to get in more and more into all these different phases.

The strides that are being made in the equipment field, the accountants are going to have to be authorities in this field. They are already and as the machines become more and more complicated they are going to have to know more and more because, granted, the largest corporations can afford to have experts on their own pay roll that are living with the accounting companies, but by and large the average company in the United States is not going to afford to do this, not going to be able to do this, but yet it is inevitable that they are going to have to somehow obtain information to keep up to date or otherwise they are going to be out of business, the developments are coming so fast in this over-all field.

To change the subject a little, I think that in the past auditors have had the reputation with the public--I don't mean with the expert or the analyst or the underwriter, but with the general public I think that accounting firms have had far too much the reputation of being policemen. The only reason why, to the average person in the street, the reason why you have an accounting firm is to be sure that the president isn't running away with all the money and that is really the only reason why you have them at all, and I think that to a certain extent the accounting firms have brought this a little upon themselves. I don't say that they are entirely responsible for this but I think that part of it is the fact that when there is some scandal or what have you the accounting firm's name is always brought out and they are always the ones that are blamed for it, for not having caught it earlier, and I think that this is part of the reason, but I think also I am a little critical of accounting firms in general who are not being more progressive in their suggestions of what can be done. I can understand some of the reasons for this but I come across many too many situations, in my opinion, where an accounting firm has been on a company's books for years, they handle their accounting the same way year after year, which makes the comparison--the thing is not nice--but situations change. One division becomes far less important, another one becomes more important, and they continue to handle the accounting the same way. There isn't, in my opinion, enough imagination in the way the accounts are set up and keeping up to date and with the changing that is taking place in the corporations today I think it is necessary for accountants to take a more progressive attitude towards the long-range outlook, the different changes that are taking place in the industry and what they are trying to portray from the point of view of the fellow who is going to be reading the figures.

I happened to just run across one recently of where expenses were allocated for an excellent reason fifteen years ago. Today the reason has changed completely, in fact it isn't there. In my opinion it was practically forgery figures because they were actually misleading you in the final result. Granted when you point it out it is sometimes a little difficult to persuade the accountant that he has overlooked this fact--he doesn't like to admit it sometimes--but I do feel that often when an accounting firm gets into a situation and is solidly in the picture that it is apt to be left to bookkeepers and there is a certain amount of just routine that goes on and on and I think this is a field which the accounting firms have to watch closely because I think their problems are going to increase in this respect and not decrease in the future. With the tremendous increase in the volume of business which actually they are going to have in the future there is going to be a greater and greater shortage of personnel to spread around on the jobs that they have got and the tendency is going to be to try and use the best people you have got for the job, but if you have got more jobs you have got to be thinner and thinner in each area and it just seems to me that there has got to be a real effort made to get additional good personnel into the accounting field to absorb the work which I feel sure is going to be there fifteen years from now.

The management end, I think probably if we get into a war, then the underwriting firms will--in fact, within the last month there are two companies that we have gotten the accounting firms to come in and make studies of. Granted they are accounting problems rather than over-all management, where we believe that the controls are not what they should be, we want to have a study made up showing exactly what is there and to point out to management changes, if there should be changes, that should be made in order to be sure that the controls are what they should be.

But again I think--and this question was asked earlier--that if it was a general over-all management problem, we would not go to the accounting firm normally. Our feeling would be that we would do better to go to a true management consultant firm and get them to come in more on the over-all picture.

One other thing which might be a collateral point, perhaps, and along the same line, is that--and there are references in here [indicating the literature before him] to changes that might be made in connection with this subject--I am afraid that the accountants, the certified public accountants, would be shocked if they knew the percentage of certifications that are read in the reports that they make out. I have a strong feeling, well, I know, that far too few of these are read by people in general. I am reminded of--I happen to have a brother who is a doctor and a new medicine came out a while ago which when it was given to some people was not good, in fact it was harmful, and one or two reputable manufacturing firms sold the thing and in their advertising they referred to an article which was published in the _American Medical Association Journal_ panning this thing, but it just referred to the section and used this as advertising. If anybody had read the article, they would have known better. [Laughter] Well, I think that some of the accounting firms could perfectly well put in all kinds of clauses if they hadn't done anything in the audit itself and nobody would ever know the difference.

But I do think that one of the reasons that people read the certificates so little is the fact that a lot of them say the same thing over and over again. I have a feeling that if the accounting firms would put into their certificates more of what they haven't done and really tried to show in detail what they have done that it might be of more interest. I think that most of the certificates are so general in nature that--what the companies normally do is to publish it--they don't want to pay more than they have to, so they do whatever is necessary to get the standard certificate and that's all. It seems to me that most corporations--well, every corporation is different and I can't help but ask the question of myself, "Shouldn't the audit that the firm makes vary with the firm and shouldn't the auditor therefore, the accounting firm therefore specify how he has done the particular audit and try and really make a tailormade audit and explain that it is tailormade rather than merely--granted I know that this varies from firm to firm obviously, but couldn't more of this be done so that more people will refer to this certification and therefore have the certification mean more? This is perhaps a public relations problem.

CHAIRMAN TRUEBLOOD: It is a public relations problem, surely.

MR. CROSS: But I just have a feeling that something should be done in this area. I can't say how it should be done. I just think that it is a fault. Let me stop there.

MR. CAREY: On that last point, when I first came to work here many, many years ago, every accounting firm wrote its own certificate and some of them gave the banks long-form reports and the net result was more confusion than clarity, we thought, because everybody using different words, you didn't quite know how they compared and the accounting firm might show a long-form report "We tested 30 per cent of the accounts receivable," of "5 per cent of the inventory," or "We did this," or "We did that," and how are you going to evaluate that as against what they should have done? Now we have got this standard opinion which is backed up by a whole library of literature. If you haven't done what is necessary in the circumstances you can't give it, so you get it clean and I think you have the right to assume that all has been done that should have been done and it is different in every case.

Isn't that right?

CHAIRMAN TRUEBLOOD: That is quite right, but---

MR. CAREY: But people don't seem to know it.

CHAIRMAN TRUEBLOOD: People don't understand that and it is a public relations educational kind of thing, which in my own view, Jack, is the result of our talking to ourselves too much. We understand thoroughly that this is not a tailor-made thing, that we have direct responsibility for having done what we should have done, but obviously the public does not generally understand this.

MR. CROSS: Maybe you should put it that wherever you don't have the standard I think there should be more than merely a change in that little paragraph at the beginning, which you don't want to lose your customers so you make it a little wishy-washy. [Laughter]

MR. CAREY: I will go with you on that.

CHAIRMAN TRUEBLOOD: Yes, I will, too.

MR. CROSS: It seems to me that you don't give enough of the exceptions. In other words, again I come back and say let's have more details of what you don't do, if there is any exception. If you are not completely satisfied with it, then I think it should have red stars all over it. Granted this may be lost from a customer's relations angle---

CHAIRMAN TRUEBLOOD: Let me ask you this question: do you say exceptions in terms of our doubts about the validity of our over-all opinion or exceptions to usual practice that you would simply like to know about?

MR. CROSS: I think that it should vary with the importance of it. I don't think that you can come up with an over-all thing that you have got to put a black border around every statement no matter how small the exception may be. I think it has to vary with the importance of it. Certainly if there is any question in the validity it should be the maximum that should be put in.

[General simultaneous comments]

MR. CROSS: It would depend on the situation. Obviously, if you are dealing with U. S. Steel the answer is no. I mean, you are not going to--but when you get down into the smaller companies or where you have some question, and we do check on it, and I think that we do this more than most banking institutions, the accounting firms on the books, and we keep a cross-reference and we know every account in the bank that uses the XYZ form, so that we can cross-check, but I would say that I am sure this does not happen everywhere.

CHAIRMAN TRUEBLOOD: Again, Jack, I was sort of redirecting that to our public relations, that is, if our people, our members, would take some initiative with the clients in getting to the ? officer case by case, this would be part of the education and mutual understanding process, or it would improve the mutual understanding process.

MR. CAREY: I just want to be sure that that would be welcome.

MR. CROSS: Oh, I think so.

MR. CAREY: It wouldn't take too much time.

MR. CROSS: No. I think that a lot could be done along those lines.

CHAIRMAN TRUEBLOOD: Dave!

MR. LINOWES: Pursuing that same point where you seem to stress the importance of indicating what was not done, I am wondering how familiar the users are of our product, which is financial statements, might be with the things that we actually consider necessary. For example, we all know, and I assume the users know, that we confirm accounts receivable and inspect inventory, but such a basic thing, for example, as confirmation of accounts payable, which laymen might think the accountants would generally do, is not basically required in an audit, nor does the profession basically require the verification of recorded liabilities such as mortgages payable. That could be very obvious.

Do you feel that in the interest of our profession we should get across to our users, whether it is in the transmittal letter or in the newspaper that these are certain areas that we don't touch on, or is it adequate for us merely to say in our judgment we think it is all right, that it can be taken as a whole?

MR. CROSS: I would say probably that your general statement is all right. However, I feel more not from that angle as much as that you start with the premise that if you think the guy is dishonest you shouldn't be doing business with him to start with. It is not that area that I worry as much about as I do whether your inventory controls--whether the inventory is--the management is really there. They may think that it is there, the figures may indicate that it is there, but is it there and how well convinced is the accounting firm that the controls are what they should be? Now, this is a hard thing to put in one sentence, but I think that there are lots of cases where I know--I am working on one right now where I am very suspicious of the inventory situation. I am sure that the management is convinced that it is perfectly all right. They think it is ridiculous to spend any money reviewing the accounting controls--and this is where you can get into a very difficult area and if the accounting firm is not absolutely convinced that the thing is covered the way it should be, I think they should say so.

MR. LINOWES: Let me ask a question specifically about something that the profession does not do generally. Do you think that we should confirm accounts payable?

MR. CROSS: I think they should be tested, sample tested. The answer is, I think, yes.

MR. LINOWES: They should confirm it or test it?

MR. CROSS: Yes, I think yes.

MR. LINOWES: And may I ask another question a little bit off of the subject?

MR. CROSS: Yes.

MR. LINOWES: You seem to stress, I would say, the caliber of the personnel or the work habits of the accounting firms in that once they have a client they stick with him and they do things in the same old way. Greenwald, Chairman of du Pont, in his "The Uncommon Man," makes a point that this is universally true of people. In other words, there aren't enough of the so-called uncommon men who will speak out and take a fresh approach to things. Now, do you think, however--this is my question--do you think it prevails more in the accounting profession than other groups of people with whom you come in contact?

MR. CROSS: I think it prevails more in the accounting field but I think this may be due to the fact that I think there is less changing of accountants than there is in many other fields. First of all, you only have normally one accountant, unlike, say, the banking industry, where you may have six accounts and perhaps there will be changes in the importance of those six accounts and that therefore always the banks are being jostled into getting into position and doing more. In the accounting industry you have a single accounting firm normally and he can get more entrenched and once he gets started to work with the people and this kind of thing I think he can let his bars down a lot further without having any disastrous effect on his business and that therefore the answer is that I think that you do have more of a problem than many other industries.

MR. LINOWES: Do I infer from what you say that you would almost like to see the accounting firms change their personnel on jobs even if it would be more costly to the client?

MR. CROSS: Well, I think this might be one way of accomplishing it-- I hadn't thought of it from exactly that angle -- unless there is a tendency on the part of accounting firms when they put a new man on to the job to have the new man just sort of follow what the old fellow did anyway, even if he is a new man, because this is the easiest way to do it. I can't answer that question. It just might be a way of accomplishing what you are after.

CHAIRMAN TRUEBLOOD: Take it one step further. Would you endorse a program by which the individual client or company was required to change accounting firms, not personnel, every five years.

MR. CROSS: I think that would be a pretty stiff pill.

CHAIRMAN TRUEBLOOD: It would be a pretty stiff pill for some firms. [Laughter]

MR. CROSS: As you know, at stockholders' meetings this suggestion is made quite often by some of our friends that own five shares of stock, that the accounting firms have been in for a long period of time and why don't we change. I think that your answer to this is that this is a costly operation to change, once you do have your personnel trained to know how a major corporation runs its books, and I am not at all convinced that it would be worth the money involved, in fact, I would say that it would not.

CHAIRMAN TRUEBLOOD: But you do endorse Dave's suggestion of a systematic change of personnel?

MR. CROSS: I would rather put it this way. I think that this certainly is a consideration that should be given. I don't know enough about the way a new person might come in and take over from an old one to know whether you would be accomplishing what you are trying to, but I think a definite, progressive effort should be made to keep your accounts up to date and review your over-all policies. I think that perhaps this could be done by a committee that reviews your figures to be sure that it is done,or a partner should go in, or something like this, to review the way the figures are being presented and the way the audit is being taken to be sure you are up to date.

CHAIRMAN TRUEBLOOD: You see, there again, Jack, our public relations have fallen down because I think you would be quite staggered if you understood the quality control built into the practice of certain firms.

MR. HEIMBUCHER: I was going to ask a question somewhat related to this. Mr. Coyle has told us something about how his firm evaluates accounting firms. Now, admittedly he has a more specialized kind of problem because he starts out with an initial one-shot problem, which may become a continuing one, and his is more specific, as you pointed out, because he is dealing with the SEC and he has the matter of selling in a sense, at least "selling" in quotes, to associated underwriters, but you must have somewhat the same kind of an evaluation problem on a broader or longer range approach and I wonder if you could tell us something about the criteria that you take into account in evaluating the CPA firms that your customers have and at what point do you decide that you are not satisfied with the CPA firm and make an issue of it with your customer, or if the customer wants advice on how to use the firm, what criteria you use in offering that advice.

MR. CROSS: This is a very difficult question because we don't have a specific problem. We don't have to have a report prepared for the SEC and this firm says, "Sure, we can do it." or, "We can't do it. We don't have the personnel. We can't handle the problem." So that it is normally not a problem which you can face by saying, "We require A, B, C, and D." or, "We require that the firm is able to do a certain job." This is the kind of a situation where you sort of ooze into a bad situation and I think that normally what happens is that you slowly get further and further in and normally as long as everything goes along fine you let it slide along and then the company will have a poor year, the inventory will start to look as if it is getting out of line, the stock going slow in the trade, or something will give you a signal that something may not be quite right, so then you will go in and you will talk to the management and they will try and talk you out of it, and finally enough steam will be gotten up until you say, "Look, we have got to have something done here." and you will force the issue, but I can't say any particular thing that we would look for. It is the general reputation of the company, of the firm, your knowledge of how they operate and this type of thing, but we do, as I mentioned earlier, keep files on the accounting firms, what companies we do do business with. They are on the books so that we can get other examples and try and find out from that as to how good a job we think that they are doing, and if we find all of a sudden that the quality appears to be going down across the board, well, then, obviously you are going to start to be suspicious and you are going to take your weakest credit first and start to investigate the situation.

14 CHAIRMAN TRUEBLOOD: Do you give any consideration to industry competence in evaluating these firms?

MR. CROSS: Oh, sure. There are accounting firms, obviously, that specialize in a given industry and if you find a firm is getting out of their area you may be more suspicious than a firm which is a general firm in all different kinds of business and again if you have--it might well be that if you are talking about real estate and it is a firm which specializes in real estate, it might be a tiny firm but if you are convinced that they really know their business, this might be the firm that you would like to suggest if you had an opportunity to. I doubt if we have the opportunity to suggest firms to the extent that the underwriting people do, because they have a specific job that has to be done. Ours is a much more general question which is normally put to us and we also get into many cases of where a company may have an accounting problem due to mergers. They may have four accounting firms that are working on different parts of their books and the thing just doesn't make sense but yet a little baby firm which happened to have been the firm that was in the little company that started so they still have this thing that doesn't fit into the over-all and he doesn't want to leave them and this is where your tussles come in. You finally have to make your decision.

MR. CAREY: In evaluating these firms do you give any weight to the memberships in the Institute and the state society, and that sort of thing?

MR. CROSS: I think so, but I think we would give more weight to our own experience and the general reputation.

CHAIRMAN TRUEBLOOD: I am going to suggest a five-minute break at this point and then we will proceed with Mr. Caterer's general remarks.

MR. CATERER: May I ask Mr. Linowes a question before we do that?

CHAIRMAN TRUEBLOOD: Yes, sure.

MR. CATERER: I didn't realize, Mr. Linowes, that typically the audit did not, as I understand you, check the accounts payable--

MR. LINOWES: Not check, confirm. Write to the credit man and ask him to confirm.

MR. CATERER: Or--I think you mentioned mortgage liability as well.

MR. LINOWES: We do not inspect the recorded liabilities.

MR. CATERER: Does that mean that the only defense that the user--that is, the outside user--of your audit certificate has is, as I think Mr. Cross indicated, the belief that you are dealing with reputable people and plants?

MR. LINOWES: No, they do test them to their satisfaction but we don't go outside of the client to try to confirm them such as we do with accounts receivable. As you know, with accounts receivable we send a confirmation notice out to the debtor and he must reply or if he doesn't reply we assume it is okay. The normal requirement for an audit, in so far as liabilities are concerned, does not require that type of confirmation.

MR. HEIMBUCHER: It may be users. In our firm---

MR. CATERER: What is involved in testing, would you say?

MR. LINOWES: Satisfy in the files, tracing through the purchasing and gear procedures and the approval of purchase orders and the payment of the bills and the inspection of, perhaps, the endorsement on a check in the event there might be some collusion with somebody on the outside, but not going outside at all.

CHAIRMAN TRUEBLOOD: Can we break for just a few seconds and then get back.

[The meeting was recessed briefly.]

MR. HEIMBUCHER: So that there isn't any confusion on the question you asked Dave Linowes here, I am not sure really that you [to Mr. Linowes] made it clear on that point, because I think it is customary for a CPA firm to confirm mortgage liability direct with the credit, but Mr. Linowes' remark referred particularly to checking the public record to see that these mortgages were properly recorded.

Wasn't that your point?

MR. LINOWES: Yes.

MR. CATERER: I was thinking more of credit existing and not shown, not claimed.

MR. HEIMBUCHER: I think it is generally customary, in fact always so, I think, to confirm the existing credit with the creditor and the balance of the credit but this doesn't prove that it has been recorded.

MR. CATERER: Yes.

CHAIRMAN TRUEBLOOD: Would you like to take off, Mr. Caterer?

MR. CATERER: Yes. My approach, of course, is quite a little different than that of Mr. Coyle and Mr. Cross. Mine is that of the financial analyst, the adviser to investors in the securities of these companies principally and, as you gentlemen know all too well, I guess, the one battle cry we have is the word "disclosure." We are never satisfied with the amount of disclosure that we get in the company's financial statements and in its annual reports.

I have to say that personally I am not an unhappy man on this subject because I think that a great deal of progress has been made in the last thirty years in increasing the flow of useful information that comes to the investment analyst. I do not know how the credit for that should be allocated as among the agencies in Washington and the Stock Exchange on the one hand and investment analysts' organizations themselves on the other and the accounting profession on its, and I might say one thing, the accounting profession and its clients, the attitude of the companies for whom they make these audits. Anyway, a lot of progress has been made and I think my attitude is a little bit more satisfied, a little bit more complimentary than that of some of the committees organized by the Financial Analysts Federation, for instance, or some of the local societies.

I think that there is more that should be done for the maximum benefit of the investors in these companies' securities and their advisers. In view of the trend towards horizontal expansion, diversification, it seems to me that the need is growing for analyses of divisional earning power. This is one area where companies seem quite reluctant to disclose--sometimes I think maybe the diversification was undertaken in order to give them a reason for holding back on such information--but it seems to me that the trend towards diversification is so powerful that this has got to be a strong pressure on the part of the investment analyst and will.

I believe that the need for interim reports of companies with a large public interest that are not listed on registered exchanges--which, of course, is part of the SEC package--is a sound one and should be supported.

I am happy to see the greater use of sources and uses of funds more and more in annual reports. I don't think this is important to me. I just mention--those are as a rule, I think almost always, not part of the certified audit.

CHAIRMAN TRUEBLOOD: That is right. That is right.

MR. CATERER: I presume that they are made up at least with the surveillance of the auditors and I have no reason to think there is anything ? about them. I just mention that. I presume there is very good reason for it. I think I can almost imagine it.

There are other items here but I don't think it is necessary to just run down the list of all of these. They have different degrees of importance and you perhaps have seen this tome [displaying a book] put out by the Information Committee of the Financial Analysts Society, which gets into everything in a good deal of detail, and I don't know whether detail is required.

I would say this, that the analyst does and should understand the reasons, the legitimate reasons for not giving out as much information as he would like to have. I think he does, but I think it is the duty of the financial analyst to press for all he can get. It is not his duty to try to sit there and act as judge. His job is to try to do all he can and somebody else can make the decision, as it has been made by the give-and-take of discussion and pressure.

In that regard, speaking about who should be the judge, I am not sufficiently familiar with the position of what you call the attesting accountant, who, as I see it, stands somewhat between the client companies on the one hand and the public on the other. I hope that in his view of his calling that he recognizes the high importance of adequate disclosure of information to investors and to those who advise them. "Adequate" is a vague term which accountants don't like, I am sure, but what it means to me is enough information to allow the investor or his analyst to make a comprehensive, thorough analysis of the investment of this particular security and also to be able to follow up the investment once it is made.

Now, the twist to this, that I must confess is a personal reaction, is that where disclosure, fullest disclosure, is combined, or I would say confused, with making accounts completely comparable, I think that a certain public loss is incurred--Mr. Coyle is looking at me with a little surprise. I will come to that in a second--to the extent that it forces accountants to adopt rigid rules of definition and presentation upon which qualified members of that profession differ. I don't think it is good, not from their point of view so much but I think that if in the face of these legitimate deep differences of opinion nevertheless some kind of rigidity is imposed, that one of the results is to attach a degree of sanctity to the residual figures of earnings that it doesn't have and that leads the investor and the less industrious or less qualified investment analyst into making errors of investment judgment. I think that full disclosure means supplying in the documents the material whereby the analyst or his boss or his client can make whatever adjustments he feels, in his judgment, should be made to get to a sound figure of earning power. That material should be there but I think that there is a damage, really,to the public interest in leading to the superficial conclusion that this figure of net income is the same quality year by year and for all companies. I think, for instance, that the current argument about how to handle the investment credit is largely a dispute among professionals. So long as I know how it is being handled and the figures are there in notes or are available, I am satisfied in my own effort to treat a bid as I think it should be treated with.

Now, I realize that I am speaking now not in a narrow sense--well, I don't think it is narrow because I don't believe I can think of the investor as being a small segment of our public interest, but I may be speaking narrowly in the sense of speaking as an investment analyst. I believe that for the use of the--I recognize certainly that for the use, the internal use of the data by executives in the companies who need it to make decisions, that a decision must be made and must be adhered to, and this I can understand. They haven't got the time to philosophize about the concepts, and Mr. Coyle's comments--

I am frank to say I hadn't realized before hearing you [to Mr. Coyle] the particular position that you are in as an underwriter, where you have really a tremendous commitment, where you have to work under a tremendous pressure of time, and to you, as in the end result you are selling something, this true comparability of data I can see is of great importance.

I don't suppose that it really is a highly controversial, or rather a highly important thing, but I have been, as investment counsel I really have been disturbed and will be disturbed again by the sloppy use to which these earnings statements, ? earnings statements are put. I have had it said to me many times that if this company's--if the headlines report, or the lead reports that such-and-such a company will show a decline in earnings, that this will probably cause the stock to go down--and it may have been caused by quite a slip-up in depreciation, for instance, that will be down somewhere in the body of the dispatch and that will be missed. Well, I don't really take that kind of comment seriously, I don't think it should really affect our thinking, but it is typical of a kind of attitude either by the lay investor or about him that I think is destructive.

More importantly I think that even among--in fact, particularly among many investment analysts that this tendency to use figures fast rather than to dig behind them has led to some serious investment mistakes based on growth patterns. I know many an investment analyst, I think, who would shy away from constructing an income statement of five years hence on a balance sheet five years hence for a company but he is not afraid to look at the past and say, "This company has got a growth trend of 5 or 7 per cent a year." This they can hide behind as a nice round approximation and I think the mistake is just as bad whether they do it that way or whether they come up with a projected earnings statement and balance sheet and are wrong. And of course we have all seen the sins committed in the name of cash flow in the last few years.

I don't look with any equanimity at all upon these programs such as I think the SEC is interested in now for further narrowly defining the accounting standards to make it fast to come to a judgment about a company's earnings last year, for the past several years or the future. I think I am a little--frankly, I am a little worried. I don't understand this subject too well but it seems to me it is part of the use of the output of computers where a great almost diarrhea of figures are being put in, and out of them will come at a moment's notice all sorts of comparisons. I think that probably this is going to lead to some poor judgment on the part of people who substitute analysis for this kind of reading of these sheets.

I was approached by a firm the other day which was trying to sell us such a service and the man who was offering me the service is also a buyer of securities, or an analyst of securities, and he mentioned Dow Chemical Company stock as--I forget whether it was Dow Chemical or American Cyanamid, it doesn't matter, one of those two chemical companies' stocks--that he had made an investment,and it had been a fortunate investment, because of this assemblage of ratios trends that had been developed by a certain--this was not a computer job but it was the simpler version of the same thing--by bringing together a number of ratios and weighing them and coming up with a reading. I asked a little bit more about that and it turned out that the specialist, the chemical specialist that he had had had analyzed the company, had decided that the company was coming into better days and that the stock was relatively attractive and recommended it to him. He went through the figures and saw that there was a favorable trend in the past in these figures and therefore he followed the analyst's advice. I asked him what he would have done had the figures not shown this favorable trend and he indicated he would not have followed the analyst's advice.

Well, I think this information is valuable, don't get me wrong on that, but I think also that more times than not the really attractive opportunity is the case which is changing and doesn't show up so well in these past figures and I think that the easier it is to have these assemblages of ratios the more likely it is not that we are going to do more intensive research or more penetrating research, but rather do less.

So, in summary, on the subject of this disclosure, as an analyst I ask for more and more, I am never satisfied with it, but not as one arbitrary form of presentation but as that which permits me and my colleagues to do as thoroughgoing a job as possible of appraising and studying the companies in which we are asking our clients to invest.

Before I close these sort of prepared comments, inasmuch as the material which Mr. Carey sent me did go into--I say in all compliment a very lofty point of view toward the profession and its functions, I might be permitted to make a couple of statements along those lines.

It seems to me that one of the important public functions, public service functions, that the profession I am sure is following but it should continue to follow is that of explaining and justifying the function of profits in our economy, our system. Somehow or other it seems to me that most of the talks that I have seen or heard on this subject have come from business leaders, industrialists. This is wise and fine but I also feel that the accountants, that is, the certified public accountants, have a knowledge of this which is in many respects greater than that of the business leader and that in many cases since the end of the War, when this analysis was presented in some attention-getting way, would have been very useful and will be useful in the future.

And the second general point is, I am impressed with the bridge which accounting is between various countries of the world. I think that in Russia, behind the first page news there is developing a pressure for a higher standard of living that is proving difficult to meet and which will be met in a large part by the use of business methods that we have found effective in our part of the world. This inevitably has to mean accounting for these transactions in ways which your profession is so well qualified to understand.

It would seem to me that if in the unfolding of the years this communication, this line of communication could be widened it would have a usefulness that it would be very hard to exaggerate in terms of the future.

CHAIRMAN TRUEBLOOD: Thank you.

Would you like to ask any questions of Mr. Caterer?

MR. HEIMBUCHER: Well, one question that came to my mind affecting as to what is likely to occur in the future, I was impressed immediately with quite a harsh cleavage in the point of view between Mr. Coyle on the one hand and you and Mr. Cross on the other hand, arising from your different fields in this old, old problem of rigidity of rules versus complete disclosure as an alternative to uniformity.

You mentioned, for example, and Mr. Cross did, too, that you like to have full disclosure and like to have complete explanations of what was done and what was not done, and the like. On the other hand, Mr. Coyle has the problem of coping with differences between treatments given to the same kind of thing, such as the investment credit which you mentioned, by leading firms, which I imagine in some cases might even lead, in an extreme case, to shopping among firms by a company to find the one that is going to give them the treatment that they would like to have.

I wonder if you would comment on what you see in the future. Now, this is going to be pointed up more, I think, by the recent SEC report and you mentioned again the requirements for more reporting, interim reporting, by unlisted firms.

This conflict here is going to go down now to smaller firms and I wonder what comments you would have on that as regards the future.

MR. CATERER: Well, I also said that I think that the specific differences are not so great as to be a fundamental cleavage.

I also understand that the Institute, the American Accounting Institute, produces bulletins which give recommendations--maybe they are directives, I don't really know what they are and how they handle these things.

I think--you asked me what I thought was going to happen. I think that the differences are going to continue to exist. I don't know all the members of your profession well enough to speak authoritatively but it seems to me that where there are deeply held differences of opinion about how certain items of depreciation, inventories, or whatever, should be treated that they will get up and fight for them just the same.

I am only asking that the bases be spelled out so that a qualified--I don't mean a professional accountant but a qualified student of balance sheets and income statements can know where the differences are and what they amount to quantitatively. You raised the question of shopping around for the firm which would allow, I presume, the most generous, the most liberal approach. I don't really know how serious that is, Mr. Heimbucher. It seems to me that we should not let ourselves get too much impressed by what might be the one-paragraph summary statement of what this income account shows. We ought to not let that influence our decisions very much.

I am sorry that is not a very adequate answer but I am speaking a little bit out of knowledge of it and I am well aware of Mr. Coyle's problem.

MR. HEIMBUCHER: It is very helpful.

MR. COYLE: May I comment a little bit on that one?

CHAIRMAN TRUEBLOOD: Go ahead.

MR. COYLE: I indicated we look for a clean, simple certificate. I don't mean to imply that the things that you are looking for as an analyst are not required in any investigation by the respective underwriting firms.

MR. CATERER: Oh no. I know you are very painstaking.

MR. COYLE: We are--well, let's--I couldn't agree more with you about this division breakdown of departments as well as sales because companies tend to use the sales breakdown if it seems to help get their image over better and if there is any reason in the world why they can use the division breakdown of earnings to make their picture better they might do it, but most of the time they get out of it on the basis of this competitive disadvantage. This has never been consistent to me because how do you compare one-product companies with multiple-product companies, because there is no such pretension with the one-product companies.

MR. CATERER: There is a big gap.

MR. COYLE: I couldn't agree with you more and from the standpoint of an investigation of a company about the very first thing you ask before you get into an underwriting is, "We want to see the profits on sales and we want to see the reports." and they can hedge and they can duck it but they can't get around the fact that you can ask for confidential treatment and we have actually turned down underwritings where they have ducked this problem of giving us the profits, because you felt something was wrong and you have to go to the accounting firms and have them confirm the controls, but it doesn't get into the prospectus most of the time and of course it never gets into the quarterly or annual statements unless there is some advantage to the company. I think it is a problem and I just don't think they are justified in ducking the responsibility.

CHAIRMAN TRUEBLOOD: An interesting observation on that, if I recall my history correctly, the SEC first required uniform sales disclosure in, I suppose, the '32, '33 and '34 Acts, with the stipulation, however, that on request and for good reason they would recognize requests not to disclose gross sales. I don't remember the initial filings they gave but there was less than 20 per cent of the subject companies who in fact requested the---

MR. CATERER: The hold back?

CHAIRMAN TRUEBLOOD: The hold back, in spite of all the clamor at that time.

Now, somewhere along the line I would be reasonably certain that this divisional breakdown is one of those same kind of deals, so I wonder whether we can take ourselves seriously enough to feel that we can be the pushing force on it.

MR. CAREY: It seems to me that we might be more pushing than we have been.

CHAIRMAN TRUEBLOOD: That I agree with.

MR. CAREY: It occurred to me as I listened to Mr. Caterer that when I called on Macurda, through whom I was introduced to you in a remote kind of way, he said he had just come back from a meeting of the Society of Financial Analysts in New York and a company president was talking quite freely and giving information orally that never was given in published reports.

I remember reading also in Bob Metz's book, "The Philosophy of Quantity," a comment on the fact that company presidents who want a good market for their stock and want a good reputation in the financial community are getting much more accessible to interviews by analysts and others and are giving out a lot of dope but for some reason--it then becomes public because you circulate it to other people--but for some reason there is a kind of traditional reluctance to print it and it seems to me that we CPAs might point out to them that they are telling selected audiences things that the stockholders would like to know too, and they would get credit therefor. I don't think our people really do much along this line.

I was happy to hear you say that you thought there had been a lot of progress.

MR. CATERER: I think there has been.

MR. CAREY: This was a slow process and the fact that the companies had control pretty much, within limitations, over what they want to do and how they want to do it, the CPAs have just gradually had to build a standard of their own as to what they were willing to certify. Short of that standard they won't certify anything and that standard is always rising, I think, little by little, and I would hope that in this disclosure area we might be effective as the years go by.

MR. CROSS: Don't you think part of it is due to the fact that if the president gets up and makes a statement about whatever you might want to talk about, the division breakdowns, or what have you, or how well this division is doing, this makes a good impression but it is not on the record so that he has to give it out again when it looks a little poorer and if it is published then he has got to do it all the way through ---

MR. CAREY: That's right.

[There was general assent.]

MR. CROSS: [continuing]...and I think therefore he only does it when it is to his own benefit. Now, let's face it, managment is not often in a position where they know they are going to be as strong two years from now as they are today.

MR. CATERER: Well, Mr. Cross, I would like to argue just a little bit, not in terms of those who get up on their feet and give us information now, but your own bank, I am sure, and my company send analysts around to call on companies and where we have these diversified companies we will frequently attempt to estimate ahead of time what the margins are by main divisions--that is, if we have the sales figures, we couldn't do it very well if we haven't got the sales figures--working from other companies, you see, and then prepare our estimate of what the breakdown should be and then submit it to the executive we talk with. More often than not he will give us some kind of helpful response on that. I think--I like to think that he responds to the fact that we have done some homework and haven't just gone there and sat down and said, "What are your profits in this division and that division and the other division?" but we have told him why we came to where we came and he says, "Well, we aren't doing as well as this fellow. We are doing better than this one." and such things that you haven't even mentioned.

MR. COYLE: Well, you have solved 50 per cent of the problem right off the bat because if what you have analyzed is not in his favor he will tell you and that is half the problem solved. [Laughter]

MR. CATERER: Well, again I will have to say that in a job like ours or Mr. Cross's--and yours, too, obviously, Mr. Coyle--that is, in a research organization--if you call on some of these people a couple of times a year, three or four times a year, for a number of years, you develop a sort of a rapport with them that helps out.

CHAIRMAN TRUEBLOOD: I would like to get around to the public relations aspects of some of our problems again. You all touched in a way on the probability or uniformity, as some of you called it, as distinguished from flexibility and I suppose by putting my question in prospective I will sort of have to give away my own position, but be that as it may, given the large eight steel companies, or what have you, I think, Mr. Caterer, your position is quite different from that of the lay investor in the sense that the bottom figure is all he can digest---

MR. CATERER: That's right. He doesn't know anything more about it.

CHAIRMAN TRUEBLOOD: [continuing]...so now my question is this: you are each aware of the gyrations we have gone through in the public press on this issue--

MR. CATERER: Which issue?

CHAIRMAN TRUEBLOOD: With the Accounting Principles Board.

MR. CATERER: Oh, yes.

CHAIRMAN TRUEBLOOD: I am curious what each of your reactions is as to whether we have gained stature by exposing ourselves, exposing our differing points of view to the public, or we have lost stature professionally by exposing our differences.

MR. CATERER: I have a very strong opinion that you have gained stature by it, from my own---

MR. COYLE: From an analyst's or from a public standpoint?

CHAIRMAN TRUEBLOOD: From a public standpoint.

MR. CROSS: I think you have, too.

MR. CATERER: The question would be the same, however, whether it was from the public standpoint or the analyst's standpoint.

MR. COYLE: Oh yes.

MR. CROSS: I am not positive.

MR. COYLE: I think from my standpoint I think we would recognize that these differences exist and you will probably do better about it, but from the whole of the U. S. public relations standpoint, I don't know, I think if you start chipping away at the pedestal, the uneducated people who read primarily the bottom of the line there, your statement may only confuse them.

CHAIRMAN TRUEBLOOD: Mr. Cross!

MR. CROSS: On that same subject--let me go back a little bit perhaps. I was interested in your comment in connection with the fact that an analyst will review the figures when he has got the disclosure to work with and the figures to work with on, say on lease-backs and investment credits, and what have you, and he will come up with his own figures. We get so often, we get managements coming in and saying they are buying--yesterday a large company was buying $1-1/2 million worth of equipment--"Should we, for the sake of window dressing--we know it doesn't mean anything really--should we do this on a lease basis or should we buy it if we can find the money?"

Well, we say immediately, as you do, and every sophisticated analyst, "Take a mortgage on the property, or a loan, no matter which way you do it. Why not call a spade a spade and come out and be honest? Unless there is a good dollar reason, don't consider this as a banker."

Whenever I make this statement, and I believe it but I have my tongue in my cheek and know darn well it isn't true. [Laughter]

The unsophisticated investor--and there are unsophisticated investors--doesn't know the difference. They compare the figures as they are published and the window dressing does have effect. It is basically the same as public relations or anything else. It is a four-order subject and you have the incentive for management to paint the best picture they can--well, great, and I think you ought to be realistic, but it doesn't make it right and I therefore I still think you ought to argue against it, but, boy, I can sure see the other standpoint.

MR. COYLE: Let me ask--this is a little off the direct emphasis in your study--let me ask you whether this might not have some philosophical, long-range economic aspects to it. I have heard it said that historically the only thing that seems to go up as the result of inflation is real estate and fixed plant with an unlimited life and that the reason that the use of leasing has grown seven times in twelve or thirteen years must be deeper than window-dressing and that it might be that economically, as long as we are in an inflationary period, the usable equipment in a business that runs out its useful life either through changes in technology or just wears itself out is that which should be leased and the things that have a tendency to go up in value, such as the plant and property, is where you should put your capital. Now, this may be part of the sales pitch of the leasing people but I think you should dig a little deeper, aside from the problem of window-dressing---

MR. CROSS: I did imply, which I didn't mean to, that the sole reason for sale and lease-backs is window-dressing. This is not true--I think I did say it, as a matter of fact, that there can be tax reasons involved, but I do think that this is one of the factors that management looks at and I think it is one that is looked at too much. It is perhaps because I don't believe in public relations as much as many other people do and I think that this may be the reason that I have this feeling, but there are some of these sale and lease-back deals that are done purely from the point of view of the window-dressing and I say there is something wrong somewhere or other if this is being done.

CHAIRMAN TRUEBLOOD: Well, these technical questions or alternatives are really very important to us in terms of our long-range planning from this point of view, but I think to this time quite successfully, with the considerable support of and cooperation with the SEC, we have sort of come to have an image of settling our own differences, gradually making progress, gradually increasing our standards.

Now, the APB was a considerable step forward, we all thought, in terms of extending research, because the very things you talk about do have economic impact and we are in a very tight spot if we do the wrong things too long in terms of replacement values, but from the standpoint of the profession and our future, do you feel that we are getting closer to, say, direct Government intervention in the sense of SEC saying, "Boys, this is it. Now you go and do it." or do you think we are in such a posture that, hopefully, we can continue as a profession should to set our own standards and police our own standards?

MR. CROSS: My reaction is that, sure, you will have the Government always chipping at you, but this has been going on for years and I think in general--I certainly hope that the industry will be able to continue to control its own destiny, if you want to call it that, and I think that others will assist in this.

To go back to our sale and lease-back, the banks were, in my opinion, very slow to recognize that a sale and lease-back is a mortgage and we were very slow in getting this new agreement. So with the insurance companies. I think both of us, we didn't get the change, but it is hard to make these changes. Companies kick and so long as another fellow is willing to do it without, then you have got to compromise, but slowly this kind of thing--let me--we are all in this same problem, we can all get under more and more Government control, but I think that everybody is working towards this direction of trying to maintain their own position, changing their policy to keep up with the times--but the Government is, too, so I think you will find more encroachment but I still think that the accounting professional will be able to make his major decisions for quite a long time to come.

MR. COYLE: Maybe the answer could be found in analyzing why this Government activity in taking over your prerogatives, or ours in our industry, where and how does it begin? It always seems to me to begin with a public lack of confidence.

I am not answering your question "yes" or "no" on should we fight these problems out in the press or publicly or should we settle them at the table, but I just throw out the problem that if the public is confused it would seem to me it might follow that you would get more help from the SEC in settling these problems and I think the more you tend to not be able to settle these within your own community the more confused the public is going to get and if this all adds up they are going to have an opportunity to come in and help you.

MR. CROSS: That's a good point.

MR. COYLE: That is certainly true of our business.

CHAIRMAN TRUEBLOOD: Why don't you pursue, Jack, your editorial on how we get together to do this kind of thing.

MR. CAREY: I wanted to say a word on the subject. This may be rationalizing but I think this publicity, unfavorable publicity about our hassle on the investment credit was good. I don't think it would be good to have too many of these, but for one thing I think we were oversold. I think too many people assumed that this last figure in the income statement had some sanctity--you used that word--and that things were comparable and it was something of a shock to the uninformed to find out that there are differences here that make them not comparable, so maybe just for a moment we are in the position of the acrobat on the vaudeville stage, you know, who misses it the first time but then he gets a very big round of applause if he comes through and does it the next time. That is the way I am thinking about it. We can capitalize on this if we do a good job from here on.

On this comparability business--and this is the main issue--if I remember my talk with Mr. Macurda correctly, he differed a little bit from you in this way--and I mention it only to---

MR. CATERER: Very likely.

MR. CAREY: [continuing]...I mention it only to be sure that I understand you.

MR. CATERER: Yes.

MR. CAREY: Everybody knows you can't compare a race-track operation with Standard Oil of New Jersey by looking at the bottom figures but he said that he thought within the industry, where the circumstances were identical, like the oil industry, he couldn't see any reason why one company could capitalize its intangible drilling costs and the other one could expense them and both get clean certificates from the CPA. Now, this is our problem and it is oversimplified, that maybe we think our research efforts ought to come out with a guide line--we can't issue directives, we have no enforcement procedures there because the companies are the ones that have to do it. We have some idea that maybe we ought to get together with industry groups a little more closely than we have in the past, like the American Petroleum Institute, and point out to them that if they will go along with us and--maybe either way is all right, but if they would be willing to follow one method or the other--all right, I mean, in logic and in theory, but it is a problem when they do it differently and we appear to be giving a blessing to the final figure on either basis. If we could get agreements of this sort with management it might help everybody. If we can't, you see, it is basically management that suffers the most if the SEC moves in because then they have got somebody almost with the right to go in and tell them how much their profits are at the end result of all this. The auditors will still be doing the auditing but they will be doing it according to the rules the SEC puts down, though, instead of their own good judgment and the advice of you people on what is most helpful to the public. So we think the corporate presidents ought to get a little more aware of this thing and anything that your groups can do to facilitate that awareness--

If you are going to have another forum, Mr. Coyle, maybe this is something you would like to allude to or have some speaker allude to.

I think management has taken it a little too easy on some of these things and is a little too much preoccupied with the immediate year's earnings figure that is going to be in that headline and what effect it has on them and they don't see the road ahead perhaps as clearly as we do.

MR. CATERER: Does it follow, Mr. Carey, that if we were agreed that an effort should be made to get the oil companies to report on their books their handling of intangibles the same way, would it follow that they should handle inventory accounting the same way, and ? earnings the same way?

MR. CAREY: Only if the circumstances are identical. Now, when you talk about uniformity you get a reaction that we mean something like the ICC accounts where you squeeze the item into the classification whether it belongs there or not. We don't really mean that.

MR. CATERER: Comparability.

MR. CAREY: We mean comparability when the circumstances are identical and we all recognize that there can be situations in which the inventory shouldn't be handled the same way just because they are oil companies because the circumstances are different.

MR. CATERER: I would like to make it clear that I am not arguing against comparability per se, I am not against that, but I am saying that I think disclosure is more important than comparability.

MR. COYLE: On the basis that in an organization like yours you have enough professional talent to sit there and not only find the answer--and I don't say it facetiously, because we sell the same in our own research, but that you are uniquely in a position to give the investing public the differences and this is really what your contribution is. What I am worried about is that if I were in the SEC, with the number of investment decisions that are made by people less professional than yourselves, or perhaps without even the help of a brokerage research firm, on the basis that they think they are looking at comparability stock--and I have watched doctors sit down in investment clubs and make investment decisions where they don't have the help of your analyses, or even a good research department, and they are doing all kinds of statistical figurations and they make decisions and this is the part that will get the SEC back into the game again even if---

MR. CATERER: The point I want to make is that I think that at some point this effort at comparability breeds a confidence in figures on the part both of the uninformed investor and the analyst as far as that is concerned, which is greater than they are, than they are entitled to, and I want to--I don't really believe that our Stock Market debacle of 1962 or what went before it was caused very much by irregularities or distortions or lack of agreement on auditing principles. I think it was taking information which was comparable and reading into it far more than should have been read into it.

MR. COYLE: That is where you come on this cash flow.

MR. CATERER: Sure.

MR. COYLE: And, of course, then the ratios got so high that people were scared---

[General simultaneous comments and laughter]

16 CHAIRMAN TRUEBLOOD: There is a presumption of preciseness, which, of course, is again part of our public relations, which is working to the disadvantage of all of us.

I am reminded of a client once that came up with a final profit figure of, let us say, $1,093,682, and he said, "Hell, I made a million dollars. Charge bad debts. The profit is a million bucks."

MR. CROSS: Yes, that is a fact.

CHAIRMAN TRUEBLOOD: Mr. Cross, you wanted to talk on this?

MR. CROSS: Yes, just a comment on this. I do think that before you can get to a position where you can get any kind of conformity that really means much between companies and so forth, you have got to break down this division business that we talked of earlier because now with companies diversified as far as they are no two companies are comparable. You can't compare anything really, even if you did have the same accounting, and really when you come down to it the fact that it is different accounting really doesn't make too much difference. The figures are so distorted because of the different types of business that they are lined up in and if a company wants to argue that they are not comparable anyway and that this fits into their over-all system because of the fact that they are in the other line of business, I don't think the accounting firm can argue this. I don't think they are in a position to be able to even too forcefully indicate that they think they ought to take an exception in this statement because of this accounting because he does have good arguments as long as he can hide behind the fact that he is not going to give division earnings out. Then I think you are in a much stronger position, so I think that the division information is the one which you have got to tackle first if you are going to accomplish the other one.

CHAIRMAN TRUEBLOOD: Dave!

MR. LINOWES: I would just like to ask the general question: because the end results of what the accountants do are very far-reaching, I am wondering if the gentlemen here would feel that there is a social obligation on the part of any other groups other than accountants to evolve adequate accounting principles.

MR. CATERER: Any other groups?

MR. LINOWES: Underwriters, auditors, analysts---

MR. COYLE: Underwriters certainly have this.

MR. LINOWES: Would you feel it is an obligation that you should take on and participate in on a---

MR. CATERER: This is an effort that has been going on for some years by--well, I wouldn't say accounting principles.

MR. CAREY: These are more calls for disclosure.

MR. CROSS: I would say that we have an obligation to work with the accounts, but I would say "no" to your question, if I understood your question properly. I think that we should work with the accounts and try and persuade them to change the methods and this kind of thing, but don't have an obligation to do it ourselves. I think we have to work through the accountants. After all, they are the ones that have to make the statements.

MR. CAREY: That's right, but this is an interesting point and it has got to do with public relations. As you know, for thirty years or more we worked with the Robert Morris Associates in the bank credit and loan field. A lot of good stuff has come out of that work on both sides and I think it has been good for both of us. It has been suggested that we ought to make some contact officially with the Investment Bankers Association and with the Financial Analysts Federation, so that there would be communication so that the research studies that we get out could be looked at by some of your committees and we could get your reaction as representatives of the public in one way or another as to which you thought was the better way. Would this be a desirable move?

MR. CATERER: I think so.

Mr. Linowes, my answer still is "yes" to your question. I think that we do have an obligation to study the development and make our contribution if we can to the development of accounting principles. I think it ought to be conveyed to you. I think you would be the normal clearing house for them.

One that comes to my mind--I am not taking any position on it but I think it is the sort of thing that I consider a principle--would have to do with whether the client account should be stated on a placement basis or not.

MR. CAREY: Sure.

MR. CATERER: This certainly is one that has been debated. It is used in Europe, I believe and I think it is germane to our problem.

MR. CAREY: We have a research study on that right now, that is being considered by the Accounting Principles Board.

MR. LINOWES: A supplementary question: should your profession take upon itself as well as our profession on ourselves getting to the public the fact that there are these responsibilities in other groups besides the accounting profession?

MR. CATERER: I can't see any argument against it. I haven't really thought about it before. I don't want to go off without some thought, but I can't find any argument against it.

In addition to this Corporate Relations Committee of the Financial Analysts Federation there is another committee which has the name Government Relations Committee, of which I am a member,and one of the things that it has done has been to meet with Mr. Barr (?) and associates on the SEC once a year or twice a year and I know there was a lot of discussion about this handling of leases and rentals on the balance sheet and income statements--the balance sheets. This, I presume, is a principle and we have gotten involved in that really because our Chairman was interested in the subject. [Laughter]

MR. CAREY: I have a question that is kind of mischievous, if you will excuse me. The SEC has recommended putting a list of companies under these rules, which may apply audits, we are not sure. I was wondering if you advised your clients on investments in bank stocks and what you think of the initial statements available to you in that area.

MR. CATERER: Whether we advise our clients on bank stocks?

MR. CAREY: Yes.

MR. CATERER: We do. The answer, of course, is we do.

MR. CAREY: How about the financial reports you get from them?

MR. CATERER: Well, I myself have done very little on bank stock analysis. I have studied the work of Murray Shapiro downtown, who is one of the country's ranking authorities on the subject. We have a bank stock analyst ourselves. I have not been too unhappy with the statements of the larger banks. Now, of course, obviously there are thousands of smaller banks, which give you just a condition statement after all---

MR. CAREY: I was half joking, but generally speaking our experts say that the principles followed in bank accounting are the worst in the country, and---

MR. CATERER: That's right, and---

MR. CAREY: [continuing]...and that if they should come under SEC jurisdiction there would have to be some radical changes---

CHAIRMAN TRUEBLOOD: You may have a situation of comparability using bad principles. [Laughter]

MR. COYLE: Which may be enough to keep the SEC out of it. That is one of your problems. [Laughter]

MR. CATERER: Well, this whole conversation--I am glad to see more and more detailed bank statements, of course. I haven't been too upset about it. Maybe I am just waiving it.

MR. CROSS: Is this true of the general opinions on the larger banks, or are you speaking more of the 15,000 banks throughout the country?

MR. CAREY: The ones that trade in securities. They have some traditional ways of dealing with things, I don't know why--maybe you do--but they are quite at variance with public companies' accounting.

MR. COYLE: Does this also apply to insurance companies?

MR. CAREY: Yes.

MR. CATERER: That is a real mystery, I think, much more than banks.

MR. CAREY: We have been struggling to get some clarification on insurance company accounting in here. We are not too popular with the insurance companies as a result of some of the preliminary tries but there are some things that ought to be done for the investors' information.

MR. COYLE: Just as a suggestion on this relationship between the Accounting Institute and the investment banking community, I would think the spot to go would be the IBA for a committee on accounting principles, which they always seem to be ready to set up another committee in the IBA and that would be, I would think, the connection.

CHAIRMAN TRUEBLOOD: I wonder if the comments of all of you, touched off by the earlier discussions. don't pretty clearly indicate, Jack, that in so far as the profile is concerned we ought to move in the direction of closer and more complete collaboration with groups of common interests. I can think of another one, the Society of Actuaries, there being a great big problem on pensions. We really haven't been very formal about this in the past, have we?

MR. CAREY: The thing that disturbs me is partly the apparent--well, I think all these gentlemen are kind of vaguely aware that we are doing something, but maybe not specifically informed. We have got research studies under consideration by the Accounting Principles Board on leases and I would expect that they would come out with some kind of a guide line soon on this question; we have got this price level depreciation, or whatever the right name for it is, in very good shape; we have got accounting for pension cards getting ready for publication of a research study; business combinations; foreign operations; and a lot of other critical areas. Modestly I say we have spent about a half a million dollars on our own money on this research over the past five years or so struggling to find answers.

MR. CROSS: This is true, but it is a progressive problem. By the time you get these in you are going to have sixteen other problems.

MR. CAREY: We are working like the dickens on this and then they throw the investment credit at us and that has to be settled by such-and-such a date.

CHAIRMAN TRUEBLOOD: But who knows anything about this save ourselves?

MR. CAREY: Did you know this was going on in this depth?

MR. CROSS: Let me put it this way: I think that the public are sure that it is going on. I don't know whether this is right or wrong from the public relations angle, but I think you would get great disappointment--well, I think that you would have the Government move in if you didn't have it going on.

MR. CAREY: I think that is a correct statement.

MR. CATERER: Is there much variation still in the treatment of past service pension costs among companies? Is there a lot of that still?

CHAIRMAN TRUEBLOOD: You must get that only by disclosure at this point, I would say. Do you agree?

MR. CAREY: Yes.

CHAIRMAN TRUEBLOOD: Here in effect we haven't stepped in except in a very modest way and neither has SEC. It is a very difficult problem.

Going back to--I think it was probably Mr. Cross who raised the question more sharply, about your fraternity understanding what we do, why we do it, and why don't we do it, or how have we gotten to this, what is our lack there in communicating with you? Are we too technical or do we not bother to explain things to you, or what do you think the lack is? Clearly there is some lack and you are not the first man from banking to tell me this.

MR. CROSS: This is correct. I think that part of it comes from the mass of accounting people that there are in your profession and, like in every industry, there are the good and the bad. I think that in trying to simply and make uniform the industry in the way that you handle problems it has meant that perhaps the poorer fellow can be more similar to the good fellow, due to the fact that you have had to compromise so as to get your conformity and that therefore more and more is based upon the general reputation of the accounting firm that is involved, where I can't help but feel that more should be on the basis of what is actually being done rather than merely the general statement. Going back really to disclosure, this is really what it comes down to, the same basic thing. The general statement implies that certain things have been done but to take a second-grade accounting job that is being done and to find the difference you have to look pretty carefully and somehow I think this should be done away with.

CHAIRMAN TRUEBLOOD: Now, let me turn this around a little bit and say that--I don't remember all of the history on this, Jack, but I suppose our position was this, that by forcing a standard certificate into the profession, be it a large firm or a small firm, or a highly able guy or, let us say, a marginal guy, we thought we were accomplishing two things. First, you didn't, as a user, have to sit and interpret what this fellow really meant, and second, by forcing all of our 45,000 people into the same mold, we put upon him the moral and legal liability by using that certificate, whether or not he did it by marginal standards or better than average standards, you see, so in effect we were trying to protect the user.

MR. CAREY: In effect we are forcing at least a minimum standard on everybody and we will fire a member who doesn't abide by it and he can be caught in court---

CHAIRMAN TRUEBLOOD: As we do.

MR. COYLE: I don't think any of us would suggest conformity as a substitute for information and I didn't certainly mean to imply that. I think maybe in terms of your relationships with business--I don't say this is very likely--but it may be solving itself, if the suspicion I have is correct -- I have never tried to get the statistics together to prove it--and that is that men with an accounting background are finding themselves in greater and greater numbers in positions of senior management in corporations at a greater rate certainly than any other group, particularly lawyers, whereas in the thirty or forty year ago period, perhaps because of the growth of companies, lawyers seemed to be finding themselves predominantly, and certainly at the expense of other groups, in senior management positions, so I think you are getting a lot more understanding in corporations and will in the future than maybe you suspect because your graduates seem to be getting into those spots at a very increasing rate, so maybe you shouldn't be too self-critical about your relationships with corporations. It may take care of itself.

MR. CAREY: Several remarks that have been made remind me of a wild idea that we have got somewhere and it is just a question that I would like to try out. Everybody we have talked to, including you, suggests that the fact that a CPA or the partners of the firm are members of the Institute carries very little weight---

MR. CATERER: Carries what?

MR. CAREY: Very little weight. It is the reputation of the firm that counts with them and references from other banks or customers or what not. It is a little disappointing because we labor here, you know, to set a standard [laughter], we fire the bad ones and we do all this work and it doesn't seem to have too much impact, but somebody suggested that conceivably we could accredit firms. After all, it is the firm as an organization that we look to, not Joe Jones, the partner, and while this probably is wild and impracticable, it could be done to some extent, as university accreditation takes place, or hospital accreditation. You could send out a team of paid people, very skillful people, every three to five years to examine the work papers on some confidential arrangement and see the staff and look into the recruiting and training methods and give points and develop maybe a list of blue ribbon firms who met these standards who are willing to submit to these investigations. Do you think it would be worth exploring or do you think it is so far out that--or it wouldn't do you enough good anyway, so that---

MR. CATERER: You have 45,000 members of the Institute?

MR. CAREY: There are about 12,000 firms represented.

MR. CATERER: No, but I mean, is your membership---

MR. CAREY: 47,000.

MR. CROSS: Of course, you are doing that to a certain extent already.When you fire a fellow out of your organization his firm's reputation may be affected so that in a way this is already indirectly being accomplished.

CHAIRMAN TRUEBLOOD: In reverse.

MR. CROSS: In the reverse way, in a negative way.

MR. CAREY: That's right.

MR. CROSS: On the other hand, I don't think--I think one disadvantage in doing your suggestion would be that you may have a highly competent man in a restricted area--they may be experts in the real estate field, or something or others--but might not live up to your standards of being accredited because of their over-all position, or something of this sort, and therefore I think you could do damage to a fellow unjustly. I don't know. Maybe if you set up your standards so liberally that everybody who is any good in any field would automatically be accredited, then you are not going to do any good.

CHAIRMAN TRUEBLOOD: Well, let me pursue your objection, as it were.

Another wild idea we have had is on an individual basis--first I should explain it. I am sure you are aware that we regard the CPA as a minimal badge for entrance into the profession. It is the man's preliminary qualification. But we have had the idea and to a certain extent pursued it in the halls of council of establishing a group of Fellows on an individual basis, Fellows maybe in a specialty such as SEC, accounting, or in the management services. Here it would be an individual kind of thing, but you would know, the user would know, then, on a man-to-man basis, that this man had done additional work or continued to study, or something or other, in order to qualify as a Fellow of the Institute, a degree one beyond the minimal CPA.

MR. CATERER: 47,000 is just too many people to make it seem selective.

MR. COYLE: I don't see how it will help the firms with a good reputation and it might let a few people sneak under a banner that they really shouldn't.

We were talking--thinking about the relationship of the NASD and the Stock Exchange. The NASD had always operated
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on an exception basis and many firms thought that the standard

basis is better than the exception basis, but to get the support--you raised the question of whether it was practicable or not and far be it from me to say--but to get the support for such a program I can't--those firms with a good reputation have nothing to gain by it. They train their people well beyond what is required.

MR. CAREY: Well, the ones that would have to gain by it would be the large numbers of relatively small--not two or three men, but I mean relatively local firms who are not well known to you and to the metropolitan banks and to the analysts, for that matter, and if they were certified by some authority as having standards equivalent to those of the big ones that you do know well, they might benefit.

MR. CROSS: Yes, but their standards are only going to be in a specific area, presumably. They are not going to be in---

MR. CAREY: There are very few specialists.

MR. CROSS: Well, all right, but let me put it this way: they are not going to have departments to be able to take care of management problems which may come up or in some other area. On the other hand, they may be members because they do have a management department and this may be where they have excelled because of their location or because of jobs they have done in the past, or so on. I think that a bank or whoever else is looking into it is not going to take your certification as meaning that they can do anything.

MR. CAREY: I think you have answered the question. It seems to me quite clear that our function is to try to raise gradually the minimum standard for admission to the profession. After that the firms are on their own. They have got to do a job, they have got to know people, they have got to be known, they have got to perform and there will always be a wide range between the best and the worst.

MR. CATERER: I think that was a good idea, this idea of having the Fellows.

MR. CAREY: You would keep that alive?

MR. CATERER: I think the discussion keeps that alive. It rather rejects accrediting the firm for the reasons mentioned, but it does not reject at all---

MR. CAREY: Well, a fellowship would be an internal matter. It would instigate people to study more and learn more and---

CHAIRMAN TRUEBLOOD: This is a major responsibility of ours. Amongst our 45,000 people we want always to be on the upswing, even at the point of entry, but we have some responsibility to encourage them to keep improving. I would suspect that we may be the only professional group without some Fellow arrangement or an equivalent.

MR. CAREY: I would be interested to talk with some of your friends about the Institute of Chartered Financial Analysts.

MR. CATERER: Tomorrow we have examinations.

CHAIRMAN TRUEBLOOD: Any waivers?

MR. CATERER: No.

MR. COYLE: Talking about hospitals and schools, the problem in hospitals and schools, I have always felt it was directed more towards attracting faculty and researchers and specialists rather than having an impact on the people who use the facilities.

MR. CAREY: I guess you are right.

MR. COYLE: If that is true, it is not applicable---

CHAIRMAN TRUEBLOOD: It doesn't attract the public.

MR. COYLE: That's right. Of course you have got to have it in a hospital because you need the staff, because you attract a radiologist because you are accredited in radiology.

CHAIRMAN TRUEBLOOD: Yes.

Well, lunch is called for twelve-thirty and I think we are in good time to walk over and be on time.

[The meeting was recessed for luncheon at twelve twenty-two o'clock.]

FRIDAY AFTERNOON SESSION

June 14, 1963

17 The meeting reconvened on Friday afternoon, June 14, 1963, at two o'clock, Chairman Trueblood presiding, with the same attendances as at the morning session with the exception of Mr. Coyle, who was not present at the afternoon session.

CHAIRMAN TRUEBLOOD: Would you like to start out on the international situation? I know I can get a rise out of Jack on the accounting aspects rather than the research. [Laughter]

MR. CROSS: Well, as far as the accounting, as you know, there has been a tremendous increase that obviously the accounting profession is going to have to provide for in the years to come and I think that the international aspect is really one phase of this picture which the accounting firms, especially the very largest accounting firms, are going to have to prepare for, or have prepared for, but those that have gotten into it have gotten into it only to a limited extent, I am sure, compared to what they are going to have to do in the future. The problems involve not only your personnel but you have got to take into account the completely different outlook on methods of accounting, which are so tremendously different in many foreign countries. How these are all going to be resolved when you put all of these eggs in one basket I don't know, but I think this is a problem that certainly you people will have to solve, at least in a theoretical way.

MR. CAREY: It is in process actually. Most of these big firms have international offices, correspondents or partners, or what have you. They have different ways of going about it but at least one of them sends Americans over and opens an office. Others recruit local staff under American supervision and send people over when there is a job to be done.

We have a Committee on International Relations, which has hired a research man to make a study of the differences between accounting principles, and I guess auditing standards to some extent, in the major foreign countries. The differences between British, Dutch, German--well, I will leave them out, I guess--Canadians, Australians, and Commonwealth countries, excluding India, and ourselves, in accounting principles are not great. That is, they are great maybe in valid figures but they are easily reconciled. They are few and conspicuous.

The Dutch use this price-level accounting considerably, but once you know that it isn't hard to reconcile.

However, in France, Italy, Belgium, Switzerland, Spain and most of South America it is worse. After this study is made we hope to circulate it and the suggestion has been made by Bob Trueblood, actually, that instead of the United States exhorting the other people to come up to our standards which are necessary and acceptable, we ought to form a kind of international committee to disseminate information on approved methods, and here again I think the users could exercise a very influential psychological factor, if people are coming here for money and we could say that the American banks and the American investment companies and the American analysts and the SEC and the Stock Exchange like these methods, they are apt to have more acceptance than if it is just the American accountants saying to the other accountants, "You should work better than you are and you should do it our way."

MR. CROSS: This is true, is it not, on foreign securities that are sold in this country now? Doesn't the SEC or whoever the people are, demand that the ? people pay it on our methods of accounting?

MR. CAREY: Both methods. They can file their statements if they have got it reconciled.

MR. LINOWES: It has progressed mightily in the last ten years, terrifically. [Mr. Linowes continued a brief comment but dropped his voice and the reporter was unable to hear what he said.]

MR. CAREY: Dave mentioned this at the Eighth

International Congress at which Arthur Watson gave his paper. We ran this here in New York last September and we had about 2,200 people from other countries and almost an equal number from this country and it was fascinating. We had sessions in Board Rooms--I think we had one in your bank, actually, a small discussion group one morning--120 of them all over the city. We spread them by nationality so that each one would have a mixture. That did a lot to loosen up---

MR. LINOWES: That was wonderful. I still get correspondence back and forth. As a matter of fact, I recently got a referral of some audit work to be done here from New Zealand, of all places, from one of the men that sat in the sessions. He thought of another accountant that he knew, a CPA in New York, who would help him out. Now, this type of thing you can only get through--it is not that the work is of any significance but the fact that he feels he knows somebody here now whereas he did not feel that way before.

CHAIRMAN TRUEBLOOD: Apart from comparative standards I think we are ultimately going to have to get around to some kind of recognition or designation of ability, or something, on an international basis, which gets to be a great big problem because, as Jack said, I don't see how we can impose our certificate or our degree, or whatever you want to call it, on the Indian. The people of the U. K. can't do it because there is so much difficulty between them and the continent generally. Somebody is going to have to do something to raise this to a truly international perspective.

MR. CAREY: Maybe it is just competition, as we said this morning. Firm by firm they get known. There is at least one, or several, excellent firms in Mexico that know all about our methods of doing business. There is at least one in India. After a while people begin to find out about them and most of the work from here goes to them. Then their competitors get wise and begin to follow suit.

What we are doing--excuse me.

CHAIRMAN TRUEBLOOD: Go ahead.

MR. CAREY: I was going to ask a question but it is a vague one. There is another unsettled area that we have been wondering about that as the auditing situation has evolved we have got this balance sheet and this income statement and this formalized opinion that you referred to this morning, Mr. Cross, by saying that there is something else to be said. Similar statements have had a tendency to narrow the usefulness of the auditor in that he doesn't like to say anything else except just what is embraced here and this is apparently a function of the legal liability situation. The lawyers for the accounting firms tell him that if they want to be safe from lawsuits they had better stick within this attestation, but it would be more useful in a way if the auditors felt freer to write general observations, subject to whatever qualifications are necessary, giving an opinion of the situation the same way a lawyer does when we ask our attorneys, "Can we do this?"

And they say, "Well, in the case of Jinks versus Binks, it says 'no,' but the other one says 'yes,' but in our view, subject to the fact that nobody knows what the Supreme Court will do, we think you can go ahead." which is helpful and something to rely on.

Maybe this could be loosened up so that banks could get informal type reports that in one way or another liability was out of it.

MR. CROSS: Yes, but the only way that we can get anything above and beyond regular standard statements is to get the guy to go up and have a survey made and then come up with something completely different and this you are obviously not going to do except in extreme circumstances.

MR. CAREY: Yes.

MR. CROSS: This is what I meant earlier. I would like to see some deviations along these lines so that a fellow can come up with more than just this ? .

MR. CATERER: Would you illustrate the kind of comment that he might make? I am not sure I understand what you might be suggesting here.

MR. CAREY: Well, I am not quite sure I can illustrate either. He is always subject to his client's permission, but if the client wants a good credit line---

MR. CATERER: Wants what?

MR. CAREY: A good line of credit, and wants to give the bank what it wants, he might authorize the auditor to express his own views on the situation, the increase in the inventory, or the trends in the past few years, or the intentions of the company, or maybe the budget -- you get budgets sometimes shown for the next year--a sort of a discursive, discussion type of observation from this outside professional.

MR. CATERER: Obviously not to the public but just to the bank?

MR. CROSS: Yes. I am not sure that the interpretation is exactly what we need as much as something more than the figures portray--disclosure, if you want to call it that--some comments about--more details about the inventory composition, the balance of the inventory, which you can't see.

CHAIRMAN TRUEBLOOD: Are you thinking of things like age or classification of inventory by project, or receivables, or analysis?

MR. CROSS: That's right. You could say, "Well, that is just more detail of the same thing." but I think that the receivables, you may not have to make an analysis of them but he may know that there are some, a few long receivables which can't be seen by looking at the figures. On the other hand, he is not going to comment about it unless he is really cornered somewhere, because why should he get into a fight? There are not too many thousand dollars involved anyway, but if there was a little bit more of this leeway it seems to me that it could be advantageous.

MR. CAREY: You must get some long-form reports that do this.

MR. CROSS: Oh, absolutely, but usually it comes under pressure from us. I would rather have it come more as a regular thing.

CHAIRMAN TRUEBLOOD: When you say "under pressure" from you, that is because you request it and it involves an additional fee in order to get it?

MR. CROSS: Yes, this is correct, and normally this would not occur because we obviously don't want our customers to have to go to additional expense unless there is something that we are worried about.

CHAIRMAN TRUEBLOOD: But just to clarify it: you don't detect any opposition on the part of accountants in supplying it if requested and paid for?

MR. CROSS: True, but it may well be that the accountant may spot some--not irregularity, I don't mean of this sort, but just minor little things that may reflect that there is a slowing up in the trade or something of this sort, but he is not going to--this is not going to be a part of the report because this is the--the wording is going to be the same, the standard form. It is not big enough to tax. If you didn't have the stereotyped form so that it wasn't so much of a--so much pressure on the accounting firm to use it, I say that maybe we would get a better picture of the company.

MR. CAREY: Maybe you would get a worse one.

MR. CROSS: And maybe we would get a worse one.

MR. CAREY: It seems to me there is room for some propaganda here from the banks to the borrowers that their credit rating is better, that their availability is running easier if they encourage their CPAs to tell all and comment with freedom in communication. It is the only way it really can get loosened up because, as you say, the CPA isn't really a free agent to rush to the bank and tell all about the client's affairs if the client doesn't want him to do it any more than he is a free agent to rush down to the Internal Revenue and tell them all about---

MR. CROSS: He is the independent accountant and we are depending upon him to have that statement show---

MR. CAREY: And in the framework of these standards which the statement--which says what he can sign--he is perfectly independent, but there is an area beyond that which--I think the framework of the standards, as I said this morning, is always rising, but there will always be a lot of stuff that only management's permission can---

MR. CROSS: Let's assume that the guy is slow in the trade, the accounting firm will give their standard thing and unless some---

CHAIRMAN TRUEBLOOD: He is slow in paying, did you say?

MR. CROSS: That's right. In other words, he is starting to slow down on the payment of his bills, slow on the trade. Now, the accounting firm is never going to mention this and it is going to take a very astute analyst to spot that these payables have been out a little longer than they should be in relation to his cost of goods sold and it is going to be pretty tough for him to ever see this. The accounting firm can't help but see when they look at those books and I say that if there is a little bit more leeway somewhere along the line this should have to become part of the statement.

CHAIRMAN TRUEBLOOD: Dave!

MR. LINOWES: I don't know if it is all on that one side, Mr. Cross, for this reason. An accountant expresses his opinion that taken as a whole this statement adequately reflects the financial condition. If the accounts are slow, he has a moral and professional responsibility to provide adequate reserves, but I have found this in my dealings with banks, that in more cases than I would like to say so many of the loan officers are almost as anxious not to be told too much so that their record won't look like something that they might hesitate to make a loan to an old customer of the bank.

Along this line I recall one specific instance where my former office prepared a report wherein we said"We did not inspect the inventory, therefore we cannot issue--we cannot express an opinion." The loan officer came back to the client when the client presented it to him and said, "We would much rather he wouldn't put his finger on it"--now, this was a particular case. This was an old client of the banker--it was one of the larger banks--"We would much rather he would not put his finger on it because now I have to point out why he did not and what happened. If he doesn't want to give you an unqualified opinion, why doesn't he just qualify his opinion?"

Now, as I say, I am afraid this happens more--this type of thing happens more frequently than not because of very frequently the relationship between a loan officer and a customer of your bank. It is a little bit of that old school, I think, that both of our professions are concerned with. A loan officer will never have a bad loan if he doesn't make any loans and so we have this type of thing and the only reason I bring it up is, is there some means other than those we have already explored, whereby we can be mutually helpful in this whole area, including the area that so many banks don't care if the report has been prepared by a CPA or not by a CPA, and this happens too in some cases.

MR. CAREY: I was going to ask if you had any policy in that regard.

MR. CROSS: Well, I don't think that our bank is really the one that is going to give you this because most of the clients that we do business with are of a size where this is of no--they always would have a certificate.

MR. CAREY: Yes.

MR. CROSS: I think that really you could ask that question better of a banker who is more in the retail business than we are.

MR. CAREY: Chemical, Chase Manhattan.

MR. CROSS: I really think probably ninety-nine and forty-four hundredths of our clients have CPA firms so that really it is more the quality of the CPA firm.

MR. CAREY: Sure.

CHAIRMAN TRUEBLOOD: Could I switch this over to our public posture in the field of ethics? We mentioned this morning that we have imposed upon all 45,000 of our members this independence rule, which, if you want to put it one way, is a matter of nicety. They should have this independence and integrity, whether they own five shares of stock or whether they don't, but we do have a long series of rules on how we act with each other, how we act with our clients and with other people's clients, and I think it was last week that somebody in Chicago said, "I don't understand you people." He said, "If there was ever a personal service business, it is my business, the banking business. Why do you set up all these artificial barriers about saying hello to other people's clients when we don't find it necessary?" Now, how--I use that just as an example--what is our image on the outside about our ethical practices in terms of both substance and the niceties? Are you concerned about this? Are you aware of it?

MR. CROSS: No--I don't know if you are directing this at me or not, but I would say that I am not concerned about it and I think that in general your accounting business has a very high reputation, which is obviously very necessary for them to retain because they are considered more as a policeman and this kind of thing than they should be. In the public's eye there is no question that this is one of the principal functions that the accounting firms are here for. Whether this is actually the case I don't think makes much difference, but if the public were to have the image of the accounting firm being a dishonest policeman I think it would hurt your industry a great deal.

CHAIRMAN TRUEBLOOD: So you think that sort of negatively, or because you haven't heard otherwise, that we do have this kind of good image of honesty and integrity.

MR. CROSS: I don't think there is any question about it and I think the fact that you are considered a policeman improves your image because you wouldn't be there unless you were an honest policeman. In other words, just because a fellow has a blue uniform on, it is just assumed that he is honest and I think that is the sort of thing that rubs off.

CHAIRMAN TRUEBLOOD: Let's take that one step further. I remember your remark about this reflection of the policeman and I interpreted this to mean that you yourself would kind of like us to be looked at at a higher level than a kind of hand-holder, adviser, and so on, so let me ask the question: if we did get back reflection from the public, would we lose this feeling of independence and integrity? That is, if you felt we were a close consultant to a particular business, would you yourself have any doubts about our carrying up with us this integrity?

MR. CATERER: That's a good question.

MR. CROSS: I would say very little, perhaps a little but very little.

MR. CAREY: You know, it is interesting. Mr. Coyle said this morning that a lot of these small firms may be a little too close to their clients. They are in there a little too close. And then a few minutes later he said that one of the reasons he likes these big firms is that they have got management consulting divisions that work with the client constructively. They are really inconsistent statements.

MR. CROSS: Not really, because you can have a different kind of a customer.

MR. CAREY: That's right.

MR. CROSS: And I think you have to tailor make your accounting for the customer and what you are trying to accomplish. I don't think he is being inconsistent, John.

MR. CAREY: It sounds so. I know it isn't really.

He just assumes that this bigger firm isn't going to be influenced when it is signing these statements by the fact that it renders constructive services, and indeed he likes them to render the constructive services, if I hear him right.

CHAIRMAN TRUEBLOOD: Well, let's make that a specific. Let us say that we have a major audit client and let's say the audit fee is $100,000 and let's say we need $50,000 consulting. That is one thing. It is a very natural relationship. But let's say we were doing $500,000 of consulting in the mangement service field year after year after year, would you feel any differently about it then? Let's say the partners are going to continue whether or not they get the $500,000. [Laughter]

MR. CROSS: You are certainly more susceptible to criticism. I don't think there is any question that this is true. Again it would depend on the firm and what the job is that is being done and all this kind of thing. I think these are generalizations which you can't answer "yes" or "no" but I certainly feel that you are susceptible to criticism. The same way as you may have--the son of the president may come in and he may be doing the best job that anybody possibly could do, but he is susceptible to criticism, no matter how good he is.

CHAIRMAN TRUEBLOOD: But you say there is nothing per se wrong?

MR. CROSS: No.

MR. CAREY: I think it is a kind of an artificial worry, I really do. I don't think the average man in business or in the street sees anything wrong with a professional man helping his client. I think he would see something very wrong if he thought the man owned stock in the client, but I don't think he would consider it a conflict of interest that he was advising him on an urgent problem and auditing his accounts at the same time. I don't see any problem.

MR. CROSS: This may be true, but you have got to realize that this is a question which has been asked to be answered at stockholders' meetings, and you are going to have to justify your position and I think you just have to be prepared for it ahead of time because you are going to have to do it. You can see this already in stockholders' meetings today.

MR. CAREY: I am told that Lewis Gilbert was in a train with one of our members, who brought this up and said, "Why are you probing in this? Do you use your accounting firm for management purposes?"

And Gilbert said, according to my informant, "I think the management is stupid if it doesn't use them because the auditors may know more about the inside dope than other people do and if they are not making good use of these people they are wasting our money." which is entirely the reverse of the impression we get from these questionings.

MR. CATERER: I was trying to divorce myself a little bit from any position as an investing analyst since you asked the question because I think possibly I haven't been reflecting the public point of view. Unless you get some more involved with your public relations picture than what I feel as my profession, I can't speak with a great deal of authority but it does seem to me, from the stockholders' meetings that I have attended, that the typical stockholder who attends an annual meeting thinks of the accountant, the auditor, as being part of the management organization and it is very easy for him or her--oftentimes it is a she--to criticize for that reason and I must say on a couple of occasions I got this impression myself. There were direct questions which would then be referred to the representative of the accounting firm who was there and the answer was pretty evidently censored heavily by what the management was willing to say. I am not saying this particularly critically but I think if you are asking about public posture, why, I think that incorrectly that the small ambivalent vocal shareholder does think of the accountant firm as being part of the management rather than as having independence.

MR. HEIMBUCHER: Do you think he confuses the comptroller with the independent accountant?

MR. CATERER: No. I remember the last meeting I attended was the Annual Meeting of Loew's Theaters up at one of the theaters here and the meeting was held in the winter, last winter, and the company's fiscal year ends in August and at the end of August the balance sheet showed a large amount of short-term debt among the current liabilities and there was a footnote to the effect that there were plans under way to fund these--to make these permanent--I forget the exact phrasing that was used. One of the stockholders got up and asked whether this had been done and, as I say, this was three or four months later, after the end of the year. Mr. Tish referred him to the representative of the public accounting firm. I have forgotten what firm--it may be one of your firms for all I know--I don't know--and the gentleman got up and answered the question, "The situation is about as it was on August 31st," and sat down. That is all he would say. That wasn't a very responsive answer.

18 MR. HEIMBUCHER: He shouldn't have been the one to answer the question. Shouldn't that question have been referred to the treasurer or comptroller or vice president of finance of the company?

CHAIRMAN TRUEBLOOD: Well, let me--this is kind of close to home, Mr. Caterer. You and your people must in your conversations with management and so on, your company's investigations, get really some inside dope in the sense that it is information not in the public domain.

MR. CATERER: That's right.

CHAIRMAN TRUEBLOOD: Now, what are your ethical rules, and so on, about investment and applying in and selling out and that sort of thing? Has your profession set up any stipulations or is it a matter of individual moral---

MR. CATERER: It is a matter of principally your company decision as to what the restrictions will be. The analysts' organizations don't have any specific rules. They have a Code of Ethics, which is of a generalized nature. The Investment Counsel Association is debating the matter but at the moment has a generalized Code of Ethics. The individual firms--well, I can speak with more authority for the investment counsel firms than for the investment banking or brokerage firms--tend to say that all holdings, all purchases and sales, for any member of the organization or any of his family shall be reported to some designated authority in the company; to say also, as a matter of policy, that no security should be purchased or sold by a member of the firm--or any member of the staff, including the telephone girls, as far as that is concerned--or member of his family within a given period of time before or after a recommendation of that nature, or against it, was made to the clients.

I don't think of any other rule on that, but the situation is quite fluid, not because we feel that there are infractions that demand attention but because we feel that out of Washington is coming a more and more rigorous point of view on this and we don't want to be caught with our records down.

MR. CAREY: You may have read that the value line was quite a factor. There was some question in the paper about their putting out this service and at the same time running an investment company of their own.

MR. CATERER: I think so, Mr. Carey. I don't---

MR. LINOWES: SEC---

MR. CROSS: We, of course, run into this problem to a tremendous extent, not only from the investment end, which I don't happen to be mixed up with, but I know we do have very strict regulations on what our investment people may do in connection with recommendations which we make up. We also have a confidential function that you were asking about at first of information that may be used that you get. I think that probably in the investment counsel field you don't have this problem because anything that they get practically they are given. It may not be on public record but they are given the information knowing that it is going to an investment counsel firm. This is not true in banks. We obtain a great deal of confidential information in connection with loans that we are making and this kind of thing and we have to set up all kinds of barriers within our own institution to keep the information ? , and the opposite way, our investment people may come up with recommendations and we can't let their information get out in the bank as a whole or it may affect the market condition, so that you have to have barriers in both directions and this is a problem we run into in planning controls to the best of our ability.

MR. CAREY: It is complicated.

MR. CROSS: Yes, very much so.

CHAIRMAN TRUEBLOOD: Let's go one step further and pursue the question we were on yesterday, if we may, because it is a case that we all know about. Let's use the Chrysler situation, the conflict of interest case, as an example of what might be regarded as an immoral act, or a questionable act, or an act of dishonesty, or what have you.

MR. CATERER: Does this involve the company that had business with Chrysler Corporation? Would that be the issue there?

CHAIRMAN TRUEBLOOD: Yes. Certain officers of

Chrysler had an investment in a supply company.

MR. CATERER: A supply company, yes.

CHAIRMAN TRUEBLOOD: I may quickly say that we were auditors for Chrysler and were called in the investigation and did not know of the facts before it happened.

But let us say that as an auditor--and this is the specific of the question that came up yesterday in the question, as I recall--you ran into this in your audit work and somehow or other found out that President X owned stock in Supplier A and let's say that you didn't even know, as in the Chrysler case, or couldn't find out, whether any damage was done, now is it the responsibility of the auditor to report this, and if so, to whom?

MR. CATERER: Obviously not to the chairman.

CHAIRMAN TRUEBLOOD: Nor to President X. [Laughter]

I don't know about the Chrysler circumstance, but let's say--let's assume (a) that you were hired by the Board of Directors. In a company that large it is never a strictly management appointment. It is always as a minimum blessed by the Board of Directors. And then let us assume (b) that you were elected by proxy of the stockholders.

MR. CROSS: My reaction--and I haven't thought about this--is that if it is a clear case of being unethical--if it is one of these borderline cases I think that your problem is a great deal greater, but if it is a clear case of unethical practices it seems to me that you have to report it to the management.

CHAIRMAN TRUEBLOOD: To the body which hired you.

MR. CROSS: Yes.

MR. CATERER: May I ask this? Quite apart from whether the subject was unethical and quite apart from whether the amount of business is significant or not, is this more the exception than the rule among your client companies? Are there any of you who care to answer that question?

CHAIRMAN TRUEBLOOD: I would answer it this way that there is no ethical stipulation on this point across industry. You mean, does this kind of thing---

MR. CATERER: Does it happen?

VOICES: No.

CHAIRMAN TRUEBLOOD: Not very much.

MR. CATERER: That is enough of an answer for me.

What I was going to say, if that is the case, that I would certainly think if I were in your position I would put it in writing and put it somewhere and I presume that it would be on the record book of client companies somewhere, even without an opinion but just a statement that you knew about it and it should be called to somebody's attention.

CHAIRMAN TRUEBLOOD: Let us say that you were actually employed by the stockholders, by a proxy vote of the stockholders, so let us say you run across this, do you then stand up in the stockholders' meeting and say this?

MR. CROSS: Not being asked, you mean?

CHAIRMAN TRUEBLOOD: Not being asked.

MR. CROSS: You are hired by the stockholders to do something. You are to make the report to the Board of Directors or somebody or other and I just think this is a matter of the facts that you are reporting.

MR. LINOWES: In writing? Shall we report this in writing?

MR. CROSS: I think that it should be in writing.

CHAIRMAN TRUEBLOOD: To the stockholders?

MR. CAREY: Actually, you see, there is absolutely nothing---

MR. CROSS: No, I don't think to the stockholders.

CHAIRMAN TRUEBLOOD: Okay, that's fine.

MR. CROSS: No, I think that the stockholders have voted you, the auditors, to audit the figures and make a report usually, I think, to the Board of Directors, is it not?

MR. LINOWES: No, to the stockholders themselves, or whoever made the appointment.

MR. CAREY: The report is addressed to the stockholders in many cases, but this situation has nothing to do with the financial statement.

MR. CROSS: Or it may have a lot to do with it.

CHAIRMAN TRUEBLOOD: Let's say you establish that it is not a material item or has no effect.

MR. CAREY: In the Chrysler case nobody ever proved that anything had ever happened, that they paid any more for supplies from this company than they would have from a competitor.

MR. CROSS: True, but would it be possible from a practical standpoint for an auditing firm to determine this without anybody knowing they had even noticed it? In other words, I just question whether--you don't have to make your decision before, the decision of what you are going to do, before you can know whether there is a loss involved with this or not.

MR. CAREY: In the discussion yesterday it was pointed out that if the auditor puts it in his report to the stockholders he may hurt the company, he may hurt the stockholders.

MR. CROSS: This is the reason why, in my opinion, you should go back to the Board of Directors or the Executive Committee and say, "Here are some facts. We don't know if this is a material fact involved with these things or not, but we want to have the thing investigated."

MR. CAREY: This is done now.

[General simultaneous comments]

MR. CROSS: This would prove to me that there isn't a material fault,that there isn't a conflict of interest.

MR. CATERER: Is this a corollary to the statement that you see in the proxy statements that this director, who is, or can be, general counsel for the company, received a certain number of fees as shown there? I wonder whether---

MR. CROSS: No, because this could be misinterpreted.

MR. CAREY: That's right.

MR. CATERER: What's the difference?

CHAIRMAN TRUEBLOOD: I didn't need to have picked conflict of interest. You could pick other situations which may be more clear, maybe an anti-trust situation. Now, if it affects the statements your disclosure is bound to go in.

MR. CROSS: It might affect your statements.

CHAIRMAN TRUEBLOOD: It might affect the statements, I suppose.

MR. CROSS: If it might affect them substantially, then is it not---

MR. CAREY: Well, after the action is started there is a continuing liability to acquiesce, but suppose the auditor discovers a case which he thinks might give rise to--suppose somebody had been in General Electric and found out---

CHAIRMAN TRUEBLOOD: Suppose the auditors of General Electric--which I think were Peat Marwick--had put a footnote--had found this circumstance and put a footnote on the statement saying, "Under such and such circumstances it is possible that the anti-trust regulations might come into effect."?

MR. CROSS: I don't think your CPAs on the books of the company are supposed to be public relations agents for the company and release information.

MR. CATERER: Or the lawyers.

MR. LINOWES: This is really a legal question more than it is an accounting question. We are apparently assuming that the accountant has enough legal knowledge to raise the question but let's say we bring in something even more specific. How about if it comes to the auditor's attention that there has been a collusion in price-fixing?

MR. CATERER: Collusion in what?

MR.LINOWES: Price-fixing, on Government contracts, we will say, and let us say that the auditor even knows that in the event that this is so and they are found guilty there could be a million dollars of damages, let's assume it might have some distant financial effect, where are the responsibilities of the auditor as you see them?

MR. CATERER: You say the auditor has found that there was collusion?

MR. LINOWES: Collusion. That is the only thing we know.

CHAIRMAN TRUEBLOOD: He can't have found it. He has to have reasonable evidence.

MR. LINOWES: He has reason to know---

MR. CATERER: The legal determination involved is a matter which the auditor is not qualified to make.

MR. CAREY: I think there is a good point there.

MR. LINOWES: Well, I can even think of an illustration that I had some experience with, where in making an audit the man, in going through some files--this goes back seven or eight years ago--found that the officers and one of the principal owners were getting a kick-back. He saw copies of correspondence where it was clearly spelled out. And when he brought it to the attention of the principal officer he said, "Where did you get that? You had no business getting it." and pulled the thing right out of his hand. Now, we knew how to handle that situation. We handled it without any question about it. But these things do come to us. The only reason I bring it up is that auditors do stumble upon these things and what is their responsibility?

CHAIRMAN TRUEBLOOD: [To Mr. Cross] You got out of this one [laughter] because you said we had this public acceptance as a policeman. I think you also said that if the president went off with a million bucks we were going to get--or maybe somebody said it yesterday--if the president goes off with a million bucks we are going to get blamed for it, whether we should or should not have.

Where does this line of our responsibility end, or should we just put it---

MR. CROSS: I think that your line of responsibility is a difficult one to define because of your variations in cases, but in general I would say that it is up to you to report the facts as you see them but not interpret those facts beyond the case of where the facts are so close to being recognized that you have to realize that they are liable and therefore you have to report them.

CHAIRMAN TRUEBLOOD: But does this statement include an assumption of our responsibility to handle a suspect matter internally with appropriate independent people whether or not we do anything else about it?

MR. CROSS: I would say yes.

CHAIRMAN TRUEBLOOD: And our protection from a stockholders' suit would be the fact that we took it to appropriately independent people within the company or on the Board as a doubt came to our mind?

MR. CROSS: I would go further than that. I think that if you don't, if you come across something which would--should indicate that there may be something wrong and you then drop it rather than do anything, I think you are taking--you are giving yourself a liability.

MR. LINOWES: Can we carry that a step further? Does the CPA have a social responsibility to go beyond a corporation in the event that he feels that not appropriate action is being taken on this matter?

CHAIRMAN TRUEBLOOD: Beyond the corporation--do you mean to the stockholders or to the Government?

MR. LINOWES: To the Government, if the Government is involved.

MR. CATERER: Or resign the appointment.

[General simultaneous comments]

MR. LINOWES: Certainly resign. There is no question about resigning.

MR. CROSS: Assuming that either he makes his statement with the qualification--if he thinks there is something that hasn't been done and he hasn't gotten the cooperation that he needs, he makes a statement indicating so and if he gets fired first, he is fired first.

MR. LINOWES: Yes, but does his responsibility to the public go beyond that? We are assuming he is going to get rid of that account regardless, but he now has this knowledge.

MR. CAREY: I think our rules answer that question. He cannot violate the confidential relationship with the client. One is not allowed to go out and inform, but he can get out of there and he can put himself on record internally and he can qualify his report and if the company doesn't publish his report somebody will ask why, but---

MR. CROSS: What is your confidential relationship with the client as far as a bank, either the bank calling in the CPA and starting asking questions?

MR. CAREY: We couldn't say a word without the client's permission.

CHAIRMAN TRUEBLOOD: The client will either tell us in such a circumstance, "Tell the bank everything you know," or "Answer these questions for the bank."

MR. CROSS: Well, I know, but if you have been fired.

CHAIRMAN TRUEBLOOD: Oh, oh, oh. You are relating it to that sort of thing.

MR. HEIMBUCHER: In that case there wouldn't be any report to start from.

CHAIRMAN TRUEBLOOD: If we had been fired or if we had resigned we couldn't talk to the bank except with the client's permission.

MR. CROSS: That is discouraging. [Laughter]

MR. CAREY: It would be a lot more discouraging to us if it were otherwise because nobody would ever hire an accountant if they thought that he was going to babble all over the place.

MR. CROSS: Let me ask you this: will you tell a bank whether you have resigned or been fired?

CHAIRMAN TRUEBLOOD: I don't see why we couldn't say that.

MR. CAREY: You will have to answer the question. There is nothing in our rules that says you can't tell them that.

CHAIRMAN TRUEBLOOD: "We gave up the engagement." or "We were relieved." I think that is a factual statement.

MR. CROSS: But you wouldn't give the reasons why?

CHAIRMAN TRUEBLOOD: I don't see how we could.

[To Mr. Carey] Do you?

MR. CAREY: Not in specifics.

CHAIRMAN TRUEBLOOD: Not in specifics.

MR. CAREY: We might say, "Well, we found certain things we didn't like." or "We had a disagreement with the management."--that sort of thing. I don't think they would go into detail and tell you what it was.

MR. CROSS: Well, enough to tip off the pension or credit man [laughter] to go after the client.

MR. HEIMBUCHER: Or to go after the successor accountant.

CHAIRMAN TRUEBLOOD: There is a provision there which I am afraid I should say is honored in the breach. As a matter of courtesy, professional courtesy, no other accounting firm should take on that job without asking me why it is available.

MR. CROSS: And this information you would give them?

CHAIRMAN TRUEBLOOD: Well, not in detail.

MR. CAREY: The general signal is that something is rotten in Denmark, or they fired us because we charged too much money, or whatever.

MR. CATERER: Apart from whether there is something crooked going on, putting that aside, I am a little bit surprised to be told that there are quite a large number of instances in which the chief owners or chief executives--usually the former--of companies have side businesses with their companies and act as suppliers or contractors or whatever to those companies. I would imagine that would be a constant possibility.

CHAIRMAN TRUEBLOOD: Not in publicly held companies.

MR. CAREY: I suspect there is a distinction between publicly held companies and closely held companies.

MR. CATERER: I see.

CHAIRMAN TRUEBLOOD: I think you will find that the record shows and the stockholders' meetings minutes show that this was an area that had not been handled as explicitly as it should have been in many companies prior to the Chrysler publicity. I know in---

MR. CATERER: Prior to what?

CHAIRMAN TRUEBLOOD: The Chrysler publicity.

MR. CATERER: Oh.

CHAIRMAN TRUEBLOOD: And I know amonst our own clientele--I am talking about the majors--probably 50 per cent of them put in a set of rules and published them to all employees within a year after Chrysler.

MR. CATERER: After Chrysler.

MR. HEIMBUCHER: Even before that, during the War and during the Korean War there was a great deal of that, particularly where companies were trying to raid department heads or managers from other companies. They would often set them up in small supply companies. There was a good deal of that and a lot of bad publicity. In fact, this was one of the things--you may remember the bad publicity about the Kaiser complex of companies because that was rather commonly done. There was nothing against it at the time.

MR. CATERER: Did this wave of so-called reform emanate from the accounting profession or public feeling?

CHAIRMAN TRUEBLOOD: Public discipline.

MR. CATERER: But this is still done--this is done a lot, isn't it?

MR. CROSS: It used to be. I think this is the change in ethics. Ethics are changing all the time.

MR. CATERER: I am very glad to hear it. I didn't know it.

CHAIRMAN TRUEBLOOD: This was discussed yesterday, that fifteen years ago the Chrysler thing might not have made the newspapers and no industry group has done anything in the meantime. It is just a---

MR. CATERER: I feel better about our country!

MR. CAREY: I think the standards--let us say the standard of morality that the public expects of business people has gone up very steadily.

MR. CATERER: Despite General Electric.

MR. CAREY: Actually, General Electric wouldn't have made the newspapers twenty-five years ago.

MR. CROSS: It is the interpretation of the laws that has changed.

MR. CAREY: I mean, this used to be common practice a quarter of a century ago.

MR. CROSS: Look what the underwriting firms used to do fifty years ago.

MR. CATERER: I wasn't active then. [Laughter]

MR. CAREY: Let's say pre-SEC.

CHAIRMAN TRUEBLOOD: That's right. It was either trading, manipulation--all sorts of things were accepted. Smart people made a lot of money and were very respected citizens.

Well, we are getting very close to three o'clock and I told these gentlemen we would try to break at three.

We will have one more go-around.

Cliff, do you want to open?

MR. HEIMBUCHER: I haven't any more questions.

CHAIRMAN TRUEBLOOD: Dave!

MR. LINOWES: I haven't any more.

CHAIRMAN TRUEBLOOD: Mr. Cross!

MR. CROSS: I want to thank you for a very pleasant time. It has been most educational from my standpoint and I hope you have gotten a little out of it.

CHAIRMAN TRUEBLOOD: Indeed we have.

What about you, Mr. Caterer? I am giving Jack a few minutes here because he always has a few wrap-up questions.

MR. CATERER: No, I think I haven't any subjects that I could be more intelligent about. I think I have become more intelligent since I have been here and I am very grateful for that.

MR. CAREY: Much to your astonishment, I have covered all mine. I made notes all the way through but they are taken care of.

CHAIRMAN TRUEBLOOD: Well, very, very good.

We thank you so very, very much. This has been one of our best days.

MR. CATERER: I think I spoke to you, and maybe all three of you, that I shall start conversations with the Public Relations Committee of the Analysts Federation and the Government Relations Committee and see that we work more closely. I think we are trying to do the same thing and I am quite surprised that we haven't done more than we have, but all I can do on the lines of stimulating cooperation I sure will.

MR. LINOWES: This is an extra premium, or dividend.

CHAIRMAN TRUEBLOOD: Very well.

[The meeting was adjourned at two fifty-two o'clock.]