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SUMMARY

OF

THE ACCOUNTING ESTABLISHMENT

A STAFF STUDY

PREPARED BY THE

SUBCOMMITTEE ON REPORTS, ACCOUNTING
AND MANAGEMENT

OF THE

COMMITTEE ON GOVERNMENT OPERATIONS
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SUMMARY

The accounting establishment in the United States is primarily comprised of the Nation's eight largest accounting firms, certain influential CPA professional organizations and business lobbying groups, and a few Federal agencies—most notably the Securities and Exchange Commission. This study examines the inter-relationships and activities of those private groups and Federal agencies in order to determine their impact on accounting practices promulgated or approved by the Federal Government.

The purpose of this study is to inform Congress and the public regarding the participants involved in developing and applying accounting practices which significantly affect government policy, the economy and society in general. Concise factual information regarding the accounting establishment has not previously been readily available to Congress and the public. This study and its appendices provide information necessary to formulate sound Federal policy on accounting matters.

Accounting standards govern the presentation of information in corporate financial statements. Enactment of the Securities Act of 1933 and the Securities Exchange Act of 1934 created a need for accountants to act as independent auditors for publicly-owned corporations by requiring that certain information reported to the public by corporations be independently certified. The "Big Eight" and other large accounting firms have prospered from this Federal requirement because they are retained as the auditors for the Nation's major corporations. Such auditors are responsible for providing independent certification that corporate financial statements present fairly and accurately the results of business activities.

Independent auditors must have the complete confidence of the public for whose benefit the Federal securities laws were enacted. That confidence can only be maintained by strict adherence to standards of conduct which assure the public that auditors are truly independent and competent to perform their responsibilities. Even the appearance of bias or conflict of interest by an independent auditor can erode the public confidence necessary to make the disclosure policy embodied in the Federal securities laws successful.

The primary purpose of the Federal securities laws is to instill public confidence in the reliability and accuracy of information reported by publicly-owned corporations. Doubts as to the reliability and accuracy of such information impair its usefulness to the public for making efficient economic and social decisions, and defeat the purpose of the securities laws. Independent auditors perform a key function in achieving the goal of the Federal securities laws because they provide the means for independently checking and confirming the information reported by corporations.

Historically, Congress and the public have regarded accounting as an arcane subject better left to accountants themselves. Continual revelations of wrongdoing by publicly-owned corporations have caused a new awareness of the importance of accounting practices in permitting such abuses to occur. Unexpected failures of major corporations have led to requests for substantial assistance to such companies from taxpayers. Accounting practices ultimately involve social issues that affect the Nation's economic welfare.

Because of their broad social and economic significance, accounting issues must be addressed by Congress and the public in a manner which ensures that the public interest is protected. If past abuses are to be prevented in the future, it is important that the accounting establishment, which has permitted many abuses to occur, be understood. Accounting issues are too important to be left to accountants alone.

CHART 1

CONTROL OF THE "BIG EIGHT" ACCOUNTING FIRMS AND THE AICPA OVER ACCOUNTING STANDARDS APPROVED BY THE SEC

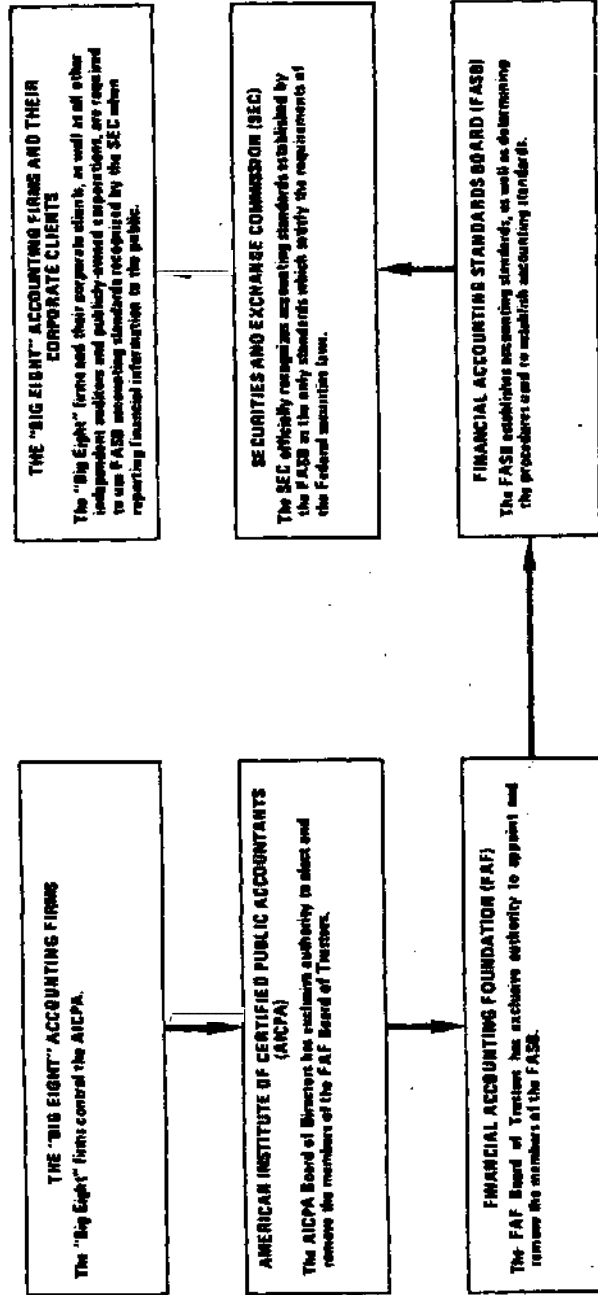


Chart 1 on page 3 provides a basic outline of the relationship among major organizations described in this study. The various boxes in Chart 1 identify the primary segments of the accounting establishment and their roles in the extraordinary process by which public authority to set accounting standards has been delegated to self-interested private parties. Chart 1 is a useful guide for summarizing the information contained in this study.

THE "BIG EIGHT" ACCOUNTING FIRMS

Chart 1 shows that the first major segment comprising the accounting establishment is the "Big Eight" accounting firms which are described in Chapter I. These eight firms are so big and influential in relation to other accounting firms that they dominate the practice of accounting in the United States and probably throughout the world. Listed alphabetically, the "Big Eight" firms are:

Arthur Andersen & Co.,
 Arthur Young & Co.,
 Coopers & Lybrand,
 Ernst & Ernst,
 Haskins & Sells,
 Peat, Marwick, Mitchell & Co.,
 Price Waterhouse & Co., and
 Touche Ross & Co.

The "Big Eight" firms provide auditing and accounting services for the vast majority of major corporations. The next seven largest accounting firms in the Nation are important, but do not match the "Big Eight" in terms of size and influence.

The "Big Eight" are often called "public accounting firms" or "independent public accounting firms." This study finds little evidence that they serve the public or that they are independent in fact from the interests of their corporate clients. For that reason, this study refers to the "Big Eight" simply as accounting firms.

Information on the "Big Eight" firms and other private segments of the accounting establishment is not readily available to Congress and the public from published sources. Therefore, it was necessary for this subcommittee to request information directly from the "Big Eight" and other private groups. Additional information was obtained from Federal agencies and other sources within and without the accounting profession.

The "Big Eight" firms are large organizations. Each has several hundred partners, and their supporting staffs range in size from approximately 4,000 to over 8,000 persons. They maintain offices in every major city in the United States, and have affiliations in major cities overseas.

The influence exercised by the "Big Eight" firms far exceeds that which might be expected from the number of CPAs working for them. Only about 11 or 12 percent of the Nation's estimated 160,000 CPAs are associated with "Big Eight" firms, but their influence is magnified because their clients are the largest and wealthiest corporations in the United States. Because of their large size, the "Big Eight" firms exercise substantial influence directly on accounting practices promulgated or approved by the Federal Government. They also exercise substantial indirect influence through the American Institute of Certified Public Accountants

(AICPA), which they control, and through the accounting practices followed by their corporate clients.

On the average, the “Big Eight” firms receive approximately 70 percent of their total revenues from performing auditing and accounting services, 18 percent from performance of tax services, and the remainder from performing management advisory services. Auditing and accounting services involve designing a reliable system of record-keeping for businesses, checking the record-keeping system periodically to assure that it is effective, providing assistance in presenting financial information so that it accurately conveys the results of business activities, and certifying financial statements for accuracy. Tax services involve helping clients achieve maximum financial benefits from provisions of Federal, State, local, and foreign tax laws.

Performance of management advisory services involves helping a client to manage its business, and goes beyond the expertise normally associated with the practice of accounting. The “Big Eight” accounting firms provide management consulting services such as executive recruitment, marketing analysis, plant layout, product analysis, actuarial services, and financial management services. All eight firms employ professionals, termed “principals,” (who are not CPAs) to provide expertise in performing non-accounting management advisory services.

The supply of auditing and accounting services to corporations listed on either the New York Stock Exchange or the American Stock Exchange is heavily concentrated among the “Big Eight” firms. A study performed by the Congressional Research Service for this subcommittee found that 85 percent of the 2,641 corporations listed on the New York Stock Exchange and the American Stock Exchange are clients of “Big Eight” firms. Those clients accounted for one-half of the \$2,552 billion in sales for the Nation’s manufacturing, trade, and retail sectors and about 84 percent of the \$75.4 billion of corporate profits after taxes, using average annual data for the years 1974 and 1975.

Concentration of major corporate clients among the “Big Eight” firms is greatest on the New York Stock Exchange where the largest corporations are listed. “Big Eight” accounting firms have 92 percent of the companies listed on that exchange as clients. For all the corporations listed on the New York Stock Exchange, the clients of “Big Eight” firms accounted for 94 percent of all sales (revenues) received, 94 percent of all profits earned, 90 percent of all income taxes paid, 94 percent of all people employed, and 94 percent of all assets owned.

A single “Big Eight” firm—Price Waterhouse & Co.—provides auditing and accounting services for clients that account for 24 percent of the sales and 28 percent of the earnings on the New York Stock Exchange. Four other firms—Arthur Andersen & Co., Coopers & Lybrand, Haskins & Sells, and Peat, Marwick, Mitchell & Co.—collectively are the auditors for 50 percent of the sales and 51 percent of the earnings for all of the corporations on that exchange. Thus, five of the “Big Eight” accounting firms collectively audit 74 percent of the total sales and 79 percent of the total net earnings of corporations listed on the New York Stock Exchange.

On the American Stock Exchange, 76 percent of the corporations listed are audit clients of “Big Eight” firms. For all the corporations listed on the American Stock Exchange, those clients account for 67 percent of all sales (revenues) received, 67 percent of all profits earned, 66 percent of all income taxes paid, 61 percent of all people employed, and 73 percent of all assets owned.

Again, the clients of Price Waterhouse & Co. account for the most revenue and income, about 16 percent of the total sales and 19 percent of the total net income of corporations listed on the American Stock Exchange. When the clients of Price Waterhouse & Co. are grouped with those of Arthur Andersen & Co., Coopers & Lybrand, Haskins & Sells, and Peat, Marwick, Mitchell & Co., those five firms are the auditors for clients that produce 45 percent of the sales and 49 percent of the earnings for all the corporations listed on the American Stock Exchange.

The Congressional Research Service found that the concentration of corporate clients among those five “Big Eight” firms was even greater when only the Nation’s 50 largest corporations are considered. Analysis of the auditors for the 10 largest companies in six selected industries also showed concentration among certain “Big Eight” accounting firms. For example, Price Waterhouse & Co. clients include six of the 10 largest oil companies—Exxon, Gulf, Standard Oil of California, Standard Oil of Indiana, Royal Dutch Petroleum and Shell.

As independent auditors for major corporations, the “Big Eight” firms exercise great influence over the financial results shown by those corporations. The accounting establishment has permitted the evolution of a system of flexible, alternative accounting methods to report similar business transactions. Drastically different financial results can be reported to the public merely by using alternative accounting methods selected from the collection of acceptable methods.

Independent auditors must agree with the accounting methods used by a corporation in order to certify to the public that the corporation’s financial statements present fairly the results of its operations. The present system of flexible, alternative accounting standards allows an independent auditor to use a great deal of discretion in approving various accounting methods. The method approved by the independent auditor can mean the difference between a corporation reporting healthy profits or severe losses to investors and the public.

The independent auditor is also responsible for certifying the accuracy of corporate records to the public. Present auditing standards permit an independent auditor to use a great amount of discretion in determining how much testing of corporate records should be done. In order to maintain the confidence of investors, government authorities and the public, corporations must receive unqualified endorsement from their independent auditors regarding the integrity of business records.

Because independent auditors presently exercise significant discretionary influence and are intimately involved in the presentation of corporate financial statements, the adverse effects traditionally associated with excessive market concentration are aggravated by the dominant position held by the “Big Eight” firms in supplying auditing and accounting services to major corporations. Excessive market concentration traditionally causes problems concerning the price and availability of goods and services. The concentration of major corporations as clients of the “Big Eight” indicates a need for an investigation of possible anti-competitive effects.

Through the various services they provide, individual “Big Eight” firms have become involved in the affairs of more than one client competing within the same industry. Excessive concentration in the supply of auditing and accounting services exists among all industries, and often within the same industry. The AICPA committee structure provides the “Big Eight” accounting firms with an opportunity to promote anti-competitive practices by meeting together privately and establishing important auditing and accounting policies.

Concentration in the supply of auditing and accounting services appears to be increasing as a result of corporate mergers and the sale of corporate securities to the public. Small and

medium-sized accounting firms usually lose clients to the “Big Eight” when smaller companies “go public” or are acquired by major corporations.

The practice of accounting is very profitable for partners in “Big Eight” firms, especially for the top partners who determine the policies followed by the firms. Collectively, the “Big Eight” firms have estimated total annual revenues of over \$2 billion and net earnings for their partners of more than \$500 million. The substantial financial interests at stake indicate that the firms have a strong vested interest in avoiding changes in the present system which might reduce the value of their services to clients.

Serious questions have been raised concerning the independence and competence of the “Big Eight” accounting firms and other independent auditors. Those questions have arisen because of accounting and auditing problems involved in the Penn Central collapse, the Equity Funding fraud, improper and illegal activities by Gulf Oil Corp. and Northrop Corp., and the many other abuses by corporations which have come to public attention in recent years. A common complaint in such cases has been, “Where was the independent auditor?”

Doubts as to the accuracy and reliability of information reported by corporations have resulted from continual revelations of corporate misconduct which was not found or not reported by independent auditors. Congress and the public have little assurance that corporate financial statements accurately portray the results of business activities because of flexible, alternative accounting standards. Public confidence in independent auditors, which is essential to the success of the Federal securities laws, has been seriously eroded.

This study finds that public doubts concerning the performance of independent auditors of major corporations are well founded. Moreover, the problems causing an erosion of confidence in the “Big Eight” accounting firms and other independent auditors are inherent in their present system of practice, the procedure by which they are chosen, and their relationship to standard-setting bodies. Restoration of public confidence in the independence and competence of such auditors depends upon reforming the manner in which they perform their responsibilities.

The most important requirement of independent auditors is that they be regarded by the public as truly independent from the interests of their clients. The “Big Eight” firms have seriously impaired their independence by becoming involved in the business affairs of their corporate clients, and by advocating their clients’ interests on controversial issues. It appears that the “Big Eight” firms are more concerned with serving the interests of corporate managements who select them and authorize their fees than with protecting the interests of the public, for whose benefit Congress established the position of independent auditor.

The management advisory services provided by “Big Eight” firms are intended to aid corporate managements in operating their businesses, and necessarily involve “Big Eight” firms in the business affairs of their clients. Such involvement creates a professional and financial interest by the independent auditor in a client’s affairs which is inconsistent with the auditor’s responsibility to remain independent in facts and in appearance.

When a “Big Eight” firm recruits executives for a corporate client, shareholders and the public may wonder if the firm is retained as the client’s independent auditor primarily because of the relationship existing between the firm and the influential executives it recruited. Similarly, the public may reasonably doubt the ability of a “Big Eight” firm to act as independent auditor for a corporate client which has also retained the firm to provide marketing analysis, financial management services, actuarial services, or other management advisory services. In such cases, an independent auditor not only becomes involved in the business affairs of its clients, but may be placed in the position of auditing its own work.

Representation of clients' interests is another area where the "Big Eight" accounting firms have failed to meet their responsibility to remain independent. They advocate the partisan interests of their corporate clients on controversial issues, both for a fee and as a "public service." Partners of "Big Eight" firms join recognized business lobbies and actively represent them before Federal, State, and local governments.

"Big Eight" firms have advocated the interests of corporate clients on substantive political issues regarding taxation of corporations. They have supported increased investment tax credits, more liberalized depreciation methods, continuation of tax credits rather than deductions for taxes paid to foreign governments, and other procedures designed to increase the amount of cash held by big corporations. Advocacy of controversial positions involving the fair distribution of taxes results in a loss of independence because the auditor's interests become associated with the interests of clients or some other special interest group.

The "Big Eight" accounting firms readily identify with the self-interests of corporate managements on many other controversial issues. They testify before State regulatory commissions on the amount of profits which should be earned by regulated utilities, and in support of automatic cost adjustment clauses which circumvent the regulatory process. "Big Eight" firms support inclusion of construction work in progress in regulated utility rate bases, as well as charging utility customers for Federal income taxes that are never paid to the Federal Government.

They testify before Congress in support of higher oil and natural gas prices, and for faster write-offs of production costs. "Big Eight" firms write to Federal agencies to urge adoption of rules that would have the Federal Government pay private contractors for "costs" that are not normally accepted costs at all. They oppose more stringent Federal regulations on reporting by corporations, and recommend that the Federal Government not adopt uniform accounting methods.

Independent auditors are endowed with a public reputation for impartiality and objectivity because of the special role assigned to them by Congress in the Federal securities laws. Their statements and recommendations are accorded great respect and credibility because of the general belief that such statements and recommendations are made independently. Thus, it is highly improper for them to use their special status as a basis for advocating the self-interests of their corporate clients, especially for profit.

The competence of the "Big Eight" accounting firms as independent auditors has also been questioned in recent years. Three of them have been officially disciplined by the SEC for auditing failures. Several of the "Big Eight" firms have been involved in legal actions resulting in adverse settlements because of alleged auditing failures.

The "Big Eight" firms provide auditing, accounting, and management advisory services to Federal, State and local governments as well as corporations. Through their employment, they are able to influence governmental policies and procedures which may affect the business activities of their corporate clients. The influence of the "Big Eight" firms on governmental policies and procedures can be substantial in certain areas, and may represent a conflict of interest with respect to services performed for clients in the private sector.

The total revenues received by the "Big Eight" firms for services to the Federal Government amounted to \$16,486,000 in 1975. That was more than double the \$8,037,000 received in 1971. Performance of services for the Federal Government appears to be of increasing importance to the "Big Eight" accounting firms.

THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Chart 1 on page 3 shows that the American Institute of Certified Public Accountants (AICPA) is the first major step in the process by which the “Big Eight” firms are able to control the establishment of accounting standards used by their corporate clients. The AICPA is the largest professional association of CPAs and the most important private group affecting the practice of accounting. It dominates all significant aspects of accounting because the accounting profession is largely self-regulated, and Federal and State authorities have recognized policies and procedures established by the AICPA as representing decisions by the accounting profession. Chapters II, III and IV of this study describe the AICPA and its activities.

The AICPA is organized in a manner which permits the parties controlling its power structure to maintain their control over the organization. The “Big Eight” firms effectively control the power structure, and use the AICPA to advance their collective interests. The AICPA’s power structure is comprised of its council, its board of directors, its president and administrative staff, and its important committees which establish AICPA policies and procedures. (See Chart 2 on page 72.)

Although CPAs associated with the “Big Eight” account for only 15 percent of the AICPA’s 117,695 members, they comprised 31 percent of the 252 members on its council in fiscal 1976. The 15 largest accounting firms comprised 42 percent of the council membership. Through control of the AICPA’s power structure, the “Big Eight” firms are able to assure that most council members agree with their views.

The AICPA’s board of directors has broad authority to set policies and manage its resources. In fiscal 1976, six of the 18 board members, including the immediate past chairman of the board and the designated next board chairman, represented “Big Eight” firms. Nine of the 18 board members were from the 15 largest accounting firms.

The real work of the AICPA in terms of performing certain tasks and accomplishing specific goals is handled almost exclusively by its committee structure. The 108 committees listed and described in the 1975-76 AICPA Committee Handbook cover every topic of interest to the accounting profession. While the influence of the “Big Eight” firms pervades the AICPA committee structure, their representation is concentrated on committees performing work in substantive areas that have an extensive impact on the actual practice of accounting, and frequently affect governmental policies. “Big Eight” representation exceeded 50 percent on several of the most important committees in fiscal 1976.

The AICPA bylaws provide that the five most important committees—called senior technical committees—shall speak for the AICPA in their respective areas without consulting either the council or the board of directors. Because Federal agencies and State boards of accountancy charged with regulating accountants have chosen to rely upon the AICPA to such a great extent, the pronouncements of senior technical committees have become the prescribed standard followed by CPAs in several substantive areas. The public and the accounting profession are profoundly influenced by the activities of senior technical committees, but these autonomous committees have no procedural guarantees to protect the interests of those not actually represented on the committees.

The “Big Eight” firms dominate all five senior technical committees. Through these committees, they are able to determine the AICPA’s policies and direct its activities on such important matters as accounting standards, auditing standards, management advisory services, Federal taxation, and professional ethics. The senior technical committees theoretically speak

for the entire membership of the AICPA in those five areas of vital interest to CPAs and the public.

The Auditing Standards Executive Committee, one of the senior technical committees, performs an especially important function. It develops the AICPA's positions on proper auditing procedures which are issued as Statements on Auditing Standards. The Federal Government, State governments, and courts of law generally recognize those standards as the ones which must be followed by all CPAs.

Chart 1 on page 3 illustrates the process by which the "Big Eight" firms and the AICPA control the establishment of accounting standards. Accounting standards are important because they govern the manner in which businesses must present financial information to the public.

The process by which the Auditing Standards Executive Committee sets auditing standards on behalf of the AICPA is more direct and tightly controlled. Auditing standards equal accounting standards in importance because they govern the procedures used by accountants to check the accuracy and reliability of business records supporting financial statements. The legal liability of accountants in cases involving fraud or other illegal activities by corporate managements is often determined by their compliance with recognized auditing standards.

In fiscal 1976, eight of the 21 members on the Auditing Standards Executive Committee, including the chairman, represented the "Big Eight" firms. The combined representation of the Nation's 15 largest accounting firms was 14, or two-thirds of the total committee membership.

The "Big Eight" accounting firms also dominate the several AICPA committees established to advise the Federal Government, such as the Cost Accounting Standards Board Committee, the Federal Government Executive Committee, the Federal Taxation Executive Committee, and the SEC Regulations Committee. When the AICPA speaks to the Federal Government, it is the voice of the "Big Eight" and, to some extent, the next seven largest accounting firms.

Several other important committees are dominated by the "Big Eight" accounting firms. An example is the Planning and Finance Committee which determines the compensation of AICPA staff officers. The 15 largest accounting firms also have their own exclusive advisory committee to promote their interests within the AICPA.

The AICPA is a big organization which spent over \$18 million on its various activities in fiscal 1975, including \$589,000 just to influence the Federal Government. Another \$187,000 was spent on Federal taxation matters. The "Big Eight" firms have used their influence to guide the AICPA into a broad range of activities intended to benefit their interests.

In addition to the professional education and ethics enforcement activities undertaken by most other professional associations, the AICPA engages in activities designed to increase its power over the practice of accounting. It controls the establishment of accounting and auditing standards. It develops and grades the Uniform CPA Examination used to test CPA applicants in every State. The AICPA also provides substantial support to the National Association of State Boards of Accountancy, an organization which purports to represent the State boards that regulate CPAs.

The AICPA is an active political organization. It has established a "key man" program to influence Members of Congress. The purpose of the program is to combat "government intervention in the profession's affairs" occasioned by an "anti-business" attitude in Congress, according to the AICPA's chairman of the board.

Representatives of the AICPA testify before Congress and make presentations to Federal agencies and departments. The AICPA lobbies Congress on both accounting and non-

accounting matters. One of its major projects is to influence Federal taxation policies.

The AICPA biennially prepares a booklet entitled “Recommended Tax Law Changes” which it distributes to all Members of Congress. Four “Statements of Tax Policy” on controversial tax issues have also been prepared and distributed. The AICPA’s recommendations consistently support more tax benefits for the accounting profession’s business clients.

Many AICPA members, especially those in large accounting firms, act as independent auditors for publicly-owned corporations, and are required to be independent of their clients’ interests in fact and appearance. However, the AICPA does not hesitate to identify the interests of CPAs with those of their business clients. The accounting profession’s reputation for objectivity and impartiality, as embodied in its preeminent professional association, is used by the AICPA to promote the partisan interests of the “Big Eight” firm’s corporate clients.

Another major AICPA project is to expand the use of CPA services by the Federal Government. This understandable effort is accompanied by statements of the benefits to be realized by the Federal Government because CPAs possess great expertise and follow strict standards. The AICPA also recommends that CPAs be hired under cost-plus type contracts rather than fixed-cost contracts, and that the Federal Government “indicate the price it has in mind” so that prospective contractors will know how much to bid.

While the AICPA promotes the capabilities of CPAs to departments and agencies of the Federal Government with money to spend, it cautions Federal enforcement authorities that only limited results can be expected from audits performed by CPAs. It advocates legislation to limit the legal liability of CPAs for performing faulty or incomplete audits. The AICPA sometimes takes contradictory positions to promote different purposes before different parties.

Actions by the SEC, the Cost Accounting Standards Board, the Internal Revenue Service, and other Federal agencies and departments often affect the “Big Eight” firms or their corporate clients. The AICPA exerts special effort to maintain liaison with such agencies and departments in order to influence their activities. The views espoused by the AICPA usually reflect those of the “Big Eight” accounting firms and their big corporate clients.

Federal employees serve on certain AICPA committees which are specifically assigned to influence Federal policies and personnel. Because the AICPA is a lobbying organization that reflects often controversial views of the “Big Eight” accounting firms, the participation of Federal employees on committees that attempt to influence the Federal Government is highly questionable. Federal employees affect Federal accounting practices through the performance of their official duties, and there is no need for them to participate in influencing other Federal employees through a professional lobbying organization.

The AICPA attempts to respond to major problems facing the accounting profession by proposing “reforms” that are acceptable to those controlling the organization. When strong criticism arose concerning failures in the establishment of accounting standards, the AICPA appointed a study commission which issued its report in March, 1972. That report recommended creation of the Financial Accounting Standards Board. Adoption of that recommendation resulted in the present inadequate system of establishing accounting standards which is described in this study.

Similarly, the AICPA appointed its Commission on Auditors’ Responsibilities—the Cohen commission—to respond to criticism of independent auditors of major corporations arising from recent disclosures of unreported corporate wrongdoing. Although the Cohen commission was established and is completely funded by the AICPA, it has been designated as

an “independent” commission in an effort to boost its credibility. The AICPA’s Cohen commission has not yet completed its study, but has given indications that it will support the concept of limited auditor responsibility advocated by the AICPA and the “Big Eight” accounting firms.

The AICPA has already adopted a voluntary program intended to assure the public regarding the quality of accounting firms practicing before the SEC. The primary participants in the program would be the “Big Eight” firms which would review each other to evaluate their quality control procedures. The program has several major deficiencies which make it wholly inadequate as a basis for public confidence in the quality of practice by large accounting firms.

Two proposals have been issued by the AICPA concerning an independent auditor’s responsibility to detect and report illegal acts by clients. Both proposals are aimed at limiting the responsibility of independent auditors. The tone of the AICPA proposals is typified by a remarkable statement in the second one that auditors are not responsible for reporting illegal acts to the proper government authorities: “Deciding whether there is a need to notify outside parties of an illegal act is the responsibility of management. In the ordinary case, the auditor is under no legal obligation to notify outside parties.”

The AICPA established the Financial Accounting Standards Board and plays a key role in selecting its members and financing its operation. AICPA control over the FASB is carefully written into the charter and bylaws creating the FASB. Chart 3 on page 137 illustrates the manner in which the AICPA controls the FASB.

Congress and the public should recognize the partisan and political nature of the AICPA when evaluating its influence on accounting practices promulgated or approved by the Federal Government. Under the control of the “Big Eight” accounting firms, the AICPA sets auditing standards and maintains control over the setting of accounting standards which have substantial impact on the public and the Federal Government. Many other areas of public policy affecting accounting and business are controlled or heavily influenced by the AICPA.

THE FINANCIAL ACCOUNTING FOUNDATION

The Financial Accounting Foundation (FAF) is the non-profit corporation organized by the AICPA and co-sponsored by four other private interest groups to operate the Financial Accounting Standards Board (FASB), which sets accounting standards.* Those groups are the Financial Executives Institute, the National Association of Accountants, the American Accounting Association, and the Financial Analysts Federation. None of those private interest groups is suited to control the setting of accounting standards which affect the Federal Government and the public.

As shown in Chart 1 on page 3 the FAF does not set accounting standards directly, but rather serves as an intermediate organization theoretically to separate the FASB from its private sponsors. That separation is the basis for the FASB’s claim that it is “independent.” Chart 3 on page 137 illustrates in more detail the relationship between the FASB organization and its private sponsoring groups. Chapters V, VI, VII, and VIII of this study describe the FASB organization, its sponsors, and its activities.

* The Securities Industry Association was added as the sixth sponsor of the FASB on October 1, 1976. Although added as a sponsoring group too late to be included in this study, the Securities Industry Association reportedly represents the interests of more than 800 investment banking firms. Its addition as an FASB sponsor does not significantly affect the findings of this study.

The FAF is comprised of nine trustees who are selected from the five sponsoring groups in the manner summarized on Chart 3. The AICPA maintains control over the FAF board of trustees because the exclusive power to elect and remove them is vested in the AICPA's board of directors, whose chairman is automatically designated as one of the trustees. The other sponsors only have the authority to nominate a single trustee each.

Eight of the nine FAF trustees are AICPA members. Only one of the trustees supposedly representing the other four sponsoring groups is not also a member of the AICPA. In addition to the control they exercise through the AICPA over the selection of all trustees, the "Big Eight" had three representatives serving directly as FAF trustees in 1976.

The board of trustees has two principal responsibilities—to appoint members of the FASB and the Financial Accounting Standards Advisory Council (FASAC), and to arrange for financing of the entire FASB organization. That organization is comprised of the FAF, the FASB, and the FASAC.

Exclusive authority to appoint and remove FASB members is vested in the FAF board of trustees, who cannot themselves simultaneously serve on the FASB. FASB members can be removed for "reasonably evidencing conduct detrimental to the purposes or repute of the FASB." Thus, FASB members are not truly independent of the trustees once they are appointed to office. The trustees themselves can be removed by the AICPA's board of directors for conduct "detrimental to the purposes or repute of the FAF or the FASB," so they are not truly independent either.

Financing for the FASB organization comes almost exclusively from its five private sponsoring groups and their members. All of the groups have pledged to support the FASB financially, but their contributions are not equal. Contributions to the FASB are concentrated among the large accounting firms and major corporations which would be most affected by any major reform of accounting standards.

The accounting profession donates about half of the money contributed to operate the FASB. In 1975, a total of \$4,129,201 was contributed to operate the FASB, and the accounting profession donated \$2,059,076. The "Big Eight", the AICPA and 41 other accounting firms donated 99.6 percent of that amount.

The "Big Eight" firms each contribute \$200,000 annually, so they accounted for \$1.6 million or 78 percent of the \$2,059,076 donated by the accounting profession in 1975. The next seven largest accounting firms contributed a total of \$286,500, meaning that the Nation's 15 largest accounting firms gave a combined total of \$1,886,500 or 92 percent of the contributions received by the FASB from the accounting profession. The AICPA, which is controlled by the large accounting firms, donated most of the remainder.

Corporate contributions toward operating the FASB amounted to \$1,928,349 in 1975, a little less than half of the total \$4,129,201 received. Approximately 80 percent of the corporate contributions was traceable to members of the Financial Executives Institute, a business lobbying group, which is one of the FASB's sponsors. Although 1,397 corporations made contributions in 1975, 580 of the Nation's largest corporations donated 91 percent of the \$1,928,349 designated by the FASB as coming from the corporate sector.

Contributions from the other FASB sponsors were much smaller. The National Association of Accountants, another organization representing business interests, contributed \$75,000 in 1975. The American Accounting Association, which primarily represents academic accountants, donated only \$6,876. The Financial Analysts Federation contributed \$7,000.

Contributions for operating the FASB are made to the FAF which, after deducting its

small operating expenses, passes the money to the FASB. That procedure is intended to create an impression that the FASB is insulated from the monetary influence of its sponsors. Donations to the FAF are tax-deductible, so the taxpayer partially subsidizes operation of the FASB.

THE FINANCIAL ACCOUNTING STANDARDS BOARD

The Financial Accounting Standards Board is the private body within the accounting establishment which actually sets accounting standards. Chart 1 on page 3 shows that the FASB is separated from the AICPA and its other sponsors by the FAF. A more detailed summary of the FASB's relationship with its sponsors is shown in Chart 3 on page 137.

The FASB's organizational separation from the private interest groups sponsoring it is the basis for the claim that it establishes accounting standards "independently." However, the separation is one in name only. This study finds that the "Big Eight" accounting firms, the AICPA and, to a lesser extent, the other sponsoring groups have control over the operation of the FASB. Such control is exercised in terms of money, personnel, and organizational support.

The FASB has seven members, and all of them belong to one or more of the five sponsoring groups. Six of the seven FASB members belong to the AICPA. In 1976, three of the members were from "Big Eight" firms.

Overall, 23 of the 32 FASB professional staff members belong to the AICPA. Ten of the 32 staff members were previously with "Big Eight" accounting firms. The concentration of FASB staff members identified with the AICPA and the "Big Eight" firms is greater in the higher staff positions and the positions which have the most impact on the accounting standards issued by the FASB.

There is a close identity between the leadership of the AICPA and the leadership in the FASB organization. The present FASB chairman is a past president of the AICPA. Even the Financial Accounting Standards Advisory Council, which is supposed to provide the FASB with a broad spectrum of outside advice, is largely comprised of representatives from the same group of big accounting firms, big investment firms, big law firms, and big corporations which dominate every facet of FASB activity.

As part of its claim to independent operation in the public interest, the FASB has developed rules of procedure for promulgating accounting standards. Those rules generally permit an opportunity for critical comment on FASB proposals before they are finally adopted as standards. However, they do not overcome the fact that the FASB and its staff are not fairly balanced as to the interests represented by those persons who perform the work and make the actual decisions regarding accounting standards which affect the Federal Government and the public.

An example of the special interest orientation found throughout the FASB is the composition of the task forces which perform much of the work in researching and developing FASB positions on particular accounting issues. The memberships of such task forces are largely comprised of outside representatives from large accounting firms, corporate clients of "Big Eight" firms, contributors to the FASB, large investment firms, and big banks. The FASB's extractive industries task force, which is attempting to develop uniform accounting standards for oil, gas, and mining companies, has 19 identifiable outside interests represented on its membership. Seventeen are easily identified as having an actual or potential financial interest in the type of accounting standards used by extractive industries.

The FASB has adopted conflict of interest policies "to establish to public satisfaction the

independence and objectivity of those responsible for establishing and improving standards of financial accounting and reporting.” Despite its recognition that even the appearance of a conflict of interest is enough to undermine public confidence, the FASB’s policies permit its members and staff to own unlimited amounts of investments, such as publicly traded securities, which could cause conflicts of interest. Members do not even have to report an investment to the FAF trustees unless it is “material,” which the annual reporting instructions define as \$25,000 or more invested in a single company.

The complete inadequacy of the FASB’s policies to prevent conflicts of interest is perhaps best illustrated by the recent departure of an FASB member from one of the “Big Eight” accounting firms who resigned prior to the end of his term in order to return to his firm. His resignation appears to violate an FASB rule prohibiting members from entering into formal or informal employment agreements while serving on the FASB. It seems doubtful that an FASB member would resign with an announcement of his intent to return to his previous business affiliation without some formal or informal agreement that he was wanted back and that there was an acceptable position for him. A “revolving door” arrangement between the FASB and the big accounting firms supporting it has apparently already begun.

A review of the FASB’s activities confirms the finding of this study that there is no reason to expect the FASB to achieve serious reform by establishing a system of uniform and meaningful accounting standards. Such a system is needed to replace the present collection of flexible, alternative standards which have permitted the growth of “creative accounting” as an acceptable option to accurate financial reporting. A study sponsored by the AICPA has listed 31 separate kinds of business transactions with an aggregate of 80 different accounting alternatives for reporting the transactions.

During its three-year existence, the FASB has issued 12 “Statements of Accounting Standards.” Those standards have addressed accounting problems of varying significance, but they have not resolved such problems in a manner which results in meaningful, as well as uniform, treatment of specific business transactions. Two of the standards have permitted alternative accounting methods, and none of them has seriously threatened the accounting prerogatives of various special interest groups in the established business community.

The FASB has also engaged in a series of private meetings with representatives of large accounting firms and big business. Meetings have not been held with other segments of the public affected by the FASB’s pronouncements because the FASB only seeks direct contact with “responsible representatives of groups having a capability to provide meaningful information and insight concerning the establishment of financial accounting standards.” Despite its failure to seek divergent views and establish a system of uniform and meaningful accounting standards in the public interest, the FASB and its sponsors launched an intensive lobbying campaign to thwart efforts by Congress to direct the SEC to establish such accounting standards for oil and gas companies.

THE SECURITIES AND EXCHANGE COMMISSION

The Securities and Exchange Commission is the Federal Government’s major participant in the accounting establishment. To an astounding degree, the SEC has permitted, and even insisted upon, establishment of accounting standards which have substantial impact on the Federal Government and the public by self-interested private accounting organizations. The result has been an extraordinary delegation of public authority and responsibility to narrow

private interests.

Chapter IX of this study describes the accounting responsibilities of the SEC. The SEC's role in the present system of setting accounting standards is illustrated by Chart 1 on page 3.

In the Securities Act of 1933 and the Securities Exchange Act of 1934, Congress directed the SEC to protect the public from false and misleading information by requiring publicly-owned corporations to disclose financial and other information in a manner which accurately depicts the results of corporate activities. Congress gave the SEC broad authority to establish accounting and reporting standards as part of its mandate to administer and enforce the provisions of the Federal securities laws. Soon after its creation, the SEC decided by a three to two vote not to exercise its authority to set accounting standards.

Instead, the SEC decided to rely on accounting standards established in the private sector as being protective of the public interest, as long as such standards have "substantial authoritative support." During the ensuing 40 years, the AICPA has created three bodies to provide such support through authoritative pronouncements. A collection of flexible, alternative accounting standards—called generally accepted accounting principles—has evolved in the private sector to satisfy the SEC's "substantial authoritative support" test.

After the failure of its previous two standard-setting bodies to develop a system of uniform and meaningful accounting standards, the AICPA created the FASB in 1972 in an effort to stem criticism of its capability to set responsive standards. The SEC issued a policy statement—Accounting Series Release (ASR) 150—in 1973 which specifically endorses the FASB as the only private body whose standards will be recognized by the SEC as satisfying the requirements of the Federal securities laws. In effect, the SEC has delegated the establishment of accounting standards which are binding on all publicly-owned corporations to the special interest groups which control the FASB, and has reserved a mere oversight role for itself.

Far from being unhappy with the private sector's failure to establish uniform and meaningful accounting standards, the SEC has consistently defended its delegation of authority to standard-setting bodies controlled by the AICPA. In ASR 150, it said: "The determinations by these bodies have been regarded by the Commission, with minor exceptions, as being responsive to the needs of investors." That assured statement was made after the conglomerate takeovers of the 1960s, the unanticipated collapse of the Penn Central, and many other problems illustrating failures of accounting standards.

When Congress attempted to achieve uniform accounting standards for oil and gas companies in 1975 by directing the SEC to exercise its authority to set such standards, the SEC joined with the AICPA, the FASB, and other private interest groups in opposing the attempt. It undertook an intensive lobbying campaign in a successful effort to preserve its delegation of standard-setting authority. The SEC demonstrated more concern for protecting the FASB privileged position than for protecting the public from misleading financial information.

Through the years, the SEC has maintained a close relationship with the AICPA and its standard-setting bodies. The SEC's chief accountants, who greatly influence its accounting policies, have belonged to the AICPA and worked with its committees intended to influence the SEC. One was even hired by the AICPA as a consultant at an annual rate of \$60,000 after his retirement from the SEC.

The SEC has also shown a tendency to treat large accounting firms more leniently than individual CPAs and small firms in disciplinary actions. Individual CPAs and small firms are routinely suspended from practice before the SEC and identified publicly as punishment for their improper or illegal acts. The three "Big Eight" firms disciplined by the SEC for similar acts

have received relatively mild sanctions and the individuals involved were not identified publicly.

Auditing standards established by the AICPA are recognized by the SEC as adequate to assure the accuracy and reliability of corporate records supporting information reported to the public. Continual revelations of unreported corporate wrongdoing have raised serious questions regarding the adequacy of present auditing standards. The SEC has no procedures for checking the quality of work by independent auditors in performing their responsibilities under the Federal securities laws.

Arthur Andersen & Co., one of the “Big Eight” firms, has brought suit in Federal court to abrogate the SEC’s policy of approving past and future standards issued by the FASB. Preliminary findings by the court indicate that Congress will have to exercise its authority to correct the adverse effects of the SEC’s delegation of standard-setting authority. Action by Congress will also be necessary to restore the opportunity for individuals to sue negligent accountants for damages under the Federal securities laws.

THE “BIG EIGHT” ACCOUNTING FIRMS AND THEIR CORPORATE CLIENTS

The last box in Chart 1 on page 3 illustrates the circular pattern of self-interest evident in the present system of setting accounting standards. The controlling influence of the “Big Eight” accounting firms in establishing accounting standards ultimately benefits the managements of their corporate clients by assuring that such standards will be generally acceptable to them. The “Big Eight” firms benefit because the present system enhances the value of their services to clients by permitting more flexibility in reporting financial results to the Federal Government and the public.

Unfortunately, accounting standards which permit corporate managements great flexibility in reporting the results of their business activities have resulted in many cases of inaccurate or misleading financial statements. Economic decisions based on such financial statements have caused substantial losses to investors, creditors, suppliers, purchasers and others. To the extent that public policies have been based on inaccurate or misleading financial statements, the Federal Government has acted upon illusion rather than fact.

For example, most Federal revenues are received from taxes computed on income or asset values. Accounting standards are instrumental in determining such income and asset values. Under the present collection of accounting standards, a business can report healthy earnings or severe losses merely by selecting alternative accounting standards. Accounting issues involve social issues such as the fair distribution of Federal taxation.

The FASB represents only the interests of its private sponsoring groups. No amount of transferring funds and authority through intermediate organizations can alter the fact that in the end all of the organizations are controlled by the same self-interested parties. The inability to divorce private influence from private control impairs all efforts to achieve public confidence in a system which vests public authority in private organizations.

Allegations of government inefficiency and wastefulness have been used to justify retention of the authority to establish accounting standards within the private sector. Available evidence, however, indicates that government agencies are capable of setting standards competently and more efficiently than private organizations. In any event, establishing accounting standards involves social issues that can be resolved effectively only by authorities responsible solely to the public.

Congress established the Cost Accounting Standards Board in 1970 “to achieve uniformity and consistency in the cost-accounting principles followed by defense contractors and

subcontractors under Federal contracts.” The CASB performs a standard-setting function essentially similar to that performed by the FASB, but the CASB’s staff and budget are approximately half the size of the FASB’s. Although there are some deficiencies in the CASB’s structure and procedures, it is performing its task competently overall. The CASB is described in Chapter X of this study.

Chapter XI of this study references some materials describing problems which have occurred because of improper or ineffective accounting and auditing practices. They demonstrate the need for accounting and auditing reforms. They also illustrate that accounting issues are information issues, involving the meaning, clarity, and amount of information given to Congress and the public regarding the activities of major corporations.

This study shows that there are serious deficiencies in the existing accounting establishment. The Federal Government, through the SEC has cooperated in permitting the use of accounting practices which have resulted in substantial damage to the public in apparent violation of the intent expressed by Congress in the Federal securities laws. Reforms are needed to restore public confidence in the accuracy and reliability of financial and other information reported by publicly-owned corporations.

RECOMMENDATIONS

The Federal Government has an important responsibility to ensure that publicly-owned corporations are properly accountable to the public. Existing accounting practices promulgated or approved by the Federal Government have failed to fulfill that responsibility adequately. The following recommendations are based on the findings of this study and identify actions which should be taken by Congress and appropriate Federal agencies in order to achieve efficient and effective accounting practices that will promote corporate accountability.

1. Congress should exercise stronger oversight of accounting practices promulgated or approved by the Federal Government, and more leadership in establishing proper goals and policies. Broad delegation of legislative authority to Federal agencies, which have in turn delegated broad authority to private interest groups, has been a major factor in the establishment of accounting practices which have benefitted special interests at the expense of the Federal Government and the public. As the branch of the Federal Government most directly representative of the public, Congress should exercise its authority to achieve proper accounting practices.

2. Congress should establish comprehensive accounting objectives for the Federal Government to guide agencies and departments in performing their responsibilities. The lack of such objectives has permitted divergent and sometimes contradictory accounting practices within the Federal Government. It has also contributed to the failure to establish uniform and meaningful accounting standards for publicly-owned corporations during the past 40 years.

The Cost Accounting Standards Board has benefitted from its specific statutory mandate to achieve “uniformity and consistency” in cost accounting standards used by the Federal Government, whereas the SEC has never established meaningful objectives for financial accounting standards. A comprehensive set of Federal accounting objectives should encompass such goals as uniformity, consistency, clarity, accuracy, simplicity, meaningful presentation, and fairness in application. In addition, Congress should establish specific policies abolishing such “creative accounting” techniques as percentage of completion income recognition, inflation accounting, “normalized” accounting and other potentially misleading accounting methods.

3. Congress should amend the Federal securities laws to restore the right of damaged individuals to sue independent auditors for negligence under the fraud provisions of the securities laws. Such legislation is necessary to overturn the holding of the U.S. Supreme Court in *Ernst & Ernst v. Olga Hochfelder, et al.*, 96 Sup. Ct. 1375 (March 30, 1976) that “scienter”—the intent to deceive, manipulate, or defraud—is a necessary requirement of private actions for damages under the fraud provisions of the securities laws. The dissenting justices recommended that Congress restore the rights denied individuals in order to achieve the remedial intent of the Federal securities laws.

The few independent auditors who perform negligently should be held responsible for their actions, and should not be permitted to impair public confidence in the competence of all independent auditors. The Federal Government should not establish any “accountant-client privilege” or provisions which would limit the liability of independent auditors. Competent independent auditors already are adequately safeguarded and unnecessary restrictions would impede the operations of Federal enforcement authorities and courts of law.

4. Congress should consider methods of increasing competition among accounting firms for selection as independent auditors for major corporations. At present, a single accounting firm, nominated by management, is placed on the ballot of annual meetings of stockholders. Domination of the corporate election process by large institutional investors and management ensures that the accounting firm nominated by management is elected. Long association between a corporation and an accounting firm may lead to such close identification of the accounting firm with the interests of its client’s management that truly independent action by the accounting firm becomes difficult.

One alternative is mandatory change of accountants after a given period of years, or after any finding by the SEC that the accounting firm failed to exercise independent action to protect investors and the public. Another alternative is amendment of the Federal securities laws to require that more than one accounting firm be on the ballot at annual meetings of stockholders. The mechanism for achieving this choice for stockholders could be a requirement that stockholders with voting rights to a given, small percentage of the stock would be entitled to nominate an accounting firm as the independent auditor. Holders of a limited number of shares also could be permitted to vote for their own representative on a corporation’s audit committee.

5. The Federal Government should directly establish financial accounting standards for publicly-owned corporations. Accounting standards involve social and economic issues which can only be resolved effectively through the processes of government responsible solely to the public. Furthermore, all segments of the public affected by accounting standards should be represented in the decision-making process.

As intended by Congress in the Federal securities laws, the SEC provides a public forum for setting accounting standards through its rule-making procedures. However, the SEC’s long association with the private accounting establishment and insistent determination to rely upon its accounting pronouncements cast substantial doubt on the SEC’s ability to establish accounting standards which would restore public confidence in corporate financial reporting.

Other alternatives would be to establish financial accounting standards through a Federal board similar in operation to the CASB or establishment of accounting standards by the General Accounting Office. Public participation and strong oversight by Congress are essential to safeguarding the public interest in any standard-setting procedure adopted.

6. The Federal Government should establish auditing standards used by independent auditors to certify the accuracy of corporate financial statements and supporting records. Again,

participation by all segments of the public is necessary to develop auditing standards that will restore public confidence in the integrity of corporate reports. In view of the substantial record of previously unreported corporate wrongdoing which has been revealed during the past few years, a special review of present auditing standards should be undertaken to determine their adequacy prior to considering their adoption by the Federal Government. Auditing standards could be established by the General Accounting Office, the SEC, or by Federal statute.

7. The Federal Government should itself periodically inspect the work of independent auditors for publicly-owned corporations. Such a mandatory inspection program should be designed to provide assurance to the public and Congress that independent auditors are performing their responsibilities competently in accordance with proper standards of conduct. Periodic quality reviews could be conducted by the General Accounting Office, the SEC, or a special audit inspection agency.

8. The Federal Government should restore public confidence in the actual independence of auditors who certify the accuracy of corporate financial statements under the Federal securities laws by promulgating and enforcing strict standards of conduct for such auditors. Those standards should specifically prohibit activities by auditors which impair their independence in fact or appearance. Direct or indirect representation of clients' interests and performance of non-accounting management advisory services for public or private clients are two activities which are particularly incompatible with the responsibilities of independent auditors, and should be prohibited by Federal standards of conduct.

The SEC is the appropriate agency to promulgate and enforce standards of conduct under its authority to determine the qualifications of independent auditors.

9. The Federal Government should require the Nation's 15 largest accounting firms to report basic operational and financial data annually. Those firms operate as partnerships and are not required to report such information to the public, but they perform public responsibilities as independent auditors for the vast majority of the Nation's sizable publicly-owned corporations. Congress and the public need basic information on the organization, activities and financial status of the 15 largest accounting firms in order to evaluate their performance of important public responsibilities under the Federal securities laws.

The subcommittee collected certain basic information on the "Big Eight" accounting firms, but this study finds that there is a need for more comprehensive information to be collected by the Federal Government on an annual basis. Such information should clearly disclose the financial position, operations, and various activities of large accounting firms. The appropriate Federal agency to collect such information is the SEC.

10. The Federal Government should define the responsibilities of independent auditors so that they clearly meet the expectations of Congress, the public, and courts of law. Independent certification concerning the accuracy of corporate records and the fair presentation of financial information is essential to successfully protecting the public through adequate disclosure of corporate activities, as intended by Congress in the Federal securities laws. The independent auditor's certification included in corporate reports should be understood by all auditors to mean that financial information is presented fairly and that corporate records are complete and accurate.

Independent audits that do not ensure fairness and accuracy are useless as a basis for public reliance upon information disclosed by publicly-owned corporations. Limited responsibility audits that provide only vague indications of fairness and accuracy, which are advocated by certain segments of the accounting establishment, result in substantial costs

without achieving the assurance necessary to make the present disclosure system operate effectively. If independent auditors cannot provide proper certification of information reported by publicly-owned corporations, then the Federal Government should seek alternative methods of performing that necessary function.

11. The Federal Government should establish financial accounting standards, cost accounting standards, auditing standards and other accounting practices in meetings open to the public. Accounting practices involve broad social and economic issues which should not be decided in private, and do not qualify as exemptions under Federal statutes regarding open meetings.

12. The Federal Government should act to relieve excessive concentration in the supply of auditing and accounting services to major publicly-owned corporations. The Department of Justice and the Federal Trade Commission should investigate and determine whether violations of the Federal antitrust laws have resulted from excessive concentration in the supply of such services among all industries or within specific industries. Congress should consider other methods of reducing concentration in the supply of auditing and accounting services to major corporations.

13. The Federal Government should retain accounting firms which act as independent auditors only to perform auditing and accounting services. The Federal Government should not contract with such firms for the performance of management advisory services or other consulting services which are incompatible with the responsibilities of independent auditors.

14. The Securities and Exchange Commission should treat all independent auditors equally in disciplinary and enforcement proceedings under the Federal securities laws. Large accounting firms and their partners should receive the same sanctions as individual CPAs and small firms for similar offenses. The SEC and other Federal agencies should not rely on private parties and organizations to conduct compliance reviews ordered as a result of disciplinary or enforcement proceedings, but should conduct such reviews themselves. Public confidence in the enforcement of Federal statutes and regulations is impaired when public responsibility is delegated to private parties and organizations which may be self-interested.

15. The membership of the Cost Accounting Standards Board should not be dominated by representatives of industry and accounting firms which may have vested interests in the standards established by the board. By statute, industry is guaranteed one position on the five-member CASB, and the remaining two appointed members from the private sector should be independent of real or potential conflicts of interest. The appointed member from the Federal Government should be rotated among the many Federal departments and agencies affected by CASB standards, and should not always represent the Department of Defense.

16. Federal employees should not serve on committees of the American Institute of Certified Public Accountants or similar organizations that are assigned to directly or indirectly influence accounting policies and procedures of the Federal Government. Federal employees should remain free from the appearance of conflicts of interest regarding the fair and objective performance of their public duties.