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American Institute of Accountants. Committee on Professional Ethics

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# A Statement to the S.E.C. on Professional Disciplinary Procedures

[This statement was presented by the American Institute of Accountants committee on professional ethics at a meeting with the Securities and Exchange Commission at Washington, June 4, 1940, at which all the members of the Commission and the Institute committee were present.—*Editor.*]

## INTRODUCTION

THE Securities and Exchange Commission, under the securities act and the securities-exchange act, requires that registration statements of most companies under its jurisdiction contain financial statements certified by independent public or certified accountants. It is natural, therefore, that the Commission should have a keen interest in the professional standards laid down by certified public accountants and, in particular, in learning what power the accounting profession possesses to enforce those standards by discipline. This statement is submitted to the Securities and Exchange Commission by the American Institute of Accountants committee on professional ethics to provide information on these matters.

## LOCAL AND NATIONAL DISCIPLINARY AGENCIES

Disciplinary authority over certified public accountants is exercised by state boards of accountancy, by state societies of certified public accountants, and by the American Institute of Accountants. State boards administer the C.P.A. laws, which exist in all the states. They have power to suspend or revoke the certificate of certified public accountant for misconduct, specified in the governing statute, or for violations of rules which the boards may have adopted under authority of the statute. State societies, which exist in every state but one, may admonish, suspend, or expel members found guilty of violations of the by-laws of such state

societies or of their rules of professional conduct, which generally resemble the rules of the American Institute of Accountants. The American Institute of Accountants may admonish, suspend, or expel a member who is found guilty of violation of its by-laws or rules of professional conduct, and may publish the name of the offending member if the council sitting as a trial board so orders.

There are believed to be some 19,000 certified public accountants in the United States. All of them are subject to the authority of one or more of the state boards. Approximately 10,000 certified public accountants are members of state societies, and some 5,300 are members of the American Institute of Accountants, the great majority of whom are partners of public accounting firms or are in practice as sole proprietors.

A complaint may be submitted to the Institute by a state society, or a complaint may be submitted by the Institute to a state society or to a state board.

Generally, if a case were known to be receiving the consideration of a state board of accountancy, the Institute's committee on professional ethics would defer consideration, because if the C.P.A. certificate of the accountant in question were revoked by the state board, he would be automatically liable to suspension or expulsion by the Institute.

However, if a state board or a state society considers a case, and takes no action, the Institute's committee on professional ethics may review the case

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if there is ground for belief that there may have been a violation of the Institute's by-laws or rules.

We have no statistics on the number of complaints officially considered by the state boards or state societies. Since the reorganization of the Institute in 1916, shortly after which rules of professional conduct were adopted for the first time, some twenty-one cases have been heard by the council sitting as a trial board, in all but a few of which some discipline was inflicted upon the respondents.

### THE INSTITUTE COMMITTEE

The American Institute of Accountants committee on professional ethics consists of five members of the council (the governing body of the Institute), elected by the council at the meeting following the annual meeting of the Institute. The members of the committee represent various geographical sections of the country and various sizes and types of accounting firms. A great deal of the committee's work, owing to the separation of the members, must be carried on by correspondence. The secretary of the Institute is the secretary of the committee.

### COMPLAINTS

The committee receives complaints from members of the Institute, from the general public, and from the secretary, who has been instructed to refer to the committee public documents such as court decisions or press clippings which include any allegation or intimation that a member of the Institute has conducted himself in a manner discreditable to the profession. The committee also receives as complaints releases of the Securities and Exchange Commission in which there is reference to members of the Institute, transmitted by the chief accountant of the Commission in accordance with a request by the Institute some two years ago that he call attention to such matters. In ad-

dition, most stop-order decisions and other releases under the securities act and the securities-exchange act are scanned in the secretary's office, who refers to the committee any release in which there is a reference to a member of the Institute, even though he be not named in the release, which raises a question likely to require the committee's attention.

There is before the committee at this time one case referred by the secretary in this manner, to which attention had not been called by the chief accountant of the Commission, but which it appears the committee will report for hearing before the trial board.

There has been some question whether as a practical matter it is necessary for the committee, which of course serves without any compensation, to investigate all the cases mentioned in releases of the Commission in which the accounting may be criticized, to ascertain whether or not a member of the Institute may have erred, or whether the committee may safely assume that all cases which would warrant its attention will be brought to notice by the chief accountant.

### BASIS FOR DISCIPLINE

The committee on professional ethics is required to determine, after considering a complaint, whether or not a prima-facie case is established showing a violation of any by-law or rule of conduct of the Institute, or conduct discreditable to a public accountant.

Article V, section 4, of the by-laws reads as follows:

"Sec. 4. A member or an associate renders himself liable to expulsion or suspension by the council sitting as a trial board if

"(a) he refuses or neglects to give effect to any decision of the Institute or of the council, or

"(b) he infringes any of these by-laws or any of the rules of professional conduct as approved by the council of the Institute, or

"(c) he is convicted of a felony or misdemeanor, or

"(d) he is declared by a court of competent jurisdiction to have committed any fraud, or

"(e) he is held by the council to have been guilty of an act discreditable to the profession, or

"(f) he is declared by any competent court to be insane or otherwise incompetent, or

"(g) his certificate as a certified public accountant is revoked or withdrawn by the authority of any state or territory of the United States or of the District of Columbia, or

"(h) his certificate as a certified public accountant shall have been revoked or withdrawn by the authority of any state or territory of the United States or of the District of Columbia and such revocation or withdrawal remains in effect."

There are thirteen rules of professional conduct, and several resolutions adopted by the council in relation to professional conduct which have to some extent the force of rules. Briefly, these rules and resolutions deal with the following matters:

(1) Use of the title "Member American Institute of Accountants."

(2) Certification of financial statements containing essential misstatement of facts or material omissions.

(3) A member permitted to allow only other members of the Institute or employees or partners to practice in his name.

(4) Members forbidden to allow to or accept from the laity commissions or brokerage, or to split fees with the laity.

(5) Members forbidden to engage in occupations incompatible with accountancy.

(6) Member forbidden to certify statements not prepared under his supervision or that of his firm, or of another accredited accountant.

(7) Members must notify Institute if they participate in legislative activity.

(8) Solicitation of clients of fellow members forbidden. (It has been proposed that this rule be extended to forbid any solicitation whatever.)

(9) Offers of employment to employees of fellow members forbidden except under specified conditions.

(10) Contingent fees forbidden except in tax cases.

(11) Advertising forbidden.

(12) Forbids improper conduct by members in conjunction with schools of accounting.

(13) Forbids members to practice public accounting as officers, directors, representatives or agents of corporations.

#### Resolutions:

April 11, 1932—Forbids certification of estimates of future earnings.

October 15, 1934—Provides that no member shall certify financial statements of enterprise in which he is actual or beneficial owner of a substantial financial interest.

October 15, 1934—Competitive bidding for professional engagements regarded as against interest of public and profession.

April 11, 1938—Competitive bidding by a member of the Institute in violation of a state society rule will be considered an act discreditable to the profession.

The committee on professional ethics has submitted to the council a suggested revision of the present rules of conduct to eliminate archaic phraseology, and to clarify the intent in certain cases, as well as to include as formal rules the substance of the council resolutions to which reference has been made. The proposed revision will probably be acted upon at the time of the annual meeting, October, 1940.

#### TRIAL PROCEDURE

The trial procedure is outlined briefly in article VI of the by-laws, which reads as follows:

"Section 1. Any complaint preferred

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against a member or an associate under section 4 of article V shall be submitted to the committee on professional ethics. If, upon consideration of a complaint, it appears to the committee that a prima-facie case is established showing a violation of any by-law or rule of conduct of the Institute or conduct discreditable to a public accountant, the committee on professional ethics shall report the matter to the executive committee, which shall summon the member or associate involved thereby to appear in answer at the next regular or special meeting of the council.

"Sec. 2. If the committee on professional ethics shall dismiss any complaint preferred against a member or an associate, or shall fail to act thereon within ninety days after such complaint is presented to it in writing, the member or associate preferring the complaint may present the complaint in writing to the council. The council shall make such investigation of the matter as it may deem necessary and shall either dismiss the complaint or refer it to the executive committee, which shall summon the member or associate involved thereby to appear in answer at the next regular or special meeting of the council.

"Sec. 3. For the purpose of adjudicating charges against members or associates of the Institute as provided in the foregoing sections, the council shall convene as a trial board. Members of the committee on professional ethics shall not be entitled to vote as members of the trial board. The executive committee shall instruct the secretary to send due notice to the parties concerned at least thirty days prior to the proposed session. After hearing the evidence presented by the committee on professional ethics or other complainant and by the defense, the trial board by a two-thirds vote of the members present and entitled to vote may admonish or suspend for a period of not more than two years the member or associate against whom complaint is made or by a three-fourths vote of the members present and entitled to vote may expel the member or associate against whom complaint is made. A

statement of the case and the decision of the trial board thereon, either with or without the name of the person involved, shall be prepared by the executive committee and published in THE JOURNAL OF ACCOUNTANCY.

"Sec. 4. At any time after the publication in THE JOURNAL OF ACCOUNTANCY of a statement of the case and decision of the trial board thereon the council, sitting as a trial board, members of the committee on professional ethics not being entitled to vote, by a three-fourths vote of the members present and entitled to vote may recall, rescind or modify such expulsion or suspension."

By resolution of the council, after consultation with the Institute's attorneys, it is generally understood that the committee on professional ethics acts as a prosecutor in the hearings before the council sitting as a trial board. As indicated in article VI, the members of the committee are not permitted to vote as members of the trial board.

### PUNISHMENT

As indicated in section 3 of article VI above, there are four conclusions which the trial board may reach. It may find the respondent not guilty, in which event there is, of course, no further action. If the respondent is found guilty, the trial board may admonish, may suspend him for a period of not more than two years, or may expel him from membership. In any case, if guilt is established, a statement of the case and the decision of the trial board is published in THE JOURNAL OF ACCOUNTANCY with or without the name of the respondent, as the trial board may direct.

The committee on professional ethics reports to the council in confidence at each meeting of the council the results of the committee's consideration of cases since the prior meeting. In these confidential reports the cases are named. The committee's formal report, which does not name the cases, briefly out-

lines the nature of each case before the committee. The formal report submitted to the council at its meeting May 13 to 15, 1940, was ordered published and distributed to all the members of the Institute.

TRANSMITTAL OF INFORMATION TO  
S.E.C.

It has become apparent that cases will arise in which the S.E.C. may, in its published releases, criticize members of the Institute named in the releases, but the Institute's committee on professional ethics after consideration may disagree with the findings of the Commission, or may find that an act criticized by the Commission does not permit disciplinary action under the Institute's by-laws or rules. An example of the first type of case might be one in which the Commission decided that there had not been adequate disclosure but the Institute's committee felt that there had been adequate disclosure. This would be simply a difference of opinion on the facts. An illustration of the second type of case might be one in which the Commission had found an accountant not independent within the meaning of the statute, as elaborated by accounting release No. 2, the one per cent rule. The Institute's committee might find no violation of the Institute's rules or by-laws in such a case, although if the member concerned possessed what the committee believed to be a substantial financial interest in the client corporation, in the light of all the circumstances, it might find a prima-facie case. The Institute's committee would probably consider the question whether there was evidence that in a given case the auditor had been in fact not independent, i.e., whether his financial interest had influenced him to certify financial statements which did not fully disclose material facts which should have been disclosed.

We believe that the Securities and Exchange Commission, which in a sense occupies a position similar to that of a complainant, is entitled to be advised of the Institute's conclusions in cases involving members of the Institute which have been considered by both bodies. We suggest, therefore, that in cases where the Institute's committee has not found a prima-facie case of violation of the by-laws or rules of the Institute, the committee informally advise the chief accountant of its conclusions before making a final report, with the thought that the chief accountant may reconcile the views of the committee and the S.E.C. staff. Subsequently, a formal written statement of the Institute committee's conclusion may be submitted to the Commission.

If the Institute's committee does find a prima-facie case of violation of the Institute's by-laws or rules, it may advise the chief accountant of the Commission unofficially merely as a matter of interim information, the final report to be rendered to the Commission only after the hearing before the trial board. At that point the matter would have left the hands of the committee, and the secretary of the Institute would normally inform the Commission of the findings of the trial board.

GENERAL

It perhaps should be mentioned that complaints considered by the Institute's committee are not, of course, limited to matters arising from findings of the Securities and Exchange Commission. The committee receives complaints from members or from the public generally. A majority of these complaints deal with relatively minor offenses and are dismissed on the receipt of written agreement by the member concerned not to repeat the offense. The committee also answers many requests for guidance and advice submitted by

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members of the Institute and other certified public accountants.

It has become the practice for the committee to defer final consideration of matters which are before the courts or other public bodies on the theory that the Institute should not prejudice a member's case before an official tribunal by reaching independent conclusions before the public authorities

have reached their conclusions.

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