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INTERVIEW OF COMMISSIONER WILLIAM CARY
SECURITIES AND EXCHANGE COMMISSION

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INTERVIEW OF
COMMISSIONER WILLIAM CARY

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The Interview with Commissioner Cary and Chief Accountant Andrew Barr of the Securities and Exchange Commission commenced at ten o'clock a.m., in Suite 206, Hay-Adams House, Washington, D. C., Messrs. Carey, Linowes and Trueblood present for the American Institute of Certified Public Accountants.

MR. TRUEBLOOD: Perhaps you or Andy or both might well get some ideas off the top of your head and start off that way.

COMMISSIONER CARY: Sure.

I am not trying to be unduly humble but because I have taught law and accounting once in my life, one year in my law school career, I asked you just to see what they are going to do there with it, George Thompson, who teaches at Columbia, and I have done a good deal in the tax field as well as the corporate field, written a lot of stuff, but since I have been here -- Andy can attest to this -- that our principal focus or my principal focus has been toward getting, as I see it, the agency revitalized to some extent in certain other areas and I have felt that the area under the general supervision of Andy Barr on the one hand and to some extent

the Division of Corporation Finance on the other have been very well and responsibly run over the years and therefore this is the area in which I had least to get myself involved.

For that reason my reactions in the accounting field are perhaps less based on current experience than they would be in almost any other field, whether dealing in trading in markets, or bankruptcy reorganizations, particularly in the investment company field, or perhaps sometimes where we should go even once in a while in the registration field, I would say much less, and I regret this because it happens to be one of my major interests, but I did feel it was where the focus, or that the focus should be in other places.

So that is the basis on which I want to state that my experience is current experience.

As far as I am concerned, I am willing to provide any little attitude that I might have developed.

MR. TRUEBLOOD: Would you like to make any general comments about your observations past and present of the relationship of the profession to the Commission and its functions?

COMMISSIONER:CARY: I'll try.

First of all, I would say that my own personal bias has always been exceedingly favorable toward the accounting profession. I told Mr. Carey years ago, I told him

several years ago -- that years ago, namely, about 10 or 15 when the battle between the accountants and the lawyers was rife that the American Bar Association group, committee, called me up and invited me and they urged me to reply to an article that he had written which appeared, I guess, in the Journal of Accountancy.

MR. CAREY: Rocky Mountain Law Review, if I remember correctly.

COMMISSIONER:CARY: Oh, yes, that was it.

And I read it over and, maybe they asked me because my name is Cary too --

(Laughter.)

But I was a Professor at Northwestern University Law School at the time and I read it over and found it unexceptionable and in fact excellent and I agreed with him, so I said, No.

That shows a general attitude.

Now, as to the role of the accounting profession in this field in which I am totally involved at the moment, I must say that I suspect I share the views Andy has and others that we ought to be moving toward a greater reliance on the accounting profession than we have in the past.

I could, if I chose, wanted to be critical for a

moment just note I think that what we need sometimes is a more independent accountant. In other words, I don't accept the fact that they are always independent. We have had a rather dramatic case not too long ago in which the senior chief executive officer said, Well, I can get the accountant to do anything we feel is what we want, and we've seen this in a number of cases in the past and I just think that that is a shade of the past and should definitely be eliminated in the future.

I have a particularly strong feeling about lawyers versus accountants in that the accountants have a greater potential for independence than the lawyers and perhaps it is because of the economics of the thing. Most accounting firms can afford to lose a client. I am not sure how much a law firm today can afford to lose a client. In the old days you used to be sort of going out and getting independent opinions of a highly skilled lawyer, perhaps a lawyer's lawyer, if you like. Today a firm represents in all phases a particular client and at that point it seems to me it's difficult to get independence because they're so tied in with overhead and the like that they simply cannot afford this.

On the other hand, there is a competing effect as major companies begin to have their own law offices within them.

then they begin to go to independent lawyers for a function, and then I still think that the lawyers have the same kind of opportunity for independence that the accountants have, but I don't feel that necessarily they have quite the potential in the future that the accounting people have, if they want to exercise it.

Of course, this is one thing I would be obviously strongly in favor of, increasing independence.

I think that is about all that I had to say to start off with in connection with the role of accountants, except for one other point, and it is suggested by a few comments that were made in these papers with respect to management services.

I feel that we in the SEC should move ahead so far as possible in giving more responsibility to accountants, and I personally initiated the idea -- maybe I shouldn't take the full credit, maybe Joe Weiner should have some, but I have had a few people in to sort of develop ideas as we went along -- the idea of placing a great-deal more responsibility on the accountants in the field of investment company work, going beyond normal auditing into really certifying with respect to a number of questions which we would have to examine by reason of our responsibility for inspection pursuant

to the mandate of the Investment Company Act of 1940. We pushed in the direction of getting the accountants to do a great deal of this work, beyond the traditional auditing.

I personally am very strong for it. Now the accountants had to meet in committee forum to try to decide how far they could go. I suppose that's all right, although frankly -- and I don't know really how reluctant, or whether there was any reluctance on their part. There was a slow process of their taking it on or even saying that they would take it on.

I don't mind their being reluctant, occasionally to say, Well, we can't give you an opinion, this is essentially a law opinion, on that point.

On the other hand, if I were they I would have seized on this as sort of a great opportunity for their representing these investment companies and I suppose they have the problem of the rather embarrassing problem of saying, well, we represent you and now we have to take on other roles which are perhaps to some extent oversight over you and therefore in terms of our business relationships this may be a little objectionable or worrisome.

But I think in principle the accounting profession simply ought to seize on this as hastily as they can to

follow their own apparent set of objectives. I have no reason to criticise them in this area, because I think they have moved ahead now. Don't you think so, Andy?

MR. BARR: They're moving ahead.

COMMISSIONER CARY: It took a little time.

MR. BARR: They were feeling something out, to reconsider certain aspects of it.

MR. CAREY: But there is, I think now, a willingness on our part --

MR. BARR: Yes.

MR. CAREY: -- to go in.

MR. TRUEBLOOD: I think that they are reluctant about everything, Mr. Cary, --

COMMISSIONER CARY: They're conservative.

MR. TRUEBLOOD: -- that's new.

COMMISSIONER CARY: They're just conservative.

MR. TRUEBLOOD: I think this is a matter of classification of material.

COMMISSIONER CARY: Unimaginative sometimes, out of reluctance.

MR. TRUEBLOOD: Reluctant about everything that they haven't done.

COMMISSIONER CARY: Yes.

MR. CAREY: Of course, it's got to be auditable material.)

COMMISSIONER CARY: That I agree with.

MR. CAREY: But I agree with you. We have moved in on the small business investment companies and this area and over considerable reluctance but we're in now. They're doing it.

COMMISSIONER CARY: Yes.

MR. BARR: This is the same type of approach.

MR. LINOWES: Of course, one of the problems here might a concern by some members of the profession of getting involved in areas outside of the attest and audit function and jeopardizing their independence.

MR. BARR: This is an attest matter.

MR. LINOWES: Yes, but it goes beyond it, does it not, in this investment company area?

COMMISSIONER CARY: It is still an attest.

MR. BARR: It goes beyond the financial statement.

MR. LINOWES: Does it not request more or less of an evaluation of the desirability of the investment or the nature of the investment?

MR. BARR: No, it does not.

COMMISSIONER CARY: No, it does not.

MR. LINOWES: It does not do that at all?

COMMISSIONER CARY: No. It's simply an evaluation of whether or not the action taken falls within the requirements set by the Investment Company Act of 1940, and not a question of judgment as to whether or not their judgment was sound.

MR. CAREY: It's compliance.

COMMISSIONER CARY: It's compliance.

MR. TRUEBLOOD: It opens up a very broad area of what we talk about as compliance examinations --

COMMISSIONER CARY: That's correct. Although curiously enough the investment company industry seems to bridle at the word "compliance".

(Laughter.)

MR. TRUEBLOOD: This is the thing, compliance with what?

MR. CAREY: Actually, I think, without knowing it, it's being done by CPAs in other areas.

MR. TRUEBLOOD: This is the thing that bothers me, about our failure to be receptive to these kinds of things, because it's always been my position that indirectly we are attesting to just one devil of a lot of things that we don't spell out in the four sentences of the standard certificate or

whatever it is, and maybe it's a matter of education amongst our 30,000 practicing members or whatever it is, to make them realize that they are in effect taking one devil of a lot of responsibility over and beyond what the words say as you take the stereotyped certificate and attach it to a financial statement.

MR. CAREY: I'm glad you expressed slight disappointment at our reluctance and you're not going to be quoted.

2a COMMISSIONER CARY: One of our big jobs, as I see it is to develop any improvements, within our own agency particularly, is to simply be pushing people, pushing them beyond what they have been thinking in the past, and I have pushed in a speech I made before the Independent Bankers Association a year ago, I really pushed, needled the investment company industry and similarly I didn't do that with respect to accounting but I can do it here in this way. It's really a gentle prod in a sense, because I just think that they ought to be much more aggressive, if they really have any idea, if this is one of their own precepts.

MR. CAREY: It seems to be a characteristic of the Carey family.

(Laughter.)

MR. BARR: That sharpened the needle.

COMMISSIONER CARY: That's right, absolutely.

MR. TRUEBLOOD: As we are moving in that direction, though, I suppose amongst ourselves, for the good of the public, the government and what-have-you, there has to be a rather careful delineation of the areas in which we permit ourselves to take positions.

COMMISSIONER CARY: Correct. Oh, no doubt. I am not questioning that second point. Once you overcome the reluctance to get into it at all, then I think that you have a responsibility to choose those things on which you have any competence to speak, and that's a different question.

I'm not questioning how far they have gone. I'm not getting into that kind of analysis here.

MR. CAREY: I think one cause of the reluctance is their legal liability and this is a pretty serious matter. We have a very unfortunate line of court decisions on auditor's liability, and whenever something happens a jury, in the light of the hindsight can easily see that the auditor should have done better than he did, he should have found it.

I think this has resulted in kind of a rigidity among the firms that makes them very cautious about putting their names on anything except that insurance policy language

that is fairly well established.

COMMISSIONER CARY: Sure.

MR. CAREY: I wish we could discover some way of loosening up, because, as we understand it, the English and the Canadians have far better judicial law on auditor's liability than we have, as you probably know.

We don't quite know how to go about it. Some people have wondered whether there is any statutory remedy. It would seem to us that is not the answer as far as common law liability is concerned. I can't think of any way except to keep fighting cases that are sound and getting the best expert testimony you can get.

Unfortunately, nobody wants to dispute this very much, so most of these things get settled.

You wouldn't have any suggestion along that line?

COMMISSIONER CARY: I don't really have any because I just literally haven't been involved in that phase of it ever in my life, either in practice in New York or elsewhere or teaching or here, so I just don't have any immediate reaction.

Andy, have you got any views on that field?

MR. BARR: We have struggled with the manner of expression in our stop order opinions to avoid language which

would put the liability or responsibility beyond what we think is reasonable. Of course, the most outstanding one was not a stop order, it was the McKesson case, and we tried to distinguish there between discovery of a gross fraud and minor discrepancies which we recognize audit procedure is not expected to turn up in every case.

MR. CAREY: In other words, you were not giving the courts any more ammunition than you felt was necessary.

MR. BARR: Than we thought was reasonable for the profession to assume. We have had to fight a tendency among some accountants to limit their responsibility more than we think they should.

I don't think the accounting profession can claim to be auditors if they disavow any responsibility for the discovery of gross fraud.

MR. TRUEBLOOD: I don't think there's any quarrel about that.

MR. BARR: But they're very cautious about the kind of language they put into auditing bulletins and we have had to watch that very, very closely.

MR. CAREY: It seems to me there's a valid distinction between responsibility, professional responsibility and absolutely unlimited financial independent. I mean, if the

thing gets to the point where any user can sue the accounting firm for the total amount of its loss claiming it relied on the statements, you'd get millions of dollars of damages, you'd wipe people out, and there's a distinction there.

I don't know any other profession that has to do this.

MR. TRUEBLOOD: What about the legal profession? You must have responsible lawyers who have given an opinion that didn't turn out, and yet you never hear about clients or the public suing lawyers.

COMMISSIONER CARY: Of course, they do have policies today, and there are situations within our knowledge of where law firms have in effect reimbursed clients for derelictions that resulted in damages to those clients. In fact, we have had a case within the last year, to my knowledge, in which there was a failure on the part of the law firm, I take it, to have their client, or have the shareholders or the Board of Directors ratify a contract which they were required to do under the law, and where, I think, the law firm turned back to the client a very substantial amount of money as sort of damages for it. Now, whether or not they were insured for that particular type of dereliction, I don't know, I didn't inquire.

You see rather frequently these cases but there are a great many more situations than there are law cases in which liability is imposed, or it is accepted, you might say.

MR. CAREY: Would it be a return of fee type of thing or real damages?

COMMISSIONER CARY: It would be in damages.

MR. CAREY: Damages?

COMMISSIONER CARY: Yes.

MR. TRUEBLOOD: Is there a distinction between the problems of the two professions in the sense that we are more directly exposed to the public than the lawyers?

COMMISSIONER CARY: I think because of your attest function you tend to have more vulnerability than we where our opinions -- it may not even be an opinion that is involved -- it is really only a letter presumably written by the firm, the law firm to the company, which the company itself may have in its files, it may not be a published thing; whereas, you do have this with your attest in the publication of the material, balance sheet, income sheet and so forth, notes.

Yours is much more subject to broad vulnerability than we are in connection with legal opinions.

MR. CAREY: It's very hazardous. It puts all the

firms and partnerships and personal fortunes of everybody at stake every minute.

COMMISSIONER CARY: Yes.

MR. TRUEBLOOD: I have often thought that it would be well to statutorily decree that Lloyds shall no longer issue insurance, and maybe the courts and the public and certain other bodies would revise their courses of action.

MR. CAREY: It shouldn't have any bearing, should it? The fact that insurance exists?

MR. LINOWES: It should not.

MR. TRUEBLOOD: It does, though.

MR. LINOWES: Mr. Cary, in your opening comments you made reference to what I gathered was the fact that you were directing your efforts towards placing greater reliance on the role of the accountant, if I may use such a term as that, that is the Commission. Do I gather from what you have indicated that you would tend to the practice of the Commission, accept the CPAs opinion on its face for the financial statements presented by the client?

COMMISSIONER CARY: I would think on a long term basis we ought to be moving in that direction. I think until you can accept the principle of uniformly high quality we probably can't go that far.

MR. CAREY: In a sense you do that now, except for desk review.

MR. BARR: That's what I was going to ask, because the Acts in effect say that we do this, but our review is intended to identify areas where we might have questions as to the quality of the work that has been done or the application of proper principles in the preparation of the statement.

Basically, we do rely on the profession so far as the financial statements go.

COMMISSIONER CARY: And I'm sure that review is less with respect to a firm or a particular partner of a firm where Andy, for example, has confidence.

Of course, if I were in the business, I probably might begin to differentiate between partners of firms as distinguished from just a firm. It all depends, because I know law firms well enough to say that they are not uniform in quality, and I am sure that accounting firms are the same way.

MR. BARR: We get pretty well acquainted with both lawyers and accountants.

COMMISSIONER CARY: That's right.

MR. BARR: As to their competence within firms and

the firm overall has an excellent reputation.

COMMISSIONER CARY: That's right. There isn't any question about that.

MR. TRUEBLOOD: I suppose you also get pretty well acquainted, don't you, Andy, with internal quality control procedures firm by firm which may temper your attitude about the performance of a particular partner on a particular job?

MR. BARR: We do.

COMMISSIONER CARY: We have those cases right before us even at the moment, that is right.

MR. CAREY: On Dave's point, you'd probably like Andy to answer this question related to your earlier remark, I was curious as to whether the thing gets better or worse or stays about the same with respect to independence of the CPA and with respect to the percentage of filings that you do have to challenge? Is there a trend that you are aware of, better or worse?

COMMISSIONER CARY: Andy can answer that technically but I can answer it one way, that probably for a while the trend might have been the other way in the sense that it depends in great part on the trend of filings we're getting.

MR. CAREY: Yes.

COMMISSIONER CARY: When you take the '61 and '62

floodtide of filings where so many companies were going to public for the first time, they frequently had accountants who were unsophisticated.

MR. CAREY: Yes.

COMMISSIONER CARY: Now, with that, if you were looking at it then at that time, you'd say all this past accumulated experience is probably not really carried over among them and therefore, if anything, our filings were in worse shape.

However, we are now in this year, 1963, getting less of a flood of filings, but they are mostly from experienced counsel and experienced accounting firms and of established companies which have been with the public before and therefore I dare say at this time you are beginning to have far less pressure than you had in the past. But when you had the whole real estate industry beginning to flow in, and all of these new problems in '61 and '62 that was scarcely typical of sort of an evolution.

MR. CAREY: How about the recurring '34 Act filings? Do you get much trouble?

COMMISSIONER CARY: Andy can speak to that much better than I.

MR. BARR: Let me add a little something to what Mr.

Cary has said about this period from about '59 through '62. At one time it reached a peak of 70 per cent of filings being from companies that had never come in before, and a very large proportion of that 70 per cent was being served by accountants, lawyers and a new fringe of underwriters with little experience, so we were experiencing there a revival of what the Commissioner experienced in its very early days, some 25 years before, going through the same problems of education of a new group of people. So we had a great deal of trouble during that period, and Mr. Orbach and I have talked before accounting societies all over the country about the problems of the new registrants.

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To get to the '34 Act, there are some of these that are now under filing obligation under Section 15-D where we have to look at them more carefully than the older companies, so we are getting that fairly well in hand due to the relaxation of the pressure of the '33 Act filings.

We're pretty well on top of it.

COMMISSIONER CARY: Right.

One thing more. If we move ahead now and the bill which is now before the Congress is enacted, which would then bring into our reporting requirement another substantial block of companies presently unlisted, still unlisted but

nevertheless subject to our reporting requirements, I think we might have a problem somewhat comparable to that which Andy uniquely had and the Corporation Finance Division also had in the period of '61, '59, '60, '61 with respect to certain companies coming to market for the first time, and I think then you will have new accountants having to be educated and companies which have never been to the public -- well, they have been to the public at one time or another, but perhaps it's been a Regulation A or an interstate offering or something like that, so they have really never had the kind of careful accounting relationship with the SEC or the public that we would require.

So I think we are going to conceivably, say, next year, if this happens -- I don't know whether the bill is going to go through, but I like to believe it will, and we will certainly have another problem somewhat analogous, if not wholly analogous.

MR. BARR: It will be very much the same problem.

COMMISSIONER CARY: To '59, '60, and '61.

MR. BARR: I might say too that this isn't going to be limited just to the small companies when this group comes in. We have seen this in '33 Act filings. The companies have been closely held and registered for the first time and ^{have} some

entrenched accounting policies that are geared to tax practices or the minimization of taxes that have had to revamp their accounting completely, and we are going to see some of that in this new group. They are waking up to the fact that tax law doesn't govern good reporting practice in every aspect.

MR. TRUEBLOOD: Let me move this over to our institutional problem for any ideas we might get, if I may.

MR. LINOWES: May I ask one question in the same area before we leave. It relates also to remarks you made in connection with the independence. You were relating independence of the accountant to the independence of the lawyer, and you made the statement, something to the effect that the accounting firm perhaps could afford to lose a client more than a law firm. Therefore you apparently placed emphasis on the economic aspects insofar as it relates to independence.

The question I have is: In your evaluation of accounting firms and their work, do you in trying to determine the degree of independence explore the economic "dependence" on the client that that particular accounting firm might have?

COMMISSIONER CARY: I don't really know. I would

think you probably don't do it in that form. Of course, if they own stock or otherwise -- I mean, that brings them into the category of having some relationship that would mar their independence. But let's say that would begin to force us into an analysis of primarily the small firms and we would get this small-firm-versus-big-firm problem which I can't speak to because I haven't had any direct experience.

I suppose that basically even big firms are beginning to have the problem in this sense, that the Des Moines office, let's say, of a big firm, after all, if accounting firms are anything like any other business operation, part of it is whether or not they have clients to keep them, and therefore I would suppose they well may be dependent on a big Iowa company as the smaller type of firm.

This poses, this isn't -- when I made this statement, I recognized that it isn't too easy to ascertain and I don't believe we ever analyze firms out in that sense, as to their dependence. I think we have on some occasions, at least as I recall an opinion or two, worked it through so that we literally find that the so-called independent certifier was simply an employee of the company. That's a different question.

Andy, you may want to summarize it.

MR. BARR: I could add a little to this, I think.

This is a very delicate area.

COMMISSIONER CARY: Yes.

MR. BARR: And the profession itself and our staff and some of our critics who think they are independent like some college professors will get very skeptical about the ability of an accountant to resist pressures of the management where most of his revenue comes from one large client.

I must say we look with particular care at some of these statements where we know that relationship exists. If you don't see any indication of influence altering the effect of the reporting, we're in no position to say that that man shouldn't keep the client.

MR. CAREY: I've always argued when this question comes up that there are people of character who resist even under pressures and even from the point of view of self-interest; if a man's spent a lifetime building up an accounting firm, his reputation is worth more to him in the long run than the \$10,000 or whatever it is.

So I wouldn't certainly hate to see a rule passed that you aren't independent if X per cent of your fees came from one client, or two clients or three clients.

MR. TRUEBLOOD: I don't think really one can relate it only to the economics of the situation. True enough large firms have a broader base therefor the loss of Client X, even though it's a major fee, rides it through, and even though it's in Des Moines, they can always close the office.

COMMISSIONER CARY: Yes.

MR. TRUEBLOOD: But they are alike in liability. There is a public relations kind of problem here. Certain firms are identified with certain major prestige clients and loss of those in a purely public relations sense of the word may be a hell of a lot more serious than the loss of the fee involved.

May I press back, because this institutional problem worries me very, very much in two ways. We have a recent analysis -- Jack, you can correct me on the figures, but I think the magnitudes are about right -- roughly 12,000 firms are represented in the Institute, of which 6,000 have one member in the Institute --

MR. CAREY: 8,000.

MR. TRUEBLOOD: 8,000. And another two or three have only two members in the Institute.

Now, we also have talked to a number of representatives of our principal users, bankers, corporate presidents,

investment bankers, and so on and without attribution I think many of them in effect say we have no alternative but to encourage our borrowers, our clients in the direction of a certain select group, be it 8 or 25 or 50 or 150 or 500 CPA firms.

MR. CAREY: CPA firms.

MR. TRUEBLOOD: Now, institutionally what can or should we do about it? I mean, we know damn well that these 3,000, except for one or two or three, wouldn't know an SEC filing if they saw one.

Should we splinter? Should we say, These are high level technicians and you belong in that group and the other 3,000 firms belong in another group? Should we go the route of accreditation or specialization, or do you just let the market place take care of it?

COMMISSIONER CARY: It's a nice problem. Of course, if you do set this sort of of a special accreditation, you prevent, really, the free flow of entry into the higher level of competent people, competent firms. I suppose as a principle that's a very bad thing. Therefore my own reaction would be I recognize the problem and I recognize also the inevitability of a considerable amount of concentration in the accounting industry or profession, the commercial banking

industry, if you like, and the brokerage industry, for instance, with which I have been dealing recently. All of these are going through measures and movements toward concentration in order to fulfil their obligations to the large-scale clients which they are destined to service.

But I suppose if I had a reaction it would be to believe that recognizing the inevitability of some increase in concentration and also an increase in the use of this top group of firms, nonetheless it would perhaps be unfortunate to go so far as to exclude the others.

That would be my reaction. I have never given that any direct thought.

Andy, have you got any views in this area?

MR. BARR: I spent a lot of time the last few years trying to protect the profession from the charge that the top 8 or driving all the others out of business. I have tried to educate the smaller ones and I think I mentioned to you the other day that some of the leaders of the profession have done the same thing, past presidents of the Institute, John Queenan, Jack Seidman and others, have done their best to alert the smaller practitioners to the fact that he must bring his level of knowledge up to where he is competent to do work. That's what the Institute is trying to do in their Education

Program.

MR. CAREY: We have an SEC course.

MR. BARR: To upgrade the quality of practice.

MR. CAREY: We also have a new practice review committee where reports may be submitted for criticism.

MR. BARR: We see some very fine work from the middle bracket and smaller accountants where their clients are of an appropriate size for them to handle it.

MR. TRUEBLOOD: Still generally speaking you are not talking about the bottom 8 or 10,000, generally speaking.

MR. BARR: No, generally speaking, we don't see them, that's right. We see about 5 or 600 firms.

MR. CAREY: Even in your broker and dealer situations?

MR. BARR: Broker-dealers add a little more but not very many more. I doubt if we have more than 1,000 firms all together.

MR. CAREY: Would it be possible -- I don't know if it's confidential or not -- you used to have a list of firms and it would help us perhaps in a way if we could identify people who were doing this type of work. As it is, you see, we don't know who they are. We might direct special attention to them in the way of seminars or courses or

exhortations of one sort or another, and if we knew which firms were of a size that they are likely to get into the SEC's orbit. We can't really tell that from our own records, though.

MR. BARR: I think the records of the courses on SEC that you ran this summer and you're repeating this fall and winter will indicate who are taking them and who are the SEC practitioners.

MR. CAREY: They've been very successful.

MR. TRUEBLOOD: And very well done.

MR. BARR: And I believe these courses have been successful.

MR. CAREY: They've been very well received by the people.

MR. BARR: The real problem is where a small firm attempts to do a bigger job than he's staffed to do and we see that weakness every once in a while.

MR. TRUEBLOOD: I think we are doing one further thing here which is a development of the past three years, various committees, and not only in this area, are encouraging a system of referrals, trying to make mechanics and machinery to get referrals on a lot of subjects around to a practical basis.

But this question of special accreditation or specialization, I should say, affects a lot of our areas, over and beyond, taxes, clearly, public offerings, management sciences. I don't care who these guys are in the smaller 11,000 firms, they probably can't be competent in more than one of the subareas as individuals.

COMMISSIONER CARY: Certainly. I agree.

MR. TRUEBLOOD: But we have no identification process.

MR. CAREY: Nor have the lawyers yet. They've been fighting it out for 10 years.

MR. TRUEBLOOD: Where do you stand on that? Wasn't that on the floor at your assembly even last year?

COMMISSIONER CARY: I think it was.

You know a lot of us don't take those problems very seriously in law. I mean, the American Bar Association, frankly, doesn't stand at the top of the law profession. Most of us don't really think about any of their problems and they seem to be almost like trade association problems by and large.

MR. TRUEBLOOD: Now you have kind of a supergroup by invitation or something or other?

COMMISSIONER CARY: The Law Institute?

MR. TRUEBLOOD: Yes.

COMMISSIONER CARY: I'm a member of that but that doesn't ever concern itself with these problems.

MR. TRUEBLOOD: It doesn't.

COMMISSIONER CARY: It concerns itself only with what the law is and should be in particular areas. It never gets down into the, shall we say, the associational aspects of law, or the economics, none of that.

MR. CAREY: Isn't it research and education?

COMMISSIONER CARY: Yes.

MR. TRUEBLOOD: Is this something we ought to be considering in a sense that some of the more difficult trying problems in accounting and auditing are of no interest whatsoever -- I hate to call them the bottom 10,000, but you know what I mean.

COMMISSIONER CARY: Sure.

MR. TRUEBLOOD: Is this helpful? You say the Institute's purpose is to define what the law should be and ought to be rather than what it is.

COMMISSIONER CARY: Yes.

It would be almost a counterpart to your Accounting Principles Board, wouldn't it?

MR. TRUEBLOOD: Yes.

COMMISSIONER CARY: I never made the analogy before but it appears to be.

MR. CAREY: It has occurred to me quite often that in the American Institute of CPAs we have under one tent and under one governing body and in a sense one staff the counterparts of the American Law Institute, the Practicing Law Institute, the Conference of Bar Examiners and a couple of other things and the American Bar Association.

COMMISSIONER CARY: Yes.

MR. CAREY: I don't know whether we're right or wrong.

COMMISSIONER CARY: It's all under one umbrella.

MR. CAREY: Under one umbrella, all these different functions.

COMMISSIONER CARY: Yes.

MR. CAREY: I am not sure whether it would be better if they were spread out, or worse.

COMMISSIONER CARY: It's a difficult question.

MR. CAREY: We do get involved with the trade association aspects of the practice and with the politics of 3,000 small guys who vote and in a way I have felt that perhaps this is an inhibiting thing and that if we did our research and education under other auspices we might be able to

do it more rapidly and more effectively.

The people who are concerned would run it and maybe that's the way it ought to be.

COMMISSIONER CARY: Of course, I'm very critical of lawyers going into fields where accountants have more competence. I was almost the reverse of my people who wanted me to write. I might have really attacked the bar and said they had no business. Some of them are trying to, let's say, make out income tax returns. They're not qualified to do so. And other things. I'm thinking back about 12 or 13 years ago, and I think that that is a -- I don't know if they have ever assumed, or shall we say recognized their limitations, which I think they well should.

Their role is really working conjunctively with members of the accounting profession and not, shall we say, in competition with some of them.

So that is one point.

Now, as to this thing -- I think Irwin Griswold though has gone -- I'm not sure about this -- Has Irwin gone so far as to say he thinks there ought to be a tax bar, in effect? I'm not sure whether he has or not.

MR. CAREY: I don't believe he has.

COMMISSIONER CARY: I know there have been a number

of people who have been speaking to that.

MR. CAREY: Some people have.

COMMISSIONER CARY: Similarly, I suppose they would say there ought to be a securities bar in the same way, only those who would be qualified to work, let's say, on registration statements and the like.

MR. CAREY: There is, of course, a Treasury Bar.

COMMISSIONER CARY: There is, but that's a conservative --

MR. CAREY: It's a permissive enrollment.

COMMISSIONER CARY: A limited field. Yes.

In thinking in terms of law, I am sure there has been considerable amount of talk in that direction, but I really haven't given it enough thought to speak to it very -- at all knowledgeably. I don't really have any knowledge on it.

It really hasn't interested me very much, to be perfectly frank. I'm not interested in foreclosing other people from entering in. I suppose the teacher in me would like to see them develop in these directions.

MR. LINOWES: Mr. Cary, on that same line in terms of expansion of lawyers' service, do you have any feeling about the expansion of the accountants' services, especially

in areas of management science? What is your own feeling as to how far we should go in our position?

COMMISSIONER CARY: Yes. I suppose -- I think I see some disadvantages but on the other hand I would think that a broadening of the accounting profession and its role is all to the good, myself. It does present some problems when it comes to the attest function and the reliance upon it because, as you begin to move from judging, let's say, the economic consequences of something in terms of the facts into sort of beginning to judge the quality of performance you really don't have the standards to attest to it, and therefore I think you probably have to be very careful, and that is why I drew a line in my discussion on the investment company matter.

You have to be very careful not to attest to things beyond your competence, beyond anybody's competence, as a matter of fact, any one person's competence. But I think if you recognize that line, there is no objection, it seems to me, for their going into a broader number of fields. Of course, it produces, in turn, an exceedingly high degree of specialization, because I am sure the people working with computers and the like are going to have to be a specialized group within a big accounting firm, and therefore it has that

further disadvantage that you lose a little flexibility as a consequence.

I suppose at some point I begin to urge that a line be drawn when big firms become so much bigger and when they begin to be so specialized that it really becomes a large-scale, multi-state institution. I think at some point along the way accounting firms, like brokerage firms, like industrial concerns ought to recognize the economic and management limits to their size.

But that's moving into another problem in this, but it does touch on it because these big firms particularly I think have got to watch this.

MR. LINOWES: Touching on the area that properly falls within the purview of the accounting profession, we certainly belong in all matters dealing with accounting.

Do you feel that there are other segments of society that have an equal responsibility with the accounting profession in accounting principle matters?

COMMISSIONER CARY: I don't --

MR. CAREY: You mean like management?

MR. LINOWES: Management, the government. Does he feel the government really has an interest in helping evolve accounting principles, for example?

In other words, are there other segments that have a positive, creative type of responsibility? Right now, we, the accounting profession have taken that on ourselves, but it seems to me accounting permeates all of our endeavors.

COMMISSIONER CARY: Right.

MR. LINOWES: Are some of the other segments of society, therefore, charged with, morally charged with some responsibility for evolving accounting principles?

COMMISSIONER CARY: I don't know that they do so consciously. Of course, each group is thinking about its own problem, even if it's within the government. I mean, whether the Internal Revenue Service is thinking in terms of, you might say, immediate receipts ought to be subject to taxation, regardless of their traditional accounting character, or whether it is the FCC thinking of it from a certain type of rate or another one of the agencies, or government contracts, or Defense Department thinking of it differently, you've got all of these government institutions thinking in terms of a narrow approach, and then you come down to us and I suppose we're the least, we really have the least axe to grind of any government institution.

Now, when we come to us I think we have that responsibility. We have been exercising it in large part, I

think, through the excellent efforts of Andy Barr, and I said, in this little talk that Mr. Carey is familiar with and is going to be published, that I feel that there is a certain responsibility on us to be pushing, you might say, accounting principles ahead, although I don't think the government should take it over. I don't think we're -- I don't think we're the answer to all these problems, and I am reluctant and conservative about that.

I do think, however, we should lend some support, even substantial support to the evolution of accounting principles and in that way -- and I stated there, lest there be some doubt in view of these positions we have taken -- that we adhere to that approach and I still adhere to it.

MR. TRUEBLOOD: But you think it should still not be directly participating?

COMMISSIONER CARY: I don't think it should be the dictator.

MR. CAREY: In other words, you would push us --

COMMISSIONER CARY: That is correct.

MR. CAREY: -- to do things, but you wouldn't necessarily do them yourself.

COMMISSIONER CARY: That is correct.

MR. TRUEBLOOD: May I press the participative

aspects of this?

COMMISSIONER CARY: Yes.

MR. TRUEBLOOD: I mean, to say, assume the Accounting Principles Board might some time work, should you have representation --

COMMISSIONER CARY: On it.

MR. TRUEBLOOD: -- on it?

COMMISSIONER CARY: I don't know, Either we should have representation, have a very large voice or not have representation. I don't know. I'd hate to speak to that, whether or not they should.

I would say it would not bother me to see us represented on that. Now the problem would come up in this form, as I see it.

Assume that our representative, be it Andy Barr or another person, expressing what he believed to be the government, SEC in this case, point of view, finds that that view is not adopted. Does that place us in a little more embarrassing posture when it comes to our putting into effect the principle that is arrived at?

My own view is: probably it really doesn't. I'm not oversensitive about the thing, but it merely would give the group some advance knowledge of how the SEC was thinking,

which might affect their judgment to some extent, moderate it or what-have-you or strengthen it, and I would still think that the Commissioner itself, for example, ought to have independence in a necessary case to express its views contrary to those arrived at by the Accounting Principles Board. I think it should do so infrequently. I didn't know and I can't yet -- I wish I had had about six months, for example, to think through that investment credit problem in order to arrive at a satisfactory conclusion and in light of all of the other points to be considered, but we didn't have that much time and therefore -- we're a group of, let's face it, primarily lawyers, corporate lawyers and we thought that technical approaches could be taken in an area of that kind and we didn't think it was quite as open and shut as that and therefore we obviously demonstrated reluctance to go along with the more finite position taken by the Accounting Principles Board.

That doesn't mean in principle that our views, A, could not be expressed earlier and that we shouldn't in principle also have a bias in favor of trying to support the Accounting Principles Board or any other institution of like kind that gets into that field.

MR. TRUEBLOOD: By the same line of reasoning, then,

not negating our professional responsibility, our primary professional responsibility in any way, I presume that you would say that in the formulation of the principles by whatever group we ultimately come up with should include or might well include active participation by other parties of primary interest such as corporate management, corporate lawyers?

COMMISSIONER CARY: Right. Absolutely. And even government.

MR. CAREY: I have some doubts. How would it work, for instance, Mr. Cary, if Andy, say, were a member of this Board and he voted his convictions and the Commission didn't back him up on it?

MR. BARR: I've been overruled by the king.

(Laughter.)

COMMISSIONER CARY: I would think in a case of that kind --

MR. CAREY: We could then claim that the Commission's representatives went along with this and I would think it would create a problem.

COMMISSIONER CARY: I would think that in a case of that kind, if you have a responsible person like Andy representing you, that he probably wouldn't vote as such in a

case of that kind where he didn't think he had the support of the Commissioner.

MR. CAREY: This would mean in effect that he wouldn't vote until he was reasonably certain what the Commission's thought and this, it seems to me, is perhaps not very good.

COMMISSIONER CARY: He could express his views. He would express his views in the meantime.

MR. CAREY: This would mean in effect that the Board couldn't issue anything until it had been cleared with the Commission?

MR. TRUEBLOOD: I know certain other members of the Board who don't vote until they find out what somebody else thinks too.

(Laughter.)

MR. LINOWES: We're discussing really accounting principles and its theory from an academic aspect when you referring to the government point of view.

COMMISSIONER CARY: A particular agency's point of view.

MR. LINOWES: Yes, or a particular agency's point of view.

COMMISSIONER CARY: There isn't a government point

of view.

MR. LINOWES: Is there a point of view of a particular agency that should be any different from objectively conceived accounting principles theoretically developed?

MR. CAREY: It all depends on who's looking whether it's objective or not.

(Laughter.)

MR. LINOWES: Yes, but I would assume, if it's theoretically developed, there could be some unanimity of feeling, and I can further see where very clearly in specific cases a commission or a board could come out with an expression of opinion contrary to what the theoretical principle is.

I don't see any necessary conflict there, frankly. That is, if important agencies' representatives sat on professions' boards and helped developed these principles. In this case, the Commission generally deals with specific cases, and there are so many important circumstances that relate to each case that even though they may go against the position taken by an Accounting Principles Board in a specific case it would not refute the objective that I think I would like to see evolve, I don't know, or at least that we should consider evolving, that is the participation of

different segments in the development of Accounting Principles.

MR. CAREY: I would like to speak to that and then ask Mr. Cary and Andy if they would give their view on it.

It has been suggested many times and it is recurringly suggested that so many people have a stake in this thing that they ought to be represented in the decision-making. I have a feeling that if you have corporate management, the SEC, the academic fraternity, the large firm, the small firm adequately represented in this situation you get a divergence of viewpoint which is going to make progress extremely difficult.

I don't think we're really certain. It seems to me what we ought to be trying to do is to decide what independent auditors can certify to, not what kind of accounting business ought to use for its purposes or what the Federal Power Commission ought to use for its purposes and whatnot.

Now, in doing that, everybody at interest ought to have voice. Their opinion should be solicited. I'm afraid we'd get into kind of a logjam, a stalemate where you never get anything out, if you've got every organization, financial executives, the internal auditors, the AAA, the NAA, the agencies and everybody else in the act, including top management of the corporations. It would be an almost unmanageable thing,

process.

We have a hard enough time getting the independent auditors to agree on anything.

COMMISSIONER CARY: Referring to that problem, your point, and your question, I think that you are getting down to really where we are no longer in theory, we're really in practice, in practical terms, and can you achieve anything with this cross-section?

It is true so many times that if we had to get a cross-section of every one we'd get nothing done, and it is also true, happily, in many institutions, and I think it's true in yours -- it's not so much true in the American Bar Association, unfortunately -- that if the leadership of it are thoughtful people they really express a broader point of view than the various segments of the organization. I don't think this is true of the American Bar Association; I think it is almost the reverse, although I wouldn't want to be quoted on that.

If you have, if you are fortunate enough to have your leadership sort of the whole being greater than the sum of its parts, in this sense, the leadership is of a higher caliber than its greatest parts, then I suppose, really, the best thing to do is to -- in most instances, to allow that

leadership to go ahead and in a smaller group, perhaps not truly representative in one way, but somehow representative of leadership, to set forward standards.

That's probably the only feasible way to do it.

MR. CAREY: With the time pressures which we feel and which I think you share toward progress --

COMMISSIONER CARY: Yes.

MR. CAREY: -- in my job I'm so conscious of administrative obstacles, of mechanics --

COMMISSIONER CARY: Yes.

MR. CAREY: -- that my intuition says, Let's give somebody the power to do something. And in this connection you may have heard -- I'm sure Andy has -- of a proposal that is now before our Council next spring, and I wondered if you have any comment -- that in effect it be required by the Institute as a part of its Rules of Ethics that when the Accounting Principles Board has spoken that shall be generally accepted accounting principles for the purposes of an auditor expressing an opinion on statements, and if he departs from it because he believes the departure is sound he must justify the departure in his opinion?

COMMISSIONER CARY: From the principle of the Accounting Principles Board?

MR. CAREY: Yes, sir.

COMMISSIONER CARY: I personally think that might be a good development myself. In other words, it's the only way to be pushing toward a sort of higher standard and making them -- it gives certain flexibility because it doesn't necessarily make them meet that standard, but it makes them justify failing to meet it, and I personally think that that is an approach that has a great deal of merit.

As I have said once or twice to Andy, I am not sure but what we ought to think in terms of forcing and adopting that approach too, sort of in effect giving it some further imprimatur, we, the SEC.

MR. CAREY: It would put you in the position of either having to accept an abnormal form of certificate in a case where the circumstances were so unusual the auditor was right and the Accounting Principles Board was wrong and he could justify the departure.

In that case you would either have to accept it or maybe unfairly penalize the company by sticking to the unqualified opinion.ruling.

COMMISSIONER CARY: Of course, we could --

MR. CAREY: Would that pose any trouble?

MR. BARR: I can see a little trouble in trying to

force all accountants by a rule of this kind -- it would be violating their code of professional ethics if they didn't do this. The Practice of the Accounting Procedures Committee and the Board in all its pronouncements up to now is that these decisions have to be tested in practice to see whether they do contain challenging subjects.

There have been a few in the past that have been ignored, --

MR. CAREY: That is true.

MR. BARR: Pretty generally.

MR. TRUEBLOOD: And in the present.

MR. CAREY: Unfortunately.

MR. BARR: Maybe unfortunately, but maybe it indicates too hasty decision or failure to convince.

MR. CAREY: I don't think 'hasty' would be an appropriate word in any situation I can remember.

(Laughter.)

MR. BARR: In the old Accounting Procedures Committee it was charged to a too hasty decision in some cases for getting out releases that were unnecessary.

MR. CAREY: Let's assume, Andy, that with a responsibility of this kind on it the Board isn't going to be hasty or ill-considered. It is obviously going to consult

everyone.

The idea that we put out a pronouncement and you can follow it or not follow it until it has gained general acceptance means in effect general acceptance by corporations, and this seems to me to be a peculiar development that the corporations are setting the standards by which auditors express their opinions and you get around backwards.

I mean you have substantial authoritative support for something because so many companies have done it, and it may not be at all what's considered the best accounting in light of the circumstances.

MR. TRUEBLOOD: There's another underlying --

MR. CAREY: I'm talking about comparability in uniformity which Mr. Cary did in his speech.

COMMISSIONER CARY: Yes.

MR. CAREY: And how do you get at it with any speed?

MR. BARR: With all deliberate speed.

MR. TRUEBLOOD: But isn't there a larger distinction? Typically the work of our committees, both in auditing and in accounting have been a matter of codifying practice as it has come to be as distinguished from prospectively saying, It shall be.

MR. BARR: Yes.

MR. TRUEBLOOD: Now, I think there is a significant distinction here in that a pronouncement of the APB or what-have-you which pulls together the pieces of practice and says, We've had enough time to decide and this is it, is one thing, making an announcement on the de minimus investment credit problem is quite another.

MR. CAREY: Because that was new.

MR. TRUEBLOOD: Because it was new and we had no experience and we had no trial and error, you see.

MR. BARR: But that was seized as the ideal one on which to get out a pronouncement and make everybody do it one way.

MR. TRUEBLOOD: But what should be the role --

MR. BARR: Or the test where the Commission kicked over the traces --

MR. TRUEBLOOD: That's right.

MR. BARR: -- and said, well, look, we don't know enough about this. We don't know enough about this to have to decide only one way is the answer.

MR. TRUEBLOOD: But don't we have to decide what our objective is, whether it is retrospective or prospective in these areas, before we decide how we are going to deal with

the pronouncements as they come off the press.

MR. BARR: As you see the application of this proposal, and I've talked to a lot of people about it, you know, and while a lot are in favor of it --

MR. TRUEBLOOD: Even though you're not a member of the Executive Committee or the Board.

MR. BARR: I hear these things. That's why I go places and keep my ears to the ground.

MR. CAREY: Did you say you're not in favor of it, or didn't you say?

MR. BARR: I was asking you now. My initial personal reaction is that it may divide the profession and create problems that are worse than the cure expected.

I was going to ask you, on this investment credit, would you say that what you are proposing is the same thing the Commission said in our release on the investment credit, that we'll take ^a qualified certificate if it's not in line with the Principle Board's solution?

MR. CAREY: Not precisely that. I would hope that would never happen again. What I had in mind --

MR. BARR: What you are saying this proposal is, is that if anybody wants to do it different from the pronouncement of the Board they have to justify it. Presumably

it would go this far that you would say that failure to do what the Board says would mean that you would have to say that this is not in accordance with generally accepted accounting principles, but that's going to give Mr. Spotcheck his opportunity to say that price level adjustment accounting presents clearly what is not in accordance with generally accepted accounting principles.

MR. CAREY: I'm not precisely sure. No one has yet--

MR. BARR: I have trouble seeing just how this will work in the area of practice that we have to administer.

MR. CAREY: As I see it, and Mr. Trueblood could say in certain circumstances, it is not that this is not in accord with generally accepted accounting principles but that he couldn't say it was in accord with generally accepted accounting principles. He could say he believes it's in accordance with sound accounting principles in the circumstances although it deviates from the decision of the APB on the ground that, just the circumstances are such and such, which he believes is better and he therefore expresses the opinion that the statements clearly reflect.

This shouldn't cause you too much trouble if you agree with him.

It's just as Mr. Cary said. It's an indication, a

revelation that the standard has been deviated from.

MR. BARR: I know what you're trying to get at and I am sympathetic with the notion that we should try to get rid of these differences. I can visualize a period, if this kind of thing goes through, where we will have a wide variety of certificates.

MR. CAREY: I think that is correct.

MR. BARR: And our problem, I think, in the Commissioner will be which of these varieties are acceptable? We have enough trouble now with insurance companies, bank holding companies and others, and you're going to multiply this diversity of certificates, I think.

MR. CAREY: You've got less trouble on the surface now but more underneath, because you're accepting unqualified opinions on financial statements, which treat the investment credit in either way and therefore reflect in different ways, minimally, I'm sure.

MR. BARR: Everything is governed by ^a materiality test...

MR. CAREY: Yes.

MR. BARR: Before any accountant will take an exception.

MR. CAREY: That's right, but let's say it weren't.

MR. BARR: Are you saying the materiality test doesn't apply to this?

MR. CAREY: Oh, no, no. It does. Materiality goes right through.

MR. BARR: That's one thing about the investment credit. I don't think we've seen more than one certificate that has an exception.

MR. CAREY: We're aware of that.

MR. BARR: And the amounts involved are so small in most cases that no accountant would mess up his certificate.

MR. CAREY: That's why, after the shouting we've had --

MR. BARR: We've had a lot of shouting over this, but it hasn't added up.

MR. TRUEBLOOD: Andy, can I press this -- Excuse me, are you finished on that? ✓

MR. BARR: I probably have said too much already.

MR. TRUEBLOOD: I want to press a question. Why the standard opinion? For you or for us?

MR. BARR: Why?

MR. TRUEBLOOD: Why? Why this stereotyped opinion?

MR. BARR: We went through that --

MR. TRUEBLOOD: I know.

MR. BARR: -- with McKesson a while back and the effort was to reach some uniformity of expression. It is supposed to indicate that accountants are thinking generally along the same lines, in arriving at that conclusion.

We've had some trouble identifying all of those lines that lead to that conclusion, I'll grant you.))

MR. TRUEBLOOD: But it takes away just one devil of a lot of flexibility in relation to things that maybe people should know, or might be helpful to know. I admit the appraisal practice is much more difficult.

MR. BARR: We had to come out on expressions of opinion about an audit in the opening inventory problem. Why? because we were reading words to say one thing and when we put our foot down and released 90 the Commission felt it was time to stop this variation in wordage and make people say what they meant. V

MR. TRUEBLOOD: I think this is Jack's point. There are more cases than you might like to see.

MR. BARR: Well, let me explain what happened after we got 90 out. I had quite a parade of people through my office on this business of an opening inventory. There were a lot of cases pending and we said we're going to apply them right now, not delay it. So we had partners from the same firm

coming in who said that with the foregoing explanation it was not an exception and that he could take it out and give a clean certificate.

A partner from the same firm would come in and say, Well, in his case, with the foregoing explanation, it is an exception and I will not give a clean certificate.

COMMISSIONER CARY: On practically the same facts.

MR. BARR: On the same facts.

So we had to get that thing cleared up.

If you can say that the statement is in accordance with generally accepted accounting principles, you ought to have a fair idea of what you are saying. If we put a variation of words in these certificates we are going to have to go through the same thing we have with this audit representation.

How much variances do these make?

MR. CAREY: You've got to look at the other side of the coin.

MR. BARR: That's why the Accounting Principles Committee or Procedure Committee was set up, to try to identify these things that ought to be done about the same way, and for the most part it works.)

MR. CAREY: When you get a standard opinion of this

sort, it is either signed or not signed. Then in the gray areas where there is a little doubt as to what is right, point one, the accounting firm is under considerable pressure because if he puts in an explanatory paragraph or has an exception why he is jeopardizing his client's filing with you. So there is an awful lot of pressure on him to compromise and somehow get under the wire.

But there is more than that. It seems to me more importantly that the company can -- well, its sales can drop a million and its net profit only drops \$10,000, because it decides to defer its maintenance, to not replace some heating, fire the advertising agency, and do a lot of things. It still gets a clean opinion, because all those things really happened.

MR. BARR: Mr. Cary mentioned all of those things that can happen. They're administration of the business.

MR. CAREY: Personally I would like to see CPAs read and almost required to make some observations, other than their two standard paragraphs, so that a reader of the statement gets some conception of why.

MR. BARR: In the prospectus we require an explanation of the variations from year to year. That's been a requirement for many years and well observed.

MR. LINOWES: Do you think one of the problems in this basic problem --

MR. BARR: Those are changes in business conditions, changes in managerial judgment as to how they're going to run the business.

MR. CAREY: That's correct, but the financial statement rarely shows to an ordinary investor or even to an analyst.

MR. BARR: They show a lot if you look at them carefully.

MR. LINOWES: We are trying to make one statement be all things to all men and maybe our approach has to be to consider multiple statements for a particular business from accountants.

I can see very clearly where from your point of view looking after the investing public's interest you want certain things expressed and feel that they could be and are material for your purposes; whereas, from another point of view, perhaps the credit lender, they might not be material.

Do you think that one of the solutions might be the development along the line of presentation of several statements?

COMMISSIONER CARY: For different consumers? }

MR. LINOWES: For different consumers.

MR. CAREY: Well, it's done. It's done regularly.

MR. LINOWES: It's done, but should that be the direction in which our whole profession is going?

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MR. TRUEBLOOD: I'm curious, let me say the motivating influence is different perhaps, but in effect what we are now suggesting or tossing in the air is that the common ordinary investor needs more than briefed up set of financial statements with a stereotyped opinion in order to have any judgment about this.

MR. CAREY: This brings up the proposal that reports to stockholders be consistent with filings with the Commissioner.

COMMISSIONER CARY: Getting to one point that you made a moment ago, Mr. Linowes, I have never given this any thought, but I have asked myself occasionally whether even the Commission ought to ask for multiple statements.

That is, if you took several major areas which are following one accounting principle which yields one result in terms of earnings per share and another principle would yield a different and larger earnings per share, I just wonder whether or not at times we shouldn't in effect compel it to be indicated both ways.

That would lead to multiple statements, wouldn't it,

within our own, as one consumer in effect.

MR. BARR: Mr. Greer, I don't know whether you know Howard Greer or not?

COMMISSIONER CARY: I don't know him.

MR. BARR: But he is a very vigorous speaker and leader in the profession for a long time. He spoke at Philadelphia about five years ago on this problem and he repeated practically the same speech at Stanford this fall at the Accounting Association Meeting. He was on the same program with Leonard Spotcheck, incidentally, but he was the last speaker.

He proposed that you take a -- plot a path with the figures developed on the most conservative basis and then another path applying the opposite views and plot that whole business, and then you draw a line through the middle and you might have the answer.

(Laughter.)

MR. TRUEBLOOD: This is going back and it's in the area of detail, Mr. Cary, but I'm kind of curious about this relatively small group of yours that decides what the law should be.

Did you indicate this was the magnitude of a thousand or less, numbers? The American Law Institute?

COMMISSIONER CARY: The American Law Institute.

By the way, they don't decide what the law should be, they come up with recommendations as to what the law should be which are not necessarily accepted or even examined by courts.

MR. TRUEBLOOD: But they do, for example, get into the drafting of model laws on a subject basis?

COMMISSIONER CARY: That is correct. I think the most creative one in recent times has been the model criminal code.

MR. TRUEBLOOD: Is this super group or however you referred to it by invitation, by examination, by application?

COMMISSIONER CARY: Purely by application, and I don't know how people are invited into it but I've had maybe 10 of my friends under my sponsorship become members. It is usually somebody who has a fairly good intellectual background and who is either a -- probably an exceptional practitioner as well or a professor and those are the people, in a sense people who have proven themselves and have some intellectual ability by and large who are the ones who are made members of it.

MR. CAREY: Do their dues support its activities?

COMMISSIONER CARY: Not really, no. They get funds

from research -- from foundations.

MR. CAREY: Do the members get any special privileges in the way of publications not available to others?

COMMISSIONER CARY: No, those could be available to anybody at a price, so there's nothing in that sense of that nature, except insofar as they have meetings.

MR. CAREY: They do have meetings?

COMMISSIONER CARY: They have an annual meeting which is about three or four days at the Mayflower every year, late May, and they have committees meeting throughout the year and they have a special committee, for instance, meeting on maybe what changes should wrought in the model criminal code, and that group would have met over a period of substantial time.

I might say that this organization, I don't know that it has immense effect. I have sometimes raised a question about whether or not it's worth the time.

Learned Hand, for example, was a very active member of the American Law Institute and I always thought that Learned Hand could have spent his time more profitably writing three or four other speeches and I think they would have had more impact than watered down versions of law which the American Law Institute produces.

That's a personal opinion of mine.

MR. TRUEBLOOD: Do you have administrative or political problems on membership or is it pretty well accepted that you get in if you're accepted?

COMMISSIONER CARY: No, no problems.

MR. CAREY: Do you have a large staff?

COMMISSIONER CARY: Relatively, almost to about one man in effect. Well, he's got assistants.

MR. CAREY: No research?

COMMISSIONER CARY: No research staff. We have had a succession of very good research directors. One died recently and that was Judge Goodrich, the Dean of the University of Pennsylvania Law School and a Judge of the Court of Appeals as well.

Now we have a professor who is a colleague of mine
Herbert ?
and one of my closest friends, Wechsler of Columbia University.

MR. CAREY: Is that a full time job?

COMMISSIONER CARY: No, it's about a half time job. In other words, he still retains his professorship.

MR. CAREY: The actual work is done by a volunteer committee?

COMMISSIONER CARY: The actual work is done -- He supervises, and he's an exceedingly accomplished man, I think

much more than Judge Goodrich was intellectually, I think probably, but he would supervise and try to get these projects going. He would also talk to the foundations about getting money for it and he would participate in all the meetings of the various committees relating to each of the projects which were under way.

MR. TRUEBLOOD: I'd like to go back to something else, again, that we talked about a bit earlier, but then I want to extend it over a little bit. You made the comment, Mr. Cary, that within limits the extension of our interests and areas of competence was perhaps not only suitable but required. Some of us on the long-range group feel pretty damn strongly about this, and there are many in the profession who still regard with holy awe the neat discipline that come computers and integrated information systems that it really isn't a debit and credit discipline any more; it becomes more a matter of algebra.

What we have thought of which gets us into the business of financial accounting as a discipline is not going to have nearly the separateness or the apartness within management that it has had. Therefore, in order to do a financial statement, which I presume there will always be, the auditor must have an understanding of a lot of things and

a lot of systems and a lot of methodologies that haven't heretofore been necessary and I gather from what you have said that with this you agree.

COMMISSIONER CARY: True.

MR. TRUEBLOOD: But now let's move over into management services which we have mentioned only casually. I think it has been generally accepted that we might be expected to consult and advise in our area of expertness -- financial accounting.

Do you have any feeling that it is inappropriate for us to extend our consultation and advice into these related fields but which are not necessarily related to our end product: the financial statement?

I think that is pretty rambling.

COMMISSIONER CARY: I get the question quite well. I don't know that I have an answer.

Now you may well have a group within your profession who are better trained to, say, go in and examine a company in marketing terms and financial terms and other things than most any other organization, with the possible exception of one of the management engineering firms. Now, should you get into it?

I don't suppose this would be an area where the

attest function would have any role.

MR. CAREY: It all depends. It might.

COMMISSIONER CARY: You think so.

MR. TRUEBLOOD: It might.

COMMISSIONER CARY: It seems to me a report by a big accounting firm on a particular company would be, might be of value but I am not sure that I would think of it as something on which there would be anything more than an opinion of that firm which could not be based on any precise standards comparable to those that you apply in connection with the attest function.

Now, then you get the question, the only question I would say, if you are qualified to do it, why not, with one limitation, and that is the other problem that I am always worried about today, that recognizing the need for firms to grow bigger they may become so big and so varied in their roles that they really don't stand for anything, and they can achieve no controls. So that it is really sort of a group of individuals with varying degrees of ability and integrity and responsibility under one umbrella using the same name.

O f course, I suppose I am slightly Jeffersonian in my approach to bigness but not really in the sense that I

worry about at some point units, whether they be industrial concerns or accounting firms or law firms or brokerage firms, reaching a point where they no longer stand for anything.

That's the only way I can answer your question.

MR. TRUEBLOOD: May I press you a little bit further?

COMMISSIONER CARY: Sure.

MR. TRUEBLOOD: And remove bigness and say we have here a competent, respectable, ethical office of 100 thoroughly expert/ⁱⁿfinancial accounting but for reasons of self-interest and necessary internal education and information they have, oh, say, a mathematical statistician. I can relate this directly to the audit process, I can relate it directly to the measurement process, or what have you.

COMMISSIONER CARY: Yes.

MR. TRUEBLOOD: Is there anything wrong in that environment with his undertaking, let us say, a sampling determination which has nothing directly to do with the financial process?

COMMISSIONER CARY: I can see nothing wrong.

MR. CAREY: Like the inventory or what have you?

COMMISSIONER CARY: I see nothing wrong. I am trying to ask myself what reason would someone give for objecting to his doing it. I don't know.

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MR. CAREY: We're looking ahead, say, 20 years, and I have a reasonably strong feeling that the individual certified public accountant 20 years from now will know something about statistical sampling and internal information systems and computers and all the men in this firm will at least have had a basic background in all aspects of this measurement process. It's getting so important I'm afraid maybe if they don't, they're dealing in a little narrow area of balance sheets and income statements and they may not be able to deal with them very effectively if they don't know what lies underneath.

So I don't think it's the congeries of unrelated specialists that will evolve. I think it will more likely be an enlargement of our basic discipline, if I may put it that way, with all qualified responsible people.

I think it may well result in a smallening of firms instead of a largening of them, because there would be so much need for so many hands as the machines take over a lot of the data processing and even auditing steps, which some people, great bodies insist they might do.

I don't have much trouble with any conflict between so-called management services, if you define it the way I mean it, but we got out an opinion from the Ethics Committee

on independence recently where they just set up their general standard that if a situation involved a conflict of interest the man's not independent, or if it doesn't involve a conflict of interest there's no reason why he shouldn't be.

MR. BARR: We've talked about that and I've been pressed for answers on that question. The distinction that I think both of us have made in articles and answers that we have to give every day is that if this management service business reaches the point where the accountant is running the business why he'd better make up his mind which way he's going.

MR. TRUEBLOOD: No argument.

MR. CAREY: No argument.

MR. BARR: But I'd say men who can avoid that kind of a conflict don't have any trouble.

MR. TRUEBLOOD: But we have many of our own, presumably, responsible members of the council who rise up on the slightest provocation and say, Okay, if you've got to have these people in the audit, put them on the payroll and use them, but not a dollar of consulting fee.

This is a defensive argument.

MR. BARR: What is it they're saying?

MR. TRUEBLOOD: Well, they say. Assuming you need

a mathematical statistician in order to accomplish the audit or to understand the underlying systems?

MR. BARR: All right.

MR. TRUEBLOOD: This is okay, but don't let him consult in the management consulting, management engineering or management services sense of the word.

MR. BARR: Oh, I see.

MR. TRUEBLOOD: Outside the audit field, right?

MR. CAREY: That's defensive and considered ultra-conservative, I think.

MR. TRUEBLOOD: Well, it is, but I want to be sure of it.

MR. CAREY: I have several questions that I have thought of, if I may, because the time is growing short.

COMMISSIONER CARY: Sure.

MR. CAREY: We wish you could stay with us after lunch, but I guess you're busy too.

COMMISSIONER CARY: I really think I'd better get back.

MR. CAREY: One of them has not really too much direct relationship and I stumbled in the course of our investigations on this long-range business on a book called Pricing Power and the Public Interest by Gardner C. Means.

Has this crossed your desk?

COMMISSIONER CARY:; I know it, but I haven't read it.

MR. CAREY: Then yesterday the New York Times announced that the steel companies had been subpoenaed to appear before a Grand Jury in connection with prices. That's what this book is about. It's an analysis of the steel industry, and he's got -- I don't know how influential he is. I know he collaborated with Burling years ago on a book that had a lot to do with the Securities Acts, I think.

COMMISSIONER CARY: Yes.

MR. CAREY: And his point generally is that prices ought to be the variant factor in determining corporate performance rather than profits. You ought to get a fair return on capital, but that management ought to be rewarded and the government should do things to see that the ultimate distribution of wealth as widely as possible is the objective of the corporations. He's got a lot of gimmicks about incentives and so on.

Is this just wild-eyed thinking or is there in Washington a real movement that way? It ties in a little bit with what some of our other consultants have said.

COMMISSIONER CARY: I can't speak to this area. It

is outside my field and I think that the idea that there is a philosophy in Washington most of the time, or at this time is a little erroneous. I think you^{can}/extrapolate a traditional or conventional approach taken by the Anti-trust Division, for example, into a much broader principle than they themselves have in mind.

I am sure there isn't any sort of general philosophy, let's say, stemming from the Council of Economic Advisors having read Gardner Means' Book, and talking with the first assistant or even the assistant attorney general in charge of the Anti-trust Division. I don't think that it's that much of a pattern. I don't see it. I don't see it at all.

MR. CAREY: Okay.

COMMISSIONER CARY: Now, whether or not -- I've forgotten whether or not the steel inquiry is being made by the Federal Trade Commission or the Anti-trust Division, but it would still apply, whichever way it is.

MR. CAREY: The other question is international standards of financial reporting. Something very interesting and accidental happened to us a couple of months ago. We have a committee that is, as a result of the International Congress, trying to analyze the basic differences in, I think, 25 countries of some importance. They are making some

progress. In fact, the firms put up some money to do it.

We got an invitation to go over and talk to aman in the Ford Foundation who is in charge of international studies. I won't take the time to explain the contact, it was accidental, but he asked us to come over, and he said they are extremely interested in this general field of the area of international business and international finance. He suggested to us that they might see fit to give us a grant to administer, to conduct researches in this area through universities and perhaps through foreign associations and perhaps have study conferences of knowledgeable people from different countries to clear up points and looking to some reconciliation of methods.

I would gather from what I heard you say that this would be important. Do you think this would be desirable?

MR. BARR: I would say I think it would be a first rate idea.

We're struggling with these foreign registrants all the time, trying to reconcile differences. Because the Japanese have a different philosophy of financial life than the European countries have and than we have. There are some deep-seated notions of saving face in the public domain in Japan that are a little harder to overcome than in

Europe, maybe, but I have noticed in some of our contacts with European management that they are pretty firmly set in what they think is the proper way to represent their business before the public.

They are almost as ingrained as the Japanese. I think the most liberal in meeting us and working out solutions are the Dutch.

MR. CAREY: Yes.

MR. BARR: We've had excellent cooperation.

COMMISSIONER CARY: KLM.

MR. BARR: Phillips, KLM, Royal Dutch.

MR. CAREY: You don't have any problems with the British do you?

MR. BARR: To some extent. They're a little stubborn about some of their views.

MR. CAREY: If this thing should develop to any extent, -I really have two questions. One is: Would it be possible for the Commission to indicate an interest in the matter that might, with a precise opportunity, convince the Ford Foundation to go ahead with their decision.

COMMISSIONER CARY: I don't see why not. I don't see why not. I mean, if that could help you and we're interested, I don't see why we cannot.

MR. CAREY: It certainly will help us.

The other thing is I wondered whether I can impose on you, as we get into the thing, if we do. It's just a spark in its daddy's eye right now. But giving some of the facts about some of the problems, some of the specifics and why they're important.

COMMISSIONER CARY: I don't think there would be any problem about helping you out on those lines.

Do you?

MR. BARR: No, indeed. I think it would be very interesting.

We have problems of law as well as accounting. I don't know how far they want to go with this.

MR. CAREY: I don't know for sure, either. I am supposed to draft a tentative proposal or indicational memorandum and see whether our Executive Committee will permit us to do this. It's a very unusual activity for us but assuming that the grant also covers administrative expenses, there is no particular problem concerned.

MR. BARR: We really have been running an international round table on accounting in our place during the last few years.

MR. CAREY: I don't doubt that.

MR. LINOWES: Is your primary concern in dealing with these, in supplying reporting one of comparability or complete disclosure?

MR. BARR: Both.

MR. LINOWES: Do you feel that it is as important in the administration of your work that you have effective comparability? I understand disclosure. I don't understand whether you have big problems in comparability.

MR. BARR: You're familiar with this little pamphlet the Institute put out for Advice to Foreign Registrants. I think that has a pretty succinct summary of our problems.

MR. LINOWES: You take the view that they are all the Commission's problems?

In other words, personally I have always felt the Commission's primary problem was one of disclosure. Comparability is of interest to the investment public and more perhaps to the investment banker. Therefore I ask the question whether your attention to foreign reporting places as much stress on comparability?

MR. BARR: We have felt if they are selling securities in the United States to an American investor, from those figures he sees he is going judge from his background

in the American form of accounting. There ought to be some explanation and reconciliation between foreign practices and what he normally would see in an American report.

COMMISSIONER CARY: You said you thought they would be of interest to an American investment banker. It seems to me our interests are very close to those of an investment banker, and therefore I would agree with Andy on that point.

MR. CAREY: My last question is reverting to this proposal that annual reports to stockholders be consistent with filings with the Commission and I am not quite sure what the effects would be, but would it have a tendency to discourage innovation and experimentation? I mean, your rules are pretty set. Once you file with the SEC you comply with the rules until they are changed. But in annual reports to stockholders the people, as I understand it now, are reasonably free to try new types of presentations in different things.

If this new proposal were adopted, would it tend to freeze everything?

COMMISSIONER CARY: This is not yet formally arrived at by the Commission so that I can't speak to it as a final matter.

I will say, when I made reference to this speech

which will appear in the Journal of Accountancy I limited myself to saying that the financial material, the reports shall be consistent with the financial statements filed. I didn't say the reports, the whole annual reports should be consistent.

I left it that narrowly because I think that the way you have framed it I would have said, if I had followed -- I mean, if my approach had been the way you interpreted it, I would have said the annual report must be consistent.

Now, whether or not we ought to go that far is a very much larger question. I personally, and I think I am only expressing my own views, might say I think it would be a good idea if we said, for example, annual reports may not be misleading in the light of the material filed. That's different from being consistent with.

MR. CAREY: That's different, true.

MR. TRUEBLOOD: Yes.

COMMISSICNER CARY: Yet I am sure some of my colleagues and I am sure a lot of industry would be upset by that because that interferes with our flexibility in writing an annual report.

Now, whether or not we go that far even is a question, but logically it seems to me we ought to some day be pushing in that direction. We shouldn't -- There should be

some, shall we say, overhanging sanction, maybe not a sanction but an overhanging worry on the part of the industry, if they literally publish something that is misleading in the light of material filed with us.

MR. CAREY: I understood there might even be a problem in this area because I should think from the point of view of civil liability nobody would want to be.

COMMISSIONER CARY: It's much greater.

MR. BARR: They can stretch this to great lengths. What they emphasize and what they suppress in the front of a report is really shocking sometimes.

MR. CAREY: You mean the text.

MR. BARR: Yes.

MR. LINOWES: The President's report.

MR. BARR: And the President's discussion.

MR. CAREY: I see you're not talking solely about financials?

MR. BARR: Mr. Cary and I were talking about the front end.

COMMISSIONER CARY: I mean the front end.

MR. CAREY: I see.

COMMISSIONER CARY: My speech related to the financial and then it moved on, and that is the thing that

Andy was referring to.

MR. CAREY: I see.

MR. TRUEBLOOD: Can I press back to this, do you feel there is a problem in the inconsistency or reliability of financials in the annual report?

COMMISSIONER CARY: We have had such problems.

MR. TRUEBLOOD: You have had such problems.

COMMISSIONER CARY: We've had such problems, that's why we wanted to put this problem at least in.

MR. TRUEBLOOD: It's kind of surprising.

MR. BARR: We have a horrible example.

COMMISSIONER CARY: A non-consolidated and consolidated, too bad.

MR. BARR: Companies that have been showing some profit and some other statements have been showing a loss. They think the suppression of consolidated figures is proper public relations.

MR. LINOWES: That points to improper accounting really.

MR. BARR: No comments.

MR. CAREY: Do you think the Institute ought to move in the direction of standards of disclosure? We have got no formulated, as far as I know, lists of things that

must be disclosed.

COMMISSIONER CARY: I think it would be an extremely valuable thing to do, .

MR. CAREY: We've talked about accounting principles and whatnot, we've talked about isolated cases, long term leases ought to be disclosed and this ought to be disclosed but we've never put out a schedule like auditing standards, you know, what you've got to do, and we've covered the waterfront and never said what you've got to disclose.

MR. BARR: That's where SX Regulation goes further than anything else. It is published as a guide as to what is adequate disclosure under the Acts.

MR. CAREY: Looking ahead, from our point of view, it seems to me that in this area, as in the rule in independence and so on, we ought to be at least as far as the Securities and Exchange Commissioner.

COMMISSIONER CARY: I think you ought to go further.

MR. CAREY: We ought to go further. We're sluggish, we have been until these dynamoes got into it.

MR. BARR: I still see the statements, they are limited in number, but there are some companies that have been registered with us for years where the income statement starts out with operating profit and the accountant certified

this as in accordance with generally established accounting principles, and I think in that case you don't show a proper operating result without showing sales; all the financial ratios hinge on volume of business.

MR. CAREY: Sure, sure. That's our cake.

MR. BARR: That kind of a report would collide with this rule of disclosure you are proposing.

MR. LINOWES: I think I would find it a little disturbing that any one agency, as is the fact, because we have another agency that has found it necessary to take the initiative in areas that we're talking about and yet draw back when it comes to participating with the profession in evolving these principles.

Do you follow me?

MR. BARR: I don't know what you say about drawing back.

MR. LINOWES: Hesitate.

MR. BARR: I don't think we've drawn back, I think we've probably --

MR. CAREY: You're talking about formal participation?

MR. LINOWES: Yes.

MR. CAREY: I think we all agree it would be absurd for us to operate in water-tight departments. We've got to

understand each other's thinking and sort of ahead of time.

The only discussion area was about a voting membership on the Board and what result that might have, but I remind you it was Mr. Phillippe's speech when he said it disturbs you that it is necessary for government agencies to move in. Government, like nature, abhors a vacuum, and if we don't fill it first government will move in. That's all there is to it. If we fill it first, I think we're okay.

COMMISSIONER CARY: That's quite true. I said that in a different way. I said it once at the Investment Bankers Association meeting and again I said it in effect in this Journal of Accountancy piece.

MR. BARR: I just delivered a paper which was more or less historical in nature and I sent it up to Charlie and I think probably to you, ,

MR. CAREY: I'd like to see it.

MR. BARR: It's up there. And I delivered it at the Michigan County Conference last Friday. They asked me to talk on the influence of regulatory agencies and the problem of accounting principles.

I devoted most of the time to what the Commission had done on collaboration with the Institute and others of the profession.

There's a lot of historical material here showing how we have participated in this operation. You can take a look at it.

MR. CAREY: If Dave isn't fully aware of that, I can testify participation has been ample and sometimes more so.

(Laughter.)

MR. BARR: Yes.

MR. LINOWES: That's what I'm concerned about.

COMMISSIONER CARY: Going off the subject, I noticed one little discussion somewhere along the line, in one of these papers that interested me, and I would like to put a plug in for it, namely, that I think you have reached the point now as a profession where you probably should be more frequently participating in government than you have in the past.

MR. CAREY: No question.

COMMISSIONER CARY: And I would hope that over a period of time you would really make people available for a year or two years, the big firms would make a partner available to the government without his losing stature or status in the process.

Now, law firms, even in the big law firms they are

still having a problem in this field, which I think is erroneous, but a person has a direct relationship with a client, I think, probably more than you do in the accounting field, and therefore if he loses those direct relationships he may lose stature in the firm, if he comes to the government too often, although in my opinion a lot of these excellent but rather narrow Wall Street Lawyers don't understand that if they did come down here and then went back they would probably on balance be not any bigger people but they'd be much more widely consulted. At least they don't think so.

But I think that, if there be any doubt in the legal profession, I think there should be less doubt in the accounting field, and as a consequence I would think there is less reason for a person to worry about leaving accounting for a couple of years to come down to the government and that this ought to be encouraged and it ought to be a financial responsibility that in effect the accounting firms take on.

MR. TRUEBLOOD: I think in my own experience and the experience of my own firm there is a barrier on the government side which makes it very, very difficult for us, even leaving out compensation.

COMMISSIONER CARY: I was assuming they could not be additionally compensated.

MR. TRUEBLOOD: Okay. Even so, if he retains his partnership, you see, the entire firm then --

COMMISSIONER CARY: Right.

MR. TRUEBLOOD: -- is in a conflict of interest situation, or so the statute says.

COMMISSIONER CARY: I assume he would have to resign for that period with the understanding --

MR. TRUEBLOOD: With the understanding --

MR. LINOWES: With the understanding he returns, you still have a conflict of interest.

COMMISSIONER CARY: Not a commitment, but on that --

MR. CAREY: Probability.

COMMISSIONER CARY: It's difficult.

MR. CAREY: It's difficult as Mr. Fosché pointed out in his paper --

COMMISSIONER CARY: Yes, I know him.

MR. CAREY: -- that in the large firm where, as you said earlier, we have a kind of a managerial situation, two years out of the life of a young partner can be kind of serious.

COMMISSIONER CARY: That's right.

MR. CAREY: In the upward movement and in taking care of clients and all this.

COMMISSIONER CARY: Right.

MR. CAREY: I wish we could do more of it. We've tried, it's very hard to dislodge them.

For one thing they are undermanned, isn't it true?

MR. TRUEBLOOD: This is true but I am not so sure that Mr. Cary appreciates the conflict, the risk and the conflict, the problem.

Because if you resign and have a contract that you will be taken back as a partner --

COMMISSIONER CARY: I said, not assuming you would have a contract.

MR. TRUEBLOOD: -- you're still in conflict.

How does the man protect himself?

COMMISSIONER CARY: Well, if he's sent, if he's competent enough to be a partner or about to be a partner and the business is growing as it seems inevitably to grow with the population, I would think that if you had a tradition to develop --

MR. TRUEBLOOD: Well, now, this is maybe the answer.

COMMISSIONER CARY: Then it would not be against him, indeed at the very most it would be neutral and in fact I think on a long term basis I think it would probably work in his favor.

MR. CAREY: If he had enough self-confidence, he'd go into another firm.

COMMISSIONER CARY: That's right.

MR. BARR: From time to time in the past I've explored this possibility of recruiting to our staff --

COMMISSIONER CARY: Yes.

MR. BARR: -- and the answer I've had from a number of our members is that they would not recommend the persons that they don't want to keep, neither would they recommend the persons they want to keep because of this interruption in their career.

COMMISSIONER CARY: I wouldn't go to the firms and ask them to recommend somebody. I would go to --

MR. BARR: I'm thinking of the lower level.

COMMISSIONER CARY: -- knowing industry well enough, I'd get -- find young people whose judgment I have confidence in and then they find others. That's the way I've been working in the SEC. We've got a lot of young men. They're just plain independents and I guess you're right, they just have enough confidence in their own ability, and they don't have to worry.

MR. CAREY: I wonder if you would be interested in people from small firms? You might have to teach them a lot,

but there are some very bright young people.

MR. BARR: We have taken on some younger people in recent years that have been very good.

COMMISSIONER CARY: Recently though it seems to me you've been getting some very strong people.

MR. BARR: Yes, they've been very good people. There was a period back there though when there was a real drought of competent people showing up.

MR. TRUEBLOOD: I overemphasized the conflict because it occurs to me that we have this same lack or criticism in our relationship with educational institutions. We do not have very much coming and going between the profession and educational institutions and there conflict is not involved.

COMMISSIONER CARY: We have it involved a good deal more, I would guess.

MR. TRUEBLOOD: Yes.

MR. CAREY: Do you criss-cross between teaching and practice?

COMMISSIONER CARY: A great deal. In certain places. I mean, in my Columbia -- it's a danger, of course, and whether people are competent to do both and therefore it endangers the law school. I think that this is possible in most of the law schools I know, the good law schools. The

people are sufficiently well qualified to become sufficiently expert so that they could shift over at any moment.

MR. CAREY: Is Mr. Warren Dean there?

COMMISSIONER CARY: Yes, he is.

MR. TRUEBLOOD: I would like to ask another question which tends toward the long range. We have talked several times about the various aspects of accounting and there is no question about how we all feel about it of course and where we should ultimately be procedurally and organizationally. Rule 13 on independence in a sense moved us one step further into the area of specifying the rules, the active rules, the specifics, whereas I think we all agree that this is no real test, or only a very minor test in a larger area.

Should we, as a profession, stick to definitions of attitudes as distinguished from wrong things to do, wrong specifics?

COMMISSIONER CARY: I think so. I think it is more than just specifics. I think it has to be an attitude. Independence has to be an attitude, absolutely.

MR. TRUEBLOOD: Would you say similarly then that by pressing down the road on defining specifics or outlawing specifics we might lose the appropriate emphasis by so doing?

COMMISSIONER CARY: Only if you overemphasize the

specifics. I mean, I don't see that they are mutually exclusive.

Just as, for instance, in the government conflict of interest field today, you have people going out of office because there is some conflict indicated. I think that that can be made more specific on the one hand but it doesn't or shouldn't derogate the general principles at the same time.

MR. CAREY: I have the impression that the standard of ethics in government and business is rising rather rapidly. I read more about codes of ethics in government, state government, municipal government, federal government, people are very leery about conflicts of interest in business that used to be, I guess, accepted as an ordinary course.

Do you think that the general morality in the business world is going up?

COMMISSIONER CARY: I think there's a greater awareness of it. I used to think that it was always evolving and I am just not so sure as I was once that there is such a splendid evolution as we might like to believe, you know.

I do think that just the law itself has been forcing industry to move ahead. For example, I suppose the electrical case had more influence on standards of business than any single case in the last decade maybe.

It has forced a sort of standard of conduct that had never been articulated before.

I agree with you, I think that certainly there is more written and there is more done and I suppose that is where the answer is. Probably something has happened.

MR. CAREY: People are more conscious of it, yes.

COMMISSIONER CARY: Yes. The law is simply moving ahead. Our own, I think in our own field of law we've pushed along in the last two or three years.

MR. BAR: I'd like to get something on the record on your point here. I think it is clear that the Commission has never underrated the importance of the attitude of mind which Mr. Cary emphasized over these years, but what we have found is that we ought to cut out some of these identifiable things and say, Look here are evidences that ought to be eliminated.

One of the most important cases on this attitude of mind point would be the Hollander case or Koehler and Koehler case in which we said there wasn't just one thing, it was a building up of a lot of relationships which gave us reason to doubt this independence of attitude which you have emphasized and that's the case to go to for that.

We expect an independent attitude.

MR. CAREY: I think as of this moment we are pretty much in identical positions.

MR. BARR: I think we are but I wouldn't want anybody to get the notion that we underrate this attitude or fine point.

MR. CAREY: True, but I wasn't relating it to the SEC, I was relating it to our organizational problem. In fact, I hope we would not get to the point where there were 29 rules and you can say if I conform with all of these I'm okay.

MR. BARR: I think you ought to hammer on the attitude of mind point, but let's sweep out these other things that you probably can say relate to questions as to your attitude about it.

That's what we've been trying to do.

MR. TRUEBLOOD: I suspect we're getting very close to getting ready for lunch, Jack. Have you a wrap-up?

MR. CAREY: I have one more question that has to do with enforcement, our enforcement of our ethical rules, which is grossly inadequate.

COMMISSIONER CARY: Right.

MR. CAREY: We have a lot of problems. First I'm not sure that a national organization can enforce ethical

rules on 50,000 people.

Second, even if we could, there's an enormous difficulty in getting evidence.

Third and worst is the fact that when a man is in litigation or threatened with it or coming before you his lawyers advise him not to respond to our requests for information on the ground that it might incriminate him, and we seem to be powerless.

Oh, we've had members in jail because their cases were on appeal. Our Council won't let us fire them because they can't defend themselves. I wish somebody could suggest a way out of this. I think it's absolutely ridiculous. It is expensive. It takes the time of our volunteer Ethics Committee members and Trial Board members and staff and, well, a case in point, which I don't mind mentioning, you might not want to comment on it, is the Olin Green deal. You may remember we had members of the Institute indicted on charges which, if true, would have justified our firing them right like that.

The indictment was quashed for reasons we don't know and can't get at, but they won't respond to our inquiries as to whether they did or whether they didn't, on advice of counsel.

They are still members in good standing. The case is still on the docket. We just can't seem to get any information out of them because they keep saying there's going to be litigation, we may be sued, the SEC may take us over.

It just raises my hackles but I don't know how to get out of it.

COMMISSIONER CARY: You have no subpoena power or anything?

MR. TRUEBLOOD: No.

MR. CAREY: It's strictly a voluntary organization.

In a sense we're sitting here waiting for the courts or for the SEC or for the Treasury Department to fire a member and then we can fire them, which isn't a very noble position to be in, while we brag about our self-discipline

COMMISSIONER CARY: Right.

MR. TRUEBLOOD: Of course we have some organizational things we should long range clear up because of the interests of various state societies, various state boards.

COMMISSIONER CARY: I don't think we've got a solution for it.

MR. BARR: I don't think we have.

MR. CAREY: I thought maybe being a lawyer you might be able to get us out of this problem.

COMMISSIONER CARY: It's a nice one.

MR. CAREY: What would the Bar do in a case like this?

COMMISSIONER CARY: The Bar is not a very active organization either. Whether or not it has subpoena power, I simply do not know whether a Grievance Committee of a Bar Association actually acts with some powers directly from a court, usually the Supreme Court of the State, can put people under oath or how far they can go in that area, I simply do not know.

MR. CAREY: Mr. Fosche gave us quite a long description on how they proceed in New York. He said in some states they have what they call an integrated bar --

COMMISSIONER CARY: Right.

MR. CAREY: -- which makes a slightly different legal situation.

COMMISSIONER CARY: Michigan and places like that. California, yes.

MR. CAREY: But in New York all that our association does is make a presentation to the court and then there's a regular hearing and trial, but it still didn't answer my question whether the court can force this man to testify if his own lawyer advises him not to on the grounds that he's in

civil jeopardy or even criminal. I don't know.

COMMISSIONER CARY: I'm afraid I'll have to beg out of that simply because I don't feel that I have enough knowledge to speak to it.

MR. CAREY: I am suggesting in a chapter I have drafted on this subject that we ought to follow this system of the association of the bar, that a state society ought to make presentations to the state boards of accountancy, which are legal bodies, generally served by the state attorney general. In other words, the professional society shouldn't content themselves with expelling members who then go on and practice anyway, but that we should be sort of the prosecuting mechanisms or the -- what do you call it? -- jury, Grand Jury mechanisms maybe to get the case before the legal bodies.

MR. BARR: You know that when we refer an accountant to you we also refer the case to the state organization to which he belongs and to the state board also.

MR. CAREY: To the state board.

MR. BARR: Yes, and the state boards do act.

MR. CAREY: Can you tell me whether there is frequent action by state boards?

MR. BARR: Yes.

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MR. CAREY: That's interesting.

MR. BARR: In fact, the Cornucopia case, Pennsylvania acted quite promptly on cases there.

MR. CAREY: Of course, our greatest triumph was the Jackson case in Texas.

MR. BARR: The Texas Board acted promptly, there's a sample.

MR. CAREY: But he very conveniently put on the record a confession so that made it a little easier.

MR. BARR: Yes.

MR. CAREY: That was before the Senate Committee.

COMMISSIONER: CARY: That's right.

MR. TRUEBLOOD: Do you have anything else, Jack, Dave?

MR. LINOWES: I think there is one question that projecting ahead concerns our own professional organization. We see ourselves getting involved in many fields of activity, management services, taxes, various areas. In the past whenever any segment of society looked for a spokesman for the attest function they turned to the American Institute. We have always been and will continue to be the spokesman. But as we broaden our horizons and get bigger and profess to be an organization of all accountants, whether they're government

accountants, industrial accountants --

MR. CAREY: CPAs.

MR. LINOWES: CPAs, yes, all CPAs. We tend to perhaps dilute the accent we have given to our attest function.

The question I have and it concerns your agency in particular: Is that bad for us as an organization? Should we try to point towards a narrowing of the function of the American Institute of CPAs so that they concentrate primarily on the attest function or should we encourage the establishment of another national organization that's going to have its primary function either attest function or is it all right to let it continue in this broad spectrum as just being one phase covering all accounting?

COMMISSIONER CARY: I'm afraid I don't have an opinion on that question. I really haven't thought enough about it to justify an opinion.

Andy might have more of one than I.

MR. BARR: I think my opinion at this moment would not be valuable. I've watched this develop for 40 years and I don't know when it ought to stop. I'm in a position of being in the government and feeling that I ought to be a member of the Institute. Now, maybe that's one side of it.

MR. CAREY: Personally I see no reason why Lynn

Townsend, who left Bob's firm to become President of Chrysler shouldn't be a member of the Institute. I can't see any reason why he shouldn't be.

MR. BARR: At this moment I don't see any reason either, and I think he could strengthen the work of the Institute.

MR. CAREY: Yes.

MR. BARR: If he took an interest in it.

MR. CAREY: Certainly no organization of the Bar makes any distinction between house counsel and practicing counsel.

COMMISSIONER CARY: No.

I think we have one danger, bar aside, that house counsel is more likely to be subsidized to attend Bar Association Meetings than others, and indeed they have, banks and others have their bar associations attendant and just by being there he becomes head of committees and therefore I think sometimes it lowers the caliber of the representation at the top at bar associations. I'm somewhat derogatory, as you know, of bar associations as a whole. It is those who attend meetings who wind up being at the very top of the leadership of those associations.

I don't think this is true of the Bar Association of

the City of New York, for example, or even the Chicago Bar Association. I've seen evidence to the contrary, but I think this is true of others.

I do think that's a problem particularly on the law side.

MR. CAREY: We are very proud of the fact that, as you noticed, that generally speaking, the best minds in the accounting profession take a very active part.

COMMISSIONER CARY: I think this is very excellent. I am aware of that and I was trying to draw a distinction. Rather than being derogatory of bars, I just think it's more in praise of your organization and I really wouldn't want to be of record --

MR. CAREY: No.

COMMISSIONER CARY: As being so critical of my attitude. But I think that many of us are rather critical.

MR. CAREY: We have to worry about our leadership, though.

COMMISSIONER CARY: Yes, we certainly do.

MR. CAREY: Because, as the thing gets bigger, politics get in and there are always some people who seek advancement in these associations because it gives them higher visibility.

COMMISSIONER CARY: That's right.

MR. CAREY: And they're not always the best people.

COMMISSIONER CARY: That's right.

MR. CAREY: Yet they can have friends and they can get votes and all that stuff.

COMMISSIONER CARY: Oh, there's no question about it.

MR. CAREY: It's something you have to fight all the time. Democracy is awfully good, up to a point.

COMMISSIONER CARY: That's right.

(The interview then concluded.)