Fair Presentation: Another View

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For nearly forty years independent public accountants have been attesting that the financial statements of their clients are presented fairly in conformity with generally accepted accounting principles. The meaning of this simple phrase has been subject to considerable and continuing debate and diverse interpretation both in accounting literature and in the courts.

The essence of this disagreement rests upon the question of whether the word “fairly” adds anything to the phrase. Like the traditional debate over how many angels can dance on the head of a pin, the solution to this problem rests on differing definitions and perceptions.

In an attempt to strengthen the authoritative literature on the subject, the Auditing Standards Executive Committee of the American Institute of CPA’s has recently developed a new Statement on the subject which attempts to articulate what the profession believes is meant by this phrase. The pendency of this Exposure Draft is perhaps a sound reason for reviewing both professional literature and judicial determinations in regard to this issue and for suggesting an additional personal viewpoint as to what the phrase does, in fact, mean today.

There is a significant body of thinking that suggests that the word “fairly” adds nothing to the key phrase. Those who believe this seem to base their conclusion on one of three possible interpretations.

The first group suggests that an underlying concept of fairness is an integral part of generally accepted accounting principles; and, hence, generally accepted accounting principles includes fairness by definition. Under this interpretation, the phrase is redundant.

A second approach holds that fairness may be defined for this purpose as being conformity to generally accepted accounting principles, since financial statements must be recognized as being based on a set of adopted conventions which have nothing to do with abstract concepts. This argument suggests that there is no inherent “truth” in financial reporting and fairness can, therefore, be nothing but meeting defined norms. There can be no standards for fairness beyond generally accepted accounting principles and without standards the term has no effective meaning.

In addition to those who believe that GAAP includes fairness and those who believe that fairness is conformity to GAAP, there is a third group that takes the historical perspective and argues that the phrase "fairly presents" was an historical accident written into the short form report without great consideration primarily to emphasize that financial statements were matters of estimation and judgment, not Truth. They point out that "fairly presents" was an attempt to lessen, not increase, the auditor's responsibility from the previous "certification" that the accounts were "correct." As they review the genesis of the current auditor's report in the correspondence between the American Institute of Accountants and the New York Stock Exchange, they conclude that "fairness" was included to measure uncertainty, not to create a sense of innate justice. On the basis of this legislative history, they suggest that fairness cannot have a constraining meaning.

It is certainly true that a view of historical auditors' reports prior to the standard now in common use indicated that auditors did, indeed, make reference to the correctness of the financial statements. Marwick, Mitchell & Company's report on the 1923 financial statements of General Electric Company, for example, stated in part:

> We have examined the books and accounts of the General Electric Company for the year ended December 31, 1923 and hereby certify that the Condensed Profit and Loss account and Balance Sheet are in accordance with the books and, in our opinion, correctly record the results of the operations of the Company for the year and the condition of its affairs as at December 31, 1923.[1]

In these early days there was no uniformity among accountants' reports and the concept of fairness did appear in some. For example, a Price Waterhouse report for the year 1923 on the accounts of the American Locomotive Company contained the following opinion:

> We certify that, in our opinion, the balance sheet is properly drawn up so as to show the financial condition of the American Locomotive Company

1 Report quoted in Carmichael, D.R., The Auditors Reporting Obligation, AICPA, 1972, p. 14.

> at December 31, 1923 and the relative income account is a fair and correct statement of the net earnings for the fiscal year at that date.[2]

While such historical analysis provides some support to those who suggest that fairness was not originally intended to be a confining attribute, it is not clear that in the forty years since the standard opinion was adopted it has not come to have such a meaning.

There are a substantial number of accountants who rest on the other side of the argument and suggest that "fairly" adds something significant to the auditor's representation beyond attesting to conformity with generally accepted accounting principles. Some suggest that fairness is a separate quality that must be explicitly covered in the report. This is the approach taken by the Canadian Institute of Chartered Accountants in its Handbook where it establishes the auditor's responsibilities as follows:

> The auditors should express an opinion, or report that they are unable to express an opinion, as to whether:
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> (a) the financial statements present fairly the financial position of the enterprise, the results of its operations and, where applicable, the source and application of its funds, and
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> (b) the financial statements were prepared in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding period.[3]

Others suggest that while fairness may be viewed from the viewpoint of a professional accountant, it does connote more than simple conformity. This approach was recently articulated by David James, a partner in Arthur Young & Co. in a speech in which he said:

> 'Fairly presented,' in my opinion, means just that. We say fairly presented in accordance with generally accepted accounting principles and that usually gives a fair answer. However, when a combination of generally accepted accounting principles does violence to the common sense of an

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[2] Ibid., p. 13.

[3] CICA Handbook, Section 5500.08

> experienced professional, it is common sense that somehow should be made to prevail.[4]

The test of common sense of a professional which is suggested in this quotation is the one applied by many who have complained about abuses of fairness.

Another group who believe that fairly adds something to GAAP suggest that fairness implies the selection of appropriate principles, not just acceptable ones, and disclosure requirements. This appears to be the approach of the Auditing Standards Executive Committee of the AICPA in its Exposure Draft. In this Draft, they offer the following judgment:

> The opinion that financial statements present fairly in conformity with generally accepted accounting principles requires judgment as to whether: (a) the principles selected and applied have been generally accepted, (b) the principles are appropriate in the circumstances, (c) the financial statements, including the related notes, are informative of matters that may affect their use, understanding, and interpretation, (d) the financial information is presented, classified and summarized in a reasonable manner, that is, neither too detailed nor too condensed, and (e) the financial statements reflect the underlying events and transactions in a manner that presents the financial position, results of operations, and changes in financial position stated within a range of acceptable limits that are reasonable and practicable to attain in financial statements.

It is apparent that the courts and the SEC have both come down in their decisions on the side of fairness meaning more than the mechanical application of the rules. Various decisions have taken somewhat different approaches and while some of the reasoning developed by the courts is difficult for accountants to agree with completely, the cases are part of the record and it is therefore worthwhile analyzing them.

The best known court decision is that in the Continental Vending case,[5] although the decision is sometimes overstated by commentators. In this case the trial court charged the jury that the critical test to be considered was whether the financial statements as a whole "fairly

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4 James, David, "Professional Responsibility of Accountants," an unpublished speech delivered at SEC Regional Enforcement Conference, Los Angeles, California, February 14, 1975.

5 United States v. Simon, F. 2d, CCH Fed. Sec. L. Rep. ¶ 92,511 (2nd Cir. 1969).

presented the financial position of Continental as of September 30, 1962 and whether it accurantely reported the operations for fiscal 1962." In reaching such a judgment, the court charged the jury that proof of compliance with generally accepted standards was "evidence which may be very persuasive but not necessarily conclusive." In the case, expert testimony was that the treatment of the item in the financial statements was in no way inconsistent with generally accepted accounting principles.

After a jury conviction, the appeals court was asked to overturn this charge and declined to do so. The court said "We think the judge was right in refusing to make expert testimony so nearly a complete defense" and they added "We do not think the jury was required to accept the expert's evaluation whether a given fact was material to over-all fair presentation, at least not when the expert testimony was not based on specific rules of prohibitions to which they could point."

In looking at this case, there are a number of key factors that should be pointed out about the decision. In the first place, the court felt that it was appropriate for a lay jury to determine fairness in their judgment, at least in the absence of specific rules to the contrary. While this approach has been attacked as exposing professionals to the judgments of persons unqualified to appraise professional performance, it seems to me this overlooks the fact that in any jury trial the jury devotes a substantial amount of time to being educated in the accounting approach by counsel on both sides. Thus, this is not a casual appraisal of fairness, but one based on education in a trial.

Second, the appeals court emphasized the concept of over-all fair presentation which suggests that the impression left by the financial statements taken as a whole was of great importance.

Finally, it should be pointed out that the court did not suggest that the presence of rules would necessarily overcome the fairness test, although they might under some actual circumstances. Judge Friendly indicated that where there were no rules, a defendant could not bring in experts to testify to the absence of such rules and thereby conclusively establish that the statements met the fairness test. He said that the jury was not required to accept the experts' evaluation whether a given fact was material to an over-all fair presentation, "at least not when the experts' testimony was not based on specific rules or prohibitions to which they could point." The decision implies that were there rules, a court might accept them, although the wording is ambiguous in this regard.

In the most recent criminal case against accountants in which two accountants employed by Peat, Marwick, Mitchell & Co. were convicted, Judge Tyler, in his charge, seemed to reiterate the principles set forth in the Continental Vending case. Judge Tyler charged the jury that:

> The fact that a given defendant's conduct was in accord with (generally accepted auditing and accounting) standards and principles does not necessarily or automatically constitute a complete defense to this charge.
>
> The weight and credibility to be extended by you to such proof must depend among other things on how authoritative you find the precedents and teachings relied upon by the parties or the extent to which they contemplate or deal with the circumstances found in the documents and evidence here and on the weight you give to expert opinion evidence offered by various witnesses.[6]

Judge Tyler then went on to say:

> Perhaps the critical issue in this case therefore can be summarized as follows:
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> Were the quoted earnings figures and footnotes set forth in count 2 fairly set out; that is to say, did they fairly present the revenue and earnings picture for NSMC for the fiscal year 1968 and the first nine months unaudited of fiscal 1969.[7]

This charge appears consistent with that of the principles set forth in the Continental Vending case while at the same time indicating even more specifically that standards were not an absolute defense.

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6 United States v. Anthony M. Natelli and Joseph Scansaroli, 74 Cr. 43, Charge of the Court, Transcript p. 2366.

7 Ibid., p. 2369.

A recent civil case, Herzfeld v. Laventhol, Krekstein, Horwath and Horwath, has also resulted in some judicial attention to the concept of fairness. Judge MacMahon in his opinion offered the following observations:

> Much has been said by the parties about generally accepted accounting principles and the proper way for an accountant to report real estate transactions. We think this misses the point. Our inquiry is properly focused not on whether Laventhol's report satisfies esoteric accounting norms, comprehensible only to the initiate, but whether the report fairly presents the true financial position of Firestone, as of November 30, 1969, to the untutored eye of an ordinary investor.
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> The policy underlying the securities laws of providing investors with all the facts needed to make intelligent investment decisions can only be accomplished if financial statements fully and fairly portray the actual financial condition of the company. In those cases where application of generally accepted accounting principles fulfills the duty of full and fair disclosure, the accountant need go no further. But if application of accounting principles alone will not adequately inform investors, accountants, as well as insiders, must take pains to lay bare all the facts needed by investors to interpret the financial statements accurately.[8]

The opinion offers a number of additional tests in regard to fairness, some of which are wise and some of which are troubling. In the first place, the Judge believes that the financial statements must meet the test of portraying "the actual financial condition of the company." Secondly, he suggests that the report must present the true financial position "to the untutored eye of an ordinary investor." And, finally, he suggests that the report must "lay bare all the facts needed by investors to interpret the financial statements accurately." These are significant tests which create some problems and certainly extend the obligation of accountants.

In the first place, the requirement for portraying the "actual financial position" suggests that there is some "financial reality" against which a statement can be tested. This presents some

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8 Herzfeld v. Laventhol, Krekstein, Horwath & Horwath, 378 F. Supp. 112 (1974).

practical problems, since “financial position” is not an absolute which has been precisely defined or is readily apparent. The test suggested, therefore, requires some agreement on a framework for presentation of financial position.

In addition, the Judge applies the test of “the untutored eye of an ordinary investor” while at the same time suggesting that the statements “lay bare all the facts needed by investors to interpret the financial statements accurately.” Some suggest that these are fundamentally conflicting requirements. At a minimum, the tests certainly suggest a dual approach since the combination of “all the facts” and the interpretive role implied by the second test may not be completely consistent with “the untutored eye of an ordinary investor.” These are some of the problems which the Commission has attempted to solve by the development of its concept of differential disclosure which suggests more detailed analytical disclosure for some and better summarization for the “ordinary investor.”

Finally, this opinion appears to place upon the preparer and auditor of financial statements an interpretive role previously assigned to the user since in order to understand what facts must be laid bare so that investors can interpret the statements accurately, it will be necessary for the preparer to place himself in the user’s position and perform some analysis. This is not an unreasonable test, although it cannot be said that accountants have always regarded such analysis as part of their role. With the increasing emphasis on user needs, it is certainly appropriate to expect preparers and auditors of statements to take this approach.

In addition to these court decisions, the Securities and Exchange Commission for many years has taken the position that fairness connotes something beyond conformity with generally accepted accounting principles. The Commission’s first statement in this regard came in the <u>Associated Gas and Electric Company</u> case in 1942 where the Commission said:

> We think, moreover, that too much attention to the question whether the financial statements formally complied with principles, practices and conventions accepted at the time should not be permitted to blind us to the basis question whether the financial statements performed the function of enlightenment, which is their only reason for existence.

> Each of the accountants' certificates in question contained the opinion that, subject to various qualifications therein, the financial statements fairly presented the financial condition of the registrant, in accordance with generally accepted accounting principles. If that basic representation was not accurate as to the financial statements as a whole, no weight of precedent or practice with respect to the minutiae of the statements could justify the accountants' certificates.[9]

This opinion emphasizes the idea of financial statements as a vehicle for communication and the view that financial statements must be taken as a whole, although it does not specifically indicate that the audience for the statements or the accountants' report is the average investor.

This emphasis was reiterated in the Commission staff's report on the Penn Central case where the emphasis on the over-all impression left by the financial statements was once again stressed:

> In addition to the analysis of various individual transactions, the over-all impression left by the financial statements is part of the responsibility of the public accountants. Statements cannot simply be the accumulation of data relating to individual transactions viewed in isolation.[10]

In sending this report to the Congress, Chairman William Casey added a covering letter which dealt with other factors. While this letter was not a formal Commission statement, it was approved by the Commission. He said, in part:

> The whole pattern of income management which emerges here is made up of some practices which, standing alone, could perhaps be justified as supported by generally accepted accounting practices, and other practices which could be so supported with great difficulty, if at all. But certainly the aggregate of these practices produced highly misleading results. . . . It is essential that the end result of applying accounting principles be a realistic reflection of the true situation of the company on which a report is prepared. Here, there was no adequate presentation of the fundamental reality that reported income was not of a character to make a contribution to the pressing debt maturities or liquidity needs of

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9 In the Matter of Associated Gas and Electric Company, 11 SEC 1058, August 4, 1942.

10 "The Financial Collapse of the Penn Central Company," Staff Report of the Securities and Exchange Commission to the Special Subcommittee on Investigations, U.S. Gov't. Printing Office, 1972, p. 77.

> Penn Central, nor was it of the sort that might reasonably be expected to be evidence of continuing earning power.[11]

In this letter, Casey raised a number of additional issues such as the existence of a pattern of income management which for the first time suggested a motivation to mislead. In addition, he applied a test of "a realistic reflection of the true situation of the company" raising the same issues as suggested in judicial decisions above. He also suggested that failure to make disclosure of the liquidity contribution made by income was a deficiency. This comment emphasizes the need for clear disclosure when income bears no relationship to cash but does not appear to suggest that income should be measured on a cash basis. Finally, he added for the first time explicitly the idea that financial statements had some implication in regard to investor forecasts. The Chairman's statement that there was no adequate presentation of the fundamental reality that reported income was not of the sort that might reasonably be expected to be evidence of continuing earning power was the key phrase in this respect.

Most recently, the Commission's views on fairness were expressed to the accounting profession in responding to an exposure draft on the subject of reports on audited financial statements. This draft proposed to add a sentence that would define fairness in terms of conformity with GAAP. The Commission's response indicated that the Commission was "deeply troubled" by this sentence and recommended its deletion. The Commission authorized the Chief Accountant to submit the following comments on this sentence:

> We believe that it is apparent from court cases and other sources that 'present fairly' cannot be defined by simple reference to generally accepted accounting principles. We are concerned by the impression the sentence gives that AudSEC is determined to deal summarily with the problem. We believe that issues such as the objectives of financial statements and the function of independent auditors have an important bearing on the meaning of 'present fairly' when used by auditors in relation to financial statements. This phrase is the focus of rising public expectations. We recognize that AudSEC cannot deal with all of these

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11 Ibid., p. x.

> issues in a Statement on Auditing Standards, and it seems important that they avoid the appearance of having closed their minds on these issues.

In response to this comment, the Auditing Standards Executive Committee removed the sentence from the final draft on auditors' reports and began the process of developing the separate statements recently exposed for comment.

In looking at these various cases and statements, it appears that four general conclusions can be drawn. First, fairness seems to be related in some fashion to "truth" which has some meaning beyond generally accepted accounting principles. Second, the courts seem to view generally accepted accounting principles as a set of defined rules and conventions and they believe that following these rules does not give complete absolution from the possibility of either civil or criminal liability. Third, the over-all impression left by the financial statements must be considered in appraising fairness and finally, the courts at least seem to view fairness as something that can be interpreted by the layman as well as the sophisticate.

The authoritative literature of accounting also speaks to the subject of fairness. Accounting Principles Board Statement No. 4 indicated that fair presentation was "the subjective benchmark against which independent accountants judge the propriety of the financial accounting information communicated" and set forth four conditions necessary in order to conclude that a fairness test had been met. These conditions were, first, that the generally accepted accounting principles applicable in the circumstances have been applied; second, that changes in accounting principles from period to period have been adequately disclosed; third, that the information in underlying records has been properly reflected in conformity with generally accepted accounting principles; and finally, that the statements represent an appropriate balance between the need for disclosure on the one hand and for summarization on the other.

In addition, Rule 203 of the Code of Ethics of the AICPA seems to indicate that a fairness test should be applied, at least on a negative basis. In the official interpretation of the specific rule, the Committee on Ethics indicates that "the proper accounting treatment is that which will render financial statements not misleading."[12] This, at a minimum, indicates that there is a test beyond conformity with generally accepted accounting principles articulated by professional bodies that must be met in the preparation of financial statements. While auditors' opinions making use of the exception spelled out in Rule 203 have been rare, they do exist. In such cases, the general practice has been to give an unqualified opinion paragraph where a statement is made in the middle paragraph of the auditor's report that to follow authoritative pronouncements under the circumstances would result in misleading financial statements.

Since this survey of cases and literature indicates that a variety of views of fairness currently exist, it does not seem inappropriate for another personal view to be expressed as part of the discussion which may lead to an accepted definition.

In the first place, it seems apparent to me that fairness means more than following a set of specific rules, standards and guidelines. Accounting cannot be viewed as a mechanistic process and remain either professional or communicative.

Secondly, fairness cannot be evaluated in terms of an absolute standard without a frame of reference. It seems to me, therefore, that when one speaks of fairness in a financial statement context, one must be referring to fairness within the framework of "the accounting model," not in absolute terms. Financial statements are inherently a vehicle for communication and, if effective communication is to take place, there must be a joint frame of reference on the part of the communicator and the communicatee.

Someone starting without any background might well conclude that economic activities should be measured in a totally different way than has been generally developed and agreed upon. For example, it would be reasonable enough to believe that all assets should be reported on the basis of current values or that the net worth of a firm should be determined by the market value of its shares. A good case could also be made for measuring income of the basis of the

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12 AICPA Professional Standards, Ethics Bylaws, Section 203.

change in expectations for the future as innovations are made. It could logically be said that income is generated from technological innovation, not from the subsequent sale of goods resulting from that innovation. If one looks at much of the literature of economic theory on the measurement of income, for example, one finds measurements suggested which are totally different from those which an accountant would view as acceptable. Economic models are not constrained by the needs for practical recordkeeping devices, objectivity and other factors which affect the selection of an accounting approach. The accounting model has grown up in practice over a period of many years based on what might be called common business sense and a series of practical decisions made over time. It may lack measurement purity but in general it has the benefit of being understood.

There have been many attempts to define “the accounting model” and it is unlikely that any specific articulation will win universal approval. Nevertheless, since it is a significant element in the determination of fairness, it seems desirable to attempt to present a simplified statement of my view of the accounting model today.

Five parameters provide a reasonable definition of this model. First, business results are presented in a set of articulated financial statements of which the income statement has primacy. Second, income is measured by an averaging approach (called matching) which is designed to show the long-run average net cash inflow at the current level of activity. Third, the current level of activity is measured by recognizing revenue on the basis of work done and the legitimization of the value of that work by an arms’ length transaction with an outside party. Fourth, asset valuations are generally based on historical monetary costs incurred in arms’ length transactions. Increases in value are recognized only when a transaction occurs, while decreases are recognized when there is a reduction in the value of assets for the purposes for which they are held. Finally, business substance rather than legal form must predominate in the analysis of transactions and the determination of the accounting to be followed for them.

This basic model is not static and may change over time based on a changing concensus of business realities, upon a Financial Accounting Standards Board study of the conceptual framework for financial reporting, or even upon divine revelation, if that is different from an FASB study.

Within the framework of this accounting model, fairness seems to me to have three essential elements when applied to the financial reporting process. First, the financial statements taken as a whole must present business results in a fashion such that users who have a general familiarity with the accounting model will be able to understand what happened to the reporting entity in a business sense. A detailed knowledge of accounting should not be required of users to achieve this result, even though general familiarity with the model is necessary. The user should not be required to be familiar with Judge MacMahon's "esoteric accounting norms comprehensible only to the initiate." The basic impression given by the financial statements should coincide with the business reality; in other words, the message must be readily receivable.

In meeting this first test, subjective determinations as to the appropriateness of accounting principles followed in the circumstances are inevitably required. It is not appropriate for the company accountant or the independent auditor to deny the need for such subjective determinations. The independent accountant is a measurer by profession and he should be best able to appraise the desirability of alternative methods in communicating a factual situation to a user of financial statements.

The statement by the Auditing Standards Executive Committee in an Exposure Draft that "the auditor cannot appraise the choice among alternative established accounting principles" in the absence of promulgated criteria for selection seems to me to be an abdication of the fundamental responsibilities of a professional. Procedures for making such determinations within a public accounting firm are a fundamental part of the firm's responsibility. To admit that there is subjectivity in the process is not to say that every individual partner and staff man should make up his own mind as to what is the best measurement in each circumstance, but rather that there should be a procedure within a firm to compare business facts with the accounting model and decide how these facts can best be communicated. We have observe a number of recent cases where firms have taken positions as firms on particular current problems, and in my judgment this has resulted in improved reporting.

A second essential element which seems to me to be a necessary part of fairness is that the financial statements presented do not lead users to a forecast or other conclusions which preparers and auditors know to be unlikely or incorrect. This is a negative criterion. It does not say that financial statements must lead to the correct forecast or conclusions, but rather that they should not lead to a forecast or conclusions which are known to be incorrect. It is recognized that forecasting is a precarious business and that users of financial statements cannot be assumed to be uniformly perceptive. Nevertheless, if the financial statements do not meet this test, it seems to me that they fail in their ultimate objective. The Trueblood Report emphasizes the user and the predictive orientation of financial statements and I believe that this cannot be ignored. While statements are not forecasts, they may not mislead as to the future in terms of the current knowledge of the preparer and auditor and still meet the test of fairness.

What are the practical implications of this criterion? It seems to me to require a more analytical approach to an income statement. It may also lead to more situations where an auditor may have to conclude that following authoritative principles will be misleading. It is fairly easy to cite extreme examples, but much more difficult to deal with marginal cases.

For example, if substantially all sales made during a year were made under a contract subsequently cancelled, it seems apparent that the face of the income statement must show this fact. Similarly, if a major portion of profits arise from the liquidation of a low cost LIFO inventory, this must be shown separately in the financial statements. Where there are material gains or losses on unusual transactions, these should be separately reflected.

More difficult questions might arise under conditions where a very substantial year-end sales campaign pushes out a large quantity of goods through the use of unusual selling terms. Here, it is likely that this test of fairness would require full disclosure of this fact where it appeared that the effect of this approach was simply to borrow normal sales from a subsequent year and place them in the current year. On the other hand, sales effort alone which led to higher sales would not seem to require the same type of disclosure. It may be difficult to determine which is which. Subjective judgments must be made.

The final criterion for fairness is that disclosure is sufficient to enable the sophisticated user to understand the basis for recording transactions. Any deviations from normal accounting procedures should be set forth and justified. Accounting Principles Board Statement No. 4 provides that "adequate disclosure relates particularly to the objectives of relevance, neutrality, completeness and understandability. Information should be presented in a way that facilitates understanding." This seems to sum up disclosure obligations rather well.

If an independent public accountant is not satisfied that financial statements meet these tests of fairness, he should not give an unqualified opinion on them.

This approach to fairness seems to have a number of different implications. In the first place, it means that professionals who have the responsibility for preparing and auditing financial statements must put themselves in the position of users. Accountants cannot view their role as talking primarily to other accountants. They must be aware of how users work with financial information. At the same time, this definition places an obligation on users of financial statements to develop their understanding of the strengths and weaknesses of the basic accounting model so that they can receive accounting communications more effectively. I think it is fair to say that one of the consistent complaints I hear from financial executives and accountants is that analysts are generally not adequately trained to receive accounting communications effectively and this is an area where substantial additional effort needs to be placed by the financial analysts' profession.

It is important that management, accountants and analysts all study the possibility of making improvements in the communication process. We do not have good information on how data can be made more understandable. Considerable research into the needs of users and the factors that determine the value of enterprises is needed as well as some study of behavioral and psychological theory to consider the ways in which communication can be improved.

This definition of fairness also should encourage the development of criteria wherever possible for the selection of measurement principles to be used. It is not reasonable to think that every circumstance can be contemplated and, accordingly, subjectivity will inevitably remain.

The need for subjective judgments in determining fairness seems to me also to emphasize the importance of an independent and unbiased measurer. This may require a rearticulation of the role of the independent public accountant in public financial reporting. Traditionally, the auditor has attested to management's financial statements. This has implied that management should make the basic reporting decisions and the auditor's role was to attest to the fact that the statements fell within acceptable limits. As the subjectivity inherent in fair presentation is recognized, it may be considered inappropriate to put the primary responsibility on management for making financial reporting decisions. At a minimum, it would seem that the independent accountant should take on a joint responsibility with management for fair presentation, so as to avoid the suspicion that management may have some bias in reporting on its own activities.

Joint responsibility would imply that management and independent accountants would have to agree on the various subjective judgments involved in determining what constitutes the best communication of business results to the investing public. If agreement could not be reached, both parties would have the obligation to report differences in view.

It is plausible to suggest that an independent accountant's function should move even further to the point where he would have the responsibility of a public financial reporter, although it seems unlikely that this approach is likely to be adopted in the near future. This would have the effect of pushing independence one step back from attestation to reporting. The analogy to the role of a newspaper reporter may be apt. Management would have the responsibility for maintaining basic financial records and controls, and for continuing consultations with independent accountants about the progress of the business, while the accountants would have the responsibility of determining how business results should be reported and what disclosures should be made.

There is evidence today that the accounting profession is recognizing the demands for greater fairness in financial reporting and the need to examine their changing role. The Statement of the Auditing Standards Executive Committee on the subject of fairness is a significant step forward. Similarly, the appointment of the Audit Commission under former SEC Chairman Manuel Cohen to explore auditor expectations is a positive step. The President of the American Institute of CPA's, Wallace Olson, in a recent speech[13] suggested that the role of the auditor might increasingly contemplate interpretation of financial results as well as simple attestation to their conformity with generally accepted accounting principles. All of these are encouraging signs. If the profession is prepared to recognize its responsibilities and to expand them, its contribution to investor confidence and knowledge and, hence, to the capital markets of the future will be substantial. The opportunity is present and the Commission stands ready to lend its enthusiastic support.

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13 Olson, Wallace, "A Look at the Responsibility Gap," Journal of Accountancy, January 1975.