

SUMMARY
of
TESTIMONY OF

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OF THE SEC PRACTICE SECTION
OF THE AICPA

Before the Subcommittee on Securities
United States Senate Committee
on Banking, Housing, and Urban Affairs

Private Litigation under the Federal Securities Laws

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The Public Oversight Board, which was constituted in 1977 as an independent body to oversee the peer review program then established by the American Institute of CPAs to review the quality control systems of accounting firms that audit publicly held companies and their compliance with such systems, has carefully considered the problem of mounting litigation expenses and risks confronting the accounting profession. It has done this primarily in response to its own concerns and, secondarily, at the request of the larger accounting firms. Its concern is whether the existing patterns of such litigation may adversely affect the public interest.

The Board's concerns led it to publish on March 5 of this year a report, In the Public Interest, which includes its reflections not only on the litigation problems of the accounting profession, but broader problems confronting the profession, of which litigation is a part. The Board believes that there is a widespread concern among users of audited financial statements about their reliability, and correlatively, that there are expectations held by such users that simply are impossible of satisfaction.

The Board concluded there are measures that can be taken by a variety of bodies and by members of the profession to enhance the credibility of financial reporting and the public confidence in such reporting. These measures are set forth in the twenty-seven recommendations contained in our Report.

The Board has concluded that there is merit in the proposal to substitute for the present "joint and several" standard for the allocation of damages a "separate and proportionate" one. This conclusion stems from two premises.

First, the Board believes the public interest requires that there be available top-quality audit services performed by highly competent and trained professionals possessed of great integrity and commitment. The amounts of damages sought from auditors in pending and threatened cases and recent judgments and settlements lead many observers to fear that one or more of the major firms may be ruined by judgments, and that the individual partners may be compelled to strip themselves of their assets to settle the judgments. If that were to happen, the Board believes that this would do serious damage to the availability of quality audit services because it would hamper the ability of the remaining firms to recruit and keep quality personnel; men and women of outstanding competence would be unwilling to put their estates and their earning capacity at the mercy of the conduct of partners they know nothing about and whom they had no role in selecting for the partnership. That difficulty of recruitment and exodus from the profession would, in the Board's estimation, harm severely the public interest.

Second, the Board believes it is simply unfair to impose upon one of the parties responsible for misleading financial statements the entire liability simply because the others responsible may not be able to answer in damages. While those who have been harmed by the misconduct of others should desirably be made whole, those responsible for harming them should only be called upon to make good to the extent of the harm they have themselves caused.

The Board believes auditors must be financially responsible for their misdeeds and **their** shortcomings, but I would put emphasis on their misdeeds and shortcomings.

One aspect of the Board's oversight entails reviewing the work of a committee of the SEC Practice Section that reviews all suits brought against member firms arising out of the audits of publicly held companies to determine whether they suggest quality control deficiencies. This oversight has indicated to us that many cases against accounting firms are ill-founded and sometimes downright frivolous. The expenses and exposures of such lawsuits pose a danger to the public interest, as well as to the accounting profession.

This leads to one of the other recommendations of the Board. Accountants should be allowed to incorporate and they should not be thwarted in doing so by state laws which prohibit the practice of accounting in the corporate form. Executives of incorporated enterprises in other businesses do not have their estates and livelihoods at risk because of misconduct they had nothing to do with. Neither should people in the accounting profession.

Finally, the experience of the Board members leads them to the conclusion that there is a litigation problem in this country that transcends the accounting profession. It is imperative that every effort be made to discourage baseless and frivolous suits, to make discovery less expensive, and to provide expeditious, but fair, treatment of litigants, both plaintiffs and defendants.