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GAO

Report to the Ranking Minority Member, Committee on Commerce, House of Representatives

September 1996

THE ACCOUNTING PROFESSION

Appendixes to Major Issues: Progress and Concerns

G A O

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GAO

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Comptroller General
of the United States

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September 24, 1996

The Honorable John D. Dingell
Ranking Minority Member
Committee on Commerce
House of Representatives

Dear Mr. Dingell:

These appendixes to our report, The Accounting Profession: Major Issues: Progress and Concerns, (GAO/AIMD-96-98), contain the individual recommendations made by the major study groups affecting the accounting profession from 1972 through 1995 and the actions taken on those recommendations. We have organized the individual recommendations by the five major issues that frequently reoccurred throughout our study period. The American Institute of Certified Public Accountants (AICPA), the Financial Accounting Standards Board (FASB), and the Securities and Exchange Commission (SEC) assisted us in identifying the actions taken in response to the individual recommendations. These appendixes also include (1) a summary of the major studies, including the studies' report titles and information on the membership of the study groups, (2) a list of experts on the subject of accounting and auditing we consulted with and other knowledgeable individuals we interviewed in conducting the study, (3) copies of written comments received from the AICPA, FASB, and the SEC on a draft of this report, and (4) a list of major GAO contributors to this study.

Sincerely yours,

Charles A. Bowsher

Charles A. Bowsher
Comptroller General
of the United States

Contents

Abbreviations

AcSEC	Accounting Standards Executive Committee
ADC	acquisition, development, and construction
AICPA	American Institute of Certified Public Accountants
AIMR	Association for Investment Management and Research
AMEX	American Stock Exchange
APB	Accounting Principles Board
ASB	Auditing Standards Board
ASR	accounting series release
AU	Auditing section of AICPA Professional Standards looseleaf service
AudSEC	Auditing Standards Executive Committee
BL	Bylaws section of AICPA Professional Standards looseleaf service
BRT	Business Round Table
CEO	chief executive officer
CON	statement of financial accounting concepts
COSO	Committee of Sponsoring Organizations of the Treadway Commission
CPA	certified public accountant
CPE	continuing professional education
EDP	electronic data processing
EITF	Emerging Issues Task Force of the FASB
ET	Ethics section of AICPA Professional Standards looseleaf service
FAF	Financial Accounting Foundation
FASAC	Financial Accounting Standards Advisory Council
FASB	Financial Accounting Standards Board
FDI Act	Federal Deposit Insurance Act
FDICIA	Federal Deposit Insurance Corporation Improvement Act of 1991
FEI	Financial Executives Institute

GAAP	generally accepted accounting principles
GAAS	generally accepted auditing standards
GASB	Governmental Accounting Standards Board
MAS	management advisory services
MD&A	management's discussion and analysis
NAA	National Association of Accountants
NASD	National Association of Securities Dealers
NYSE	New York Stock Exchange
OTC	over-the-counter
PCPS	Private Company Practice Section of the AICPA
PITF	Professional Issues Task Force of the SECPS
POB	Public Oversight Board
QCIC	Quality Control Inquiry Committee
QREC	Quality Review Executive Committee
QR	Quality Review Program Manual
RICO	Racketeer Influenced and Corrupt Organizations Act
S&L	savings and loan
SAS	statement on auditing standards
SEC	Securities and Exchange Commission
SECPS	SEC Practice Section of the AICPA
SFAS	statement of financial accounting standards
SOP	statement of position
SRO	self-regulatory organization
SSAE	statement on standards for attestation engagements

Major Studies of the Accounting Profession From 1972 Through 1995

Study/Date/ Members	Background
1. Establishing Financial Accounting Standards, Report of the Study on Establishment of Accounting Principles (Wheat Committee), AICPA, March 1972 Francis M. Wheat, Chairman John C. Biegler Arnold I. Levine Wallace E. Olson Thomas C. Pryor Roger B. Smith David Solomons	In March 1971, the AICPA appointed the Wheat Committee to study the establishment of accounting principles and make recommendations for improving that process. The Committee was formed in response to the wave of criticism on corporate financial reporting during the mid-1960s arising from the rapid expansion of accounting firms, the development of increasingly complex and innovative business practices, and the corporate merger movement. The Wheat Committee concluded that there needed to be a substantial change in the structure for establishing financial accounting standards to insure public confidence in the way financial information is reported. The Wheat Committee recommended creating a Financial Accounting Foundation, a Financial Accounting Standards Board, and a Financial Accounting Standards Advisory Council.
2. Objectives of Financial Statements, Report of the Study Group on the Objectives of Financial Statements (Trueblood Committee), AICPA, October 1973 Robert M. Trueblood, Chairman Richard M. Cyert Sidney Davidson James Don Edwards Oscar S. Gellein C. Reed Parker Andrew J. Reinhart Howard O. Wagner Frank T. Weston	In April 1971, the AICPA appointed the Trueblood Committee to provide a statement of basic objectives that would be responsive and relevant to the needs of users. Previously issued objectives, while appropriate, were stated in relatively abstract terms, which offered little practical guidance in the preparation of financial statements. The Committee's conclusions followed a fundamental concept that financial statements should aid economic decision-making, and it emphasized the needs of outside users rather than the operating needs of business managers. The Committee also stated that accounting concepts should serve the goals of both private and public sectors of the economy. The work of the Trueblood Committee laid the fundamental groundwork for the Financial Accounting Standards Board's (FASB) work during the 1970s on establishing a conceptual framework for accounting.
3. The Adequacy of Auditing Standards and Procedures Currently Applied in the Examination of Financial Statements, Report of the Special Committee on Equity Funding, AICPA, February 1975 Martin L. Stone, Chairman J.T. Arenberg, Jr. Leo E. Burger Robert C. Holsen A.E. Mackay	In May 1973, the AICPA appointed the Special Committee on Equity Funding to study whether the Equity Funding collapse in 1973 suggested a need for changes in generally accepted auditing standards. The Committee concluded that, except for certain observations relating to the confirmation of insurance in force and auditing related party transactions, generally accepted auditing standards were adequate and there were no changes called for in the procedures commonly used by auditors.

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Study/Date/ Members	Background
4. Federal Regulation and Regulatory Reform, Report by the Subcommittee on Oversight and Investigations of the Committee on Interstate and Foreign Commerce, U.S. House of Representatives (Moss Subcommittee), October 1976 John E. Moss, Chairman Richard L. Ottinger Robert (Bob) Krueger James M. Collins Norman F. Lent Anthony Toby Moffett Matthew J. Rinaldo Jim Santini W. Henson Moore W.S.(Bill) Stuckey, Jr. Samuel L. Devine James H. Scheuer Henry A. Waxman Philip R. Sharp Andrew Maguire Harley O. Staggers	In April 1975, the Moss Subcommittee undertook a comprehensive study of federal regulatory agencies that included an assessment of the independence, performance, and economic effects of the activities of regulatory agencies under the Subcommittee's jurisdiction. This study was prompted by attacks on federal regulation and the Subcommittee's obligation to measure the performance of agencies it created. The study attempted to determine the true problems of regulation, their nature and extent, and, if needed, possible remedies. The study found that all organizations investigated suffered a critical defect—an insufficient response to the public they were created to serve. The Subcommittee's recommendations related mostly to actions the SEC could take to improve the corporate governance function. Several recommendations involved corporate boards of directors and/or their audit committees and the evaluation and reporting on corporate internal control systems.
5. The Accounting Establishment, a Staff Study prepared by the Subcommittee on Reports, Accounting, and Management of the Committee on Government Operations, U.S. Senate (Metcalf Subcommittee), March 1977 Lee Metcalf, Chairman John L. McClellan Bill Brock Edmund S. Muskie Charles H. Percy Sam Nunn Lowell P. Weicker, Jr. John Glenn	The Metcalf Subcommittee staff began this study in 1975 to provide the Congress and the public with an understanding of the various private organizations and federal agencies involved in establishing and administering accounting practices which have substantial impact on federal policies and programs, as well as private economic decisions. The study was precipitated by continual revelations of previously unreported wrongdoing by major corporations, as well as a series of corporate failures and financial difficulties which had come to light. The staff study's recommendations dealt with the issues of setting accounting and auditing standards, auditor independence, and audit quality.
6. The Structure of Establishing Financial Accounting Standards, Report of the Structure Committee, the Financial Accounting Foundation, April 1977 Russel E. Palmer, Chairman J.O. Edwards James Don Edwards Walter P. Stern Alva O. Way John C. Whitehead	In 1976, the Board of Trustees of the Financial Accounting Foundation (FAF) asked the Structure Committee to perform a comprehensive review of the operations of FASB and the Financial Accounting Standards Advisory Council (FASAC) and recommend any changes needed in their size, composition, and functions. This review was undertaken for a number of reasons, one of them being the unusually vocal criticism of FASB. The Structure Committee concluded that the process of setting accounting standards should remain in the private sector, and FASB is the right body to discharge that responsibility. The Committee's report contains recommendations concerning the structure of FASB's constituency relationships, the organizational structure of FASB and staff, the process of issuing a statement, and the structure of FASB's communications.

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Study/Date/ Members	Background
7. Improving the Accountability of Publicly Owned Corporations and Their Auditors, Report of the Subcommittee on Reports, Accounting, and Management of the Committee on Governmental Affairs, U.S. Senate (Metcalf Subcommittee), November 1977 Lee Metcalf, Chairman Henry M. Jackson Sam Nunn John C. Danforth Charles H. Percy	In 1975, the Metcalf Subcommittee began an inquiry into various accounting practices and responsibilities of the federal government. The study was initiated because of concerns over the activities and accountability of publicly owned corporations arising from a series of unexpected corporate failures and disclosures of widespread questionable and illegal acts by management. The report summarizes the Subcommittee's views regarding the way in which existing accounting and financial reporting practices should be improved to benefit the public. The Subcommittee's recommendations included actions needed to improve/ensure audit quality, auditor independence, and the detection and reporting of illegal acts.
8. The Commission on Auditors' Responsibilities: Report, Conclusions and Recommendations (Cohen Commission), AICPA, 1978 Manuel F. Cohen, Chairman Lee J. Seidler Walter S. Holmes, Jr. LeRoy Layton William C. Norby Kenneth W. Stringer John J. van Benten	In 1974, the AICPA appointed the Cohen Commission to develop conclusions and recommendations on the appropriate responsibilities of independent auditors. The Commission was tasked to consider whether a generally perceived gap between what the public expects or needs and what auditors can and should reasonably expect to accomplish actually existed. If such a gap existed, the Commission was to determine how the disparity could be resolved. The Cohen Commission found that a significant gap did exist between the performance of auditors and the expectations of users of financial statements, and traced the gap to the accounting profession's failure to react and evolve quickly enough to changes in the American business. Its conclusions and recommendations address auditor independence, education, auditor communications, responsibilities for the detection of fraud, quality control mechanisms, and a broader audit function beyond the financial statements.
9. Report of the Special Committee of the AICPA to Study the Structure of the Auditing Standards Executive Committee (Oliphant Committee), AICPA, May 1978 Walter J. Oliphant, Chairman Ivan O. Bull Philip L. Delliese Samuel A. Derieux Louis M. Kessler	In June 1977, the AICPA appointed the Oliphant Committee to study the structure within the AICPA for developing auditing standards to determine what changes, if any, were necessary to improve the process. The AICPA appointed this Committee in response to concerns over the Cohen Commission's recommendations relating to setting auditing standards. The Committee concluded that there were steps that could be taken to improve the effectiveness of setting auditing standards. Accordingly, the Oliphant Committee proposed that the Auditing Standards Executive Committee (AudSEC) be reconstituted within the AICPA as the AICPA Auditing Standards Board (ASB) and made several recommendations pertaining to the mission and structure of this new board.
10. Scope of Services By CPA Firms, Report of the Public Oversight Board of the SEC Practice Section, Division for CPA Firms, AICPA, March 1979 John J. McCloy, Chairman Ray Garrett, Jr. William L. Cary John D. Harper Arthur M. Wood	In July 1978, the Public Oversight Board (POB) reported on its views with respect to the scope of services for member firms of the SEC practice section. The Executive Committee of the SEC Practice Section requested the POB's views in response to questions concerning whether engaging in management advisory services (MAS) for audit clients creates a conflict of interest. In general, the POB concluded that maintenance of independence should be the only limitation on scope of services and that independence be assessed after giving consideration to potential benefits derived from furnishing various services. The POB recommended reliance on existing programs and procedures and suggested that adherence to the portions of the existing MAS Professional Standards and the Code of Professional Ethics dealing with independence be made a condition of membership in the SEC Practice Section.

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Study/Date/ Members	Background
11. Interim Review of the FASB and FASAC, Report of the Structure Committee, Financial Accounting Foundation, May 1979 J.O. Edwards, Chairman William H. Dougherty, Jr. Richard S. Hickok Harvey Kapnick Walter P. Stern John C. Whitehead	In 1979, the Structure Committee of the FAF undertook an interim review of FASB and FASAC to follow up on progress made by FASB and FASAC in responding to the Committee's findings from its 1977 review (see number 6 above). The Committee reported that both FASB and FASAC have initiated desirable changes to the standard-setting process going beyond the Committee's 1977 report recommendations. The Committee's interim report suggests areas for further improvement including increasing public awareness, reaching out to all major constituents, experimenting with FASAC committees, improving utilization of task forces, and enhancing the quality of staff.
12. Operating Efficiency of the FASB, Report of the Structure Committee, Financial Accounting Foundation, August 1982 Charles G. Steele, Chairman Kenneth S. Axelson William H. Dougherty, Jr. Paul J. Dunphy Thomas L. Holton Warren J. Robertson Hyman Weinberg	In 1982, the Structure Committee of the FAF undertook a review of the efficiency of FASB. This review was conducted in line with the bylaws of FAF, which require a periodic review of the basic structure of establishing and improving standards of financial accounting. The Structure Committee's overall conclusion was that FASB was operating efficiently and effectively, that is, appropriate standard-setting systems were in place and functioning well. The Committee's recommendations call for improved relationships and communications with constituencies, increased responses on FASB products, accelerated progress on certain concepts statements, and timely guidance for questions concerning implementation of standards and for emerging issues.
13. Report of the Special Review Committee, Financial Accounting Foundation, 1985 R. Leslie Ellis, Chairman Charles T. Horngren Thomas L. Holton John H. Poelker John F. Ruffle	In January 1985, the Board of Trustees of the FAF initiated actions to assess the extent and nature of concerns about the standards-setting process and to begin simultaneously a study of the composition of FASB and criteria for selection of its members. These actions were taken in response to concerns expressed by certain constituents about the composition and operations of FASB. The work of the Special Review Committee of the FAF concluded that there is strong, widespread support for FASB and its operations, and there is very little evidence of deep dissatisfaction in any segment of the constituency. However, the Committee found some concerns with the qualifications of the FASB Chairman and members, the composition of FASB, the process of selecting members, the lengthy time frame imposed by FASB's due process, and inhibitions on free exchange of ideas caused by the "sunshine rule." The Committee made several recommendations to address these concerns.
14. Challenge and Opportunity for the Accounting Profession: Strengthening the Public's Confidence, the Price Waterhouse Proposals, 1985 Joseph E. Connor, Chairman	In 1985, in response to what it termed a "twin crisis in credibility and liability" (emanating from a succession of spectacular business failures that were seen as audit failures), Price Waterhouse developed a program of action to enhance the credibility and viability of the accounting profession. The principal components of this program include: expanding auditing standards to reduce the risk that management fraud will go undetected, enhancing self-regulation, and seeking equity in civil liability.

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Study/Date/ Members	Background
15. Restructuring Professional Standards To Achieve Professional Excellence in a Changing Environment, Report of the Special Committee on Standards of Professional Conduct for Certified Public Accountants (Anderson Committee), AICPA, April 1986 George D. Anderson, Chairman Robert L. Bunting Joseph P. Cummings James Don Edwards Robert C. Ellyson Francis A. Humphries Richard Kasten James Kurtz Bernard Z. Lee Herman J. Lowe Archie E. MacKay William L. Raby Frank S. Sato Ralph Saul John P. Thomas Kathryn D. Wriston	In October 1983, the AICPA appointed the Anderson Committee to study the relevance and effectiveness of professional standards in today's environment. The AICPA initiated the study in response to concerns over the profession's ability to serve the public interest and retain public confidence in a rapidly changing environment. The Committee concluded that some legitimate concerns had been raised about certified public accountants' behavior and commitment to quality and reached a strong consensus that the accounting profession must make substantial reforms in the way it achieves adherence to its standards. The Committee's report contains sweeping revisions to the AICPA's Code of Professional Ethics and substantial reforms in the way adherence to professional standards is achieved.
16. The Future Relevance, Reliability, and Credibility of Financial Information, Recommendations to the AICPA Board of Directors by seven major accounting firms (Big 7), April 1986 J. Michael Cook, Deloitte Haskins & Sells William L. Gladstone, Arthur Young Ray J. Groves, Ernst & Whinney Larry D. Homer, Peat, Marwick, Mitchell & Co. Edward A. Kangas, Touche Ross & Co. Duane R. Kullberg, Arthur Andersen & Co. Peter R. Scanlon, Coopers & Lybrand	In 1986, the heads of seven major accounting firms submitted recommendations to the AICPA Board of Directors to improve the relevance, reliability, and credibility of financial information. The firms' initiative was prompted by the swift pace and impact of changing business and economic conditions and the firms' recognition of the accounting profession's obligation to assure the utility of audited financial statements. The firms' recommendations addressed the need for more information on risks and uncertainties in financial reporting, auditor independence, peer review, an enhanced ASB, and other issues.
17. Financial Reporting and the Role of Independent Auditors, Statement of Charles A. Bowsher, Comptroller General of the United States, June 1986	In June 1986, GAO participated in a congressional hearing, before the Subcommittee on Oversight and Investigations of the House Committee on Energy and Commerce, on financial reporting, the role of independent auditors, and the SEC's oversight of the accounting profession. The hearing was part of a series of hearings prompted by alleged audit failures. At that hearing, GAO testified that the public expects improvements in the areas of early warning disclosures, fraud detection, compliance with laws and regulations, internal controls, and peer review. GAO encouraged the accounting profession and the SEC to take action in these areas.

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Study/Date/ Members	Background
18. Report of the Task Force on Risks and Uncertainties, AICPA, July 1987 Arthur Siegel, Chairman James P. Colford John D. Collins Phillip W. Crawford Richard Dieter John E. Ellingsen Rosemary E. McGovern Rudolph W. Schattke Roger W. Trupin	In 1985, the AICPA established the Task Force on Risks and Uncertainties to consider ways to improve disclosure about the risks and uncertainties that faced business enterprises in light of the volatile business environment of the 1980s. The Task Force concluded that a business enterprise should disclose more information about the risks and uncertainties facing it as of the date of the financial reports. The Task Force's recommendations focused primarily on increased disclosures of significant risks and uncertainties that stem from the necessary use of estimates in the preparation of financial statements and from significant concentrations in aspects of the entity's operations.
19. Report of the National Commission on Fraudulent Financial Reporting (Treadway Commission), October 1987 James C. Treadway, Jr., Chairman William M. Batten William S. Kanaga Hugh L. Marsh, Jr. Thomas I. Storrs Donald H. Trautlein	The Treadway Commission, formed in 1985, was a private-sector initiative jointly sponsored by the AICPA, the American Accounting Association, the Financial Executives Institute, the Institute of Internal Auditors, and the National Association of Accountants. The Commission was created to identify the causal factors that can lead to fraudulent financial reporting and steps to reduce its incidence. The Commission's conclusions highlighted the need for improvements in areas including corporate reporting on internal controls, the establishment of independent audit committees, auditor detection and reporting of fraud, and steps needed to help ensure audit quality. The Treadway Commission's report contained numerous recommendations to deter fraudulent financial reporting which were addressed to the management of public companies, independent public accountants, the SEC and other regulatory agencies, and educators.
20. Letter to the Honorable Fernand J. St Germain, Chairman, Committee on Banking, Finance and Urban Affairs, House of Representatives, GAO, (B229444) August 1988	GAO's 1988 letter to the Chairman discusses items that GAO believed should be addressed in any legislation to provide new securities powers to banks. Specifically, GAO felt that two further items should be added to the proposed legislation (Depository Institutions Act of 1988) to ensure that safeguards are in place and are functioning properly to ensure the safety and soundness of the nation's banks. The first item addresses the need for a requirement for independent financial audits of banks and bank holding companies that have a securities affiliate including requiring a financial audit of the securities affiliate. The second item addresses internal control and compliance reporting by management and the independent auditor.
21. The Structure for Establishing Financial Accounting Standards, the Report of the Financial Accounting Foundation's Committee to Review Structure for Financial Accounting Standards, January 1989 Thomas L. Holton, Chairman R. Leslie Ellis Robert E. Frazer Ray J. Groves Charles T. Horngren Robert A. Mellin J. Ronald Morgan Earle E. Morris, Jr. John E. Poelker Edus H. Warren, Jr.	In January 1988, the FAF's Committee to Review Structure for Financial Accounting Standards was appointed to review the structure and operations of FASB and FASAC, as required by FAF's bylaws. The Committee concluded that despite the concerns expressed by the business community and public accounting profession about certain aspects of FASB activities, the makeup, organization, and operations of FASB are basically sound. The Committee's report, however, does include several recommendations to strengthen FASB.

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Study/Date/ Members	Background
22. CPA Audit Quality: Failures of CPA Audits To Identify and Report Significant Savings and Loan Problems, (GAO/AFMD-89-45) February 1989	Prompted by the savings and loan (S&L) crisis of the 1980s, the Committee on Banking, Finance and Urban Affairs, House of Representatives, asked GAO to review the quality of audits of S&Ls in the Dallas Federal Home Loan Bank District. GAO concluded that, for 6 of 11 failed S&Ls in its review, CPAs did not adequately audit and/or report the S&L's financial or internal control problems in accordance with professional standards. GAO recommended that the AICPA provide improved guidance for ensuring that S&L audits are performed in a quality manner by (1) revising the AICPA industry audit guide for savings and loan associations and (2) communicating results presented in this GAO report to all AICPA members.
23. CPA Audit Quality: Status of Actions Taken To Improve Auditing and Financial Reporting of Public Companies, (GAO/AFMD-89-38) March 1989	In 1987, the Chairman, Oversight and Investigations Subcommittee, House Committee on Energy and Commerce, asked that GAO review the implementation of the changes to improve auditing and financial reporting of public companies and that GAO identify related recommendations which would require legislative or regulatory actions in order to be implemented. This request was sparked by the well-publicized business failures which raised questions about the effectiveness of the independent audit of public companies and the SEC's oversight of the public accounting profession. GAO concluded that the public accounting profession and others have taken positive actions to address concerns about audit quality and the accuracy and reliability of financial disclosures of public companies. However, the report notes that actions remain to be taken. GAO made recommendations to the SEC and the AICPA regarding additional steps needed to improve audit quality and financial disclosures.
24. Bank Failures: Independent Audits Needed to Strengthen Internal Control and Bank Management, (GAO/AFMD-89-25) May 1989	To address concerns about the steadily increasing number of failures of insured banks, GAO undertook a review to summarize data on internal weaknesses and environmental factors which bank examiners cited for insured banks which failed in 1987, to determine the extent to which insider abuse and fraud were present in 1987 failed banks and to identify potential areas of concern. GAO found that serious internal control weaknesses contributed significantly to virtually all the bank failures in 1987. GAO also found that only about a third of the banks that failed in 1987 had audits by independent public accountants. GAO recommended that each insured bank have an annual independent audit and provide auditor reports on internal controls and compliance with laws and regulations.
25. Thrift Failures: Costly Failures Resulted From Regulatory Violations and Unsafe Practices, (GAO/AFMD-89-62) June 1989	In response to a large number of thrift failures and the resulting thrift industry crisis, GAO initiated a review to provide perspective on factors that characterized those thrift failures that have caused some of the larger losses to the Federal Savings and Loan Insurance Corporation, and especially to determine whether violations of federal laws or regulations, related unsafe practices, and fraud and insider abuse were present. GAO found indications of fraud or insider abuse at all the failed thrifts in GAO's sample. GAO recommended that the Congress pass legislation that among other things, would require management and auditor reporting to the federal regulator on internal controls and on compliance with laws and regulations in order to reduce thrifts' vulnerability to fraud and insider abuse.
26. Prevention, Detection, and Reporting of Financial Irregularities, Statement of Charles A. Bowsher, Comptroller General of the United States, (GAO/T-AFMD-90-27) August 1990	In 1990, the Comptroller General testified before the Subcommittee on Telecommunications and Finance, House Committee on Energy and Commerce, on GAO's support of proposed amendments to the 1934 act to strengthen both management and auditor responsibilities for detecting and reporting irregularities. GAO made recommendations concerning management and auditor responsibilities for internal controls and compliance with laws and regulations, the need to strengthen audit requirements, methods of responding to audit discoveries, and the jurisdiction of the SEC. GAO also made suggestions concerning audit committees, peer reviews, notification of auditor changes, and sharing reports and information with independent public accountants concerning regulators' knowledge of potential mismanagement, fraud, or abuse by companies.

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Study/Date/ Members	Background
27. Failed Banks: Accounting and Auditing Reforms Urgently Needed, (GAO/AFMD-91-43) April 1991	GAO analyzed 1988 and 1989 bank failures to identify the impact of accounting and internal control weaknesses on those failures and the critical need for reforms to minimize future losses to the Bank Insurance Fund and the taxpayer. GAO initiated this review to address congressional and public concerns that the external reports prepared by banks, both annual financial statements and call reports, did not always alert users to the troubled financial condition of banks in a timely manner. GAO concluded that accounting rules for recognizing losses were seriously flawed, impeding early warning of troubled banks, and that internal control weaknesses were a major cause of bank failures. GAO made several recommendations concerning an early warning system, the role of the audit committees, the independent auditor's review of the quarterly financial reports, and auditor's communications with regulators regarding internal control weaknesses and noncompliance with laws and regulations.
28. Letter to the Honorable Ron Wyden, House of Representatives, GAO, (B-240516) May 1, 1991	As requested, the Comptroller General provided GAO's views on how internal controls could be strengthened to further protect investors and limit the government's exposure to major losses, such as the massive bailout of the savings and loans sector during the 1980s and its severe economic consequences for investors and government alike. This request was made in response to fundamental questions concerning corporate accountability, the effectiveness of corporate governance and regulation, and the adequacy of audit requirements. GAO's letter highlights the severity of internal control weaknesses and outlines the type of legislative remedies required, such as greater reporting on internal controls, stronger roles for audit committees, and direct reporting of illegal acts.
29. Audit Committees: Legislation Needed to Strengthen Bank Oversight, (GAO/AFMD-92-19) October 1991	This GAO report examines the extent to which audit committees of large banks had the independence, expertise, and information needed to properly carry out their functions and provides further support for earlier GAO recommendations. GAO undertook this review as a result of the record number of failing banks during the 1980s. The study found that many audit committees lacked the independence, expertise, and information necessary to properly oversee bank operations. The report reiterates recommendations made by GAO in an April 1991 report on failed banks (see number 27 above) which calls for legislation concerning audit committee requirements; internal control reporting by management; and internal control reporting, compliance reporting, and reporting on quarterly data by the independent auditor.
30. Employee Benefits: Improved Plan Reporting and CPA Audits Can Increase Protection Under ERISA, (GAO/AFMD-92-14) April 1992	The Chairmen of the House Subcommittee on Oversight and the House Subcommittee on Labor-Management Relations requested that GAO identify problems in the performance of employee benefit plan audits. This request resulted from significant deficiencies in audits of private employee benefit plans as identified by the Department of Labor's Office of Inspector General in November 1989. GAO's review of a sample of plan audits also found serious audit weaknesses, many of which stemmed from a lack of auditor knowledge about special considerations associated with auditing employee benefit plans. GAO recommended, among other things, that the AICPA improve its audit guide concerning audits of employee benefit plans and that the AICPA communicate to its membership the results of investigations of deficient plan audits.
31. In the Public Interest, Issues Confronting the Accounting Profession, a special report by the Public Oversight Board of the SEC Practice Section, AICPA, March 1993 A.A. Sommer, Jr., Chairman Robert K. Mautz, Vice Chairman Melvin R. Laird Paul W. McCracken Robert F. Froehlke	The POB issued this report in response to a request from representatives of a number of accounting firms that the POB consider whether it could support the accounting profession's efforts to obtain relief from what the profession believed to be an excessive burden of litigation. The POB concluded that the litigation risks confronting the profession pose serious dangers to its ability to perform its assigned role in society. The POB also addressed some of the criticisms pertaining to the profession's performance. The POB's report contains 25 recommended actions to enhance the usefulness and reliability of financial statements; strengthen the performance and professionalism of the public accounting profession, including the ability of auditors to detect fraud and irregularities; and improve self-regulation.

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Study/Date/ Members	Background
32. Meeting the Financial Reporting Needs of the Future: A Public Commitment From the Public Accounting Profession, AICPA Board of Directors, June 1993	In June 1993, the Board of Directors of the AICPA issued a policy statement which details the steps necessary to improve the value of financial information and the public's confidence in it. The policy statement describes how public confidence in the financial reporting system has been shaken in recent years by highly publicized business failures and includes actions the Board believes are needed to solidify the public trust in the financial reporting system. The statement identifies five principal goals for reform concerning the prevention and detection of fraud, the utility of financial reporting, the independence and objectivity of independent auditors, unwarranted litigation, and strengthening the accounting profession's disciplinary system.
33. Financial Reporting in the 1990s and Beyond, Association for Investment Management and Research (AIMR), November 1993 Peter H. Knutson	AIMR's report sets forth the position of investment advisors and financial analysts on the universe of financial reporting as it affects analysis today and into the next century. The report explains the function of financial analysis, its sources and uses of information, and speaks to the trends that are expected to change practices in both analysis and accounting during the next decade or more. AIMR's conclusions and recommendations call for a substantial expansion in the quality and quantity of financial information now being reported. AIMR also recommends increased participation by financial statement users in the accounting standard-setting process.
34. Staff Report on Auditor Independence, report prepared by the Office of the Chief Accountant, Securities and Exchange Commission, March 1994	This SEC staff report responds to the March 18, 1993, request from Congressman Edward J. Markey, Chairman of the Subcommittee on Telecommunications and Finance of the House Committee on Energy and Commerce, that the SEC study the need for, and any impediments to, the independence of public accountants in performing their responsibilities under the federal securities laws. This request was made in consideration of a proposed bill to make the auditing profession more accountable to the investing public. The SEC's report provides background information on the issue of auditor independence, discusses the Commission's independence rule and related interpretations and pronouncements of the AICPA and other nations' independence requirements, and discusses recent and certain current proposals regarding independence issues. The report concluded that the combination of the extensive systems of independence requirements issued by the Commission and the AICPA, coupled with the Commission's active enforcement program, provide investors reasonable safeguards against loss due to the conduct of audits by accountants that lack independence from their audit clients. Therefore, the SEC concluded that no further legislation or rules or regulations were necessary at that time with respect to auditor independence.
35. Financial Derivatives: Actions Needed To Protect the Financial System, (GAO/GGD-94-133) May 1994	In response to congressional requests, GAO undertook a review of derivative products to determine among other things whether existing accounting rules resulted in financial reports that provided market participants and investors adequate information about firms' use of derivatives. This review was sparked by congressional efforts to better anticipate and prevent future financial crises. GAO found that accounting standards for derivatives were incomplete and inconsistent and have not kept pace with business practices. GAO made recommendations to FASB and the SEC concerning the development and issuance of accounting and disclosure requirements for derivatives, the adoption of market value accounting for all financial instruments, and the requirements for independent audit committees and internal control reporting for SEC registrants that are major end users of derivatives.

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Study/Date/ Members	Background
36. Strengthening the Professionalism of the Independent Auditor, Public Oversight Board Advisory Panel on Auditor Independence (Kirk Panel), September 1994 Donald J. Kirk, Chairman George D. Anderson Ralph S. Saul	In February 1994, the POB appointed the Kirk Panel to (1) assess the working relationship among the SEC, FASB, the auditing profession, and the business community and (2) identify and evaluate steps to bolster the objectivity, independence, and professionalism of the auditing firms. The Kirk Panel was appointed in response to a January 11, 1994, speech, given by Walter Schuetze, the Chief Accountant of the SEC, which questioned the independence of auditors. The Panel concluded that at this time there is no need for additional rules, regulations, or legislation dealing with auditor independence. However, the Panel made several suggestions to strengthen auditor independence, to bring auditing into the mainstream of corporate governance, and to restore auditing to its important role in our society. These suggestions cover issues such as auditor independence; more involvement of the boards of directors and audit committees with the independent auditor; the relationships between the accounting profession, standard setters, and the SEC; and litigation reform.
37. Improving Business Reporting - A Customer Focus: Meeting the Information Needs of Investors and Creditors, Comprehensive Report of the Special Committee on Financial Reporting (Jenkins Committee), AICPA, 1994 Edmund L. Jenkins, Chairman Gregory J. Jonas, Executive Director Michael H. Sutton, Vice Chairman Lonnie Arnett Raymond J. Bromark Edmund Coulson Robert K. Elliott Larry Grinstead William W. Holder Robert L. Israeloff Gaylen N. Larson Joseph D. Lhotka James C. Meehan Harold L. Monk, Jr. Edward F. Rockman Barry N. Winograd	In 1991, the AICPA Board of Directors formed the Jenkins Committee to address concerns about the relevance and usefulness of business reporting. The Committee's charge was to recommend (1) the nature of information that should be made available to others by management and (2) the extent to which auditors should report on the various elements of that information. The Committee concluded that a lot is right with today's business reporting in that it generally provides users with essential information that heavily influences their decisions. In particular, financial statements are viewed as an excellent framework for capturing and organizing financial information. However, many users are strongly critical of certain aspects of today's reporting. Accordingly, the Committee made recommendations to standard setters, the Congress, regulators, and the accounting profession to improve the types of information in business reporting, to improve financial statements and related disclosures, to improve auditor involvement with business reporting, and to facilitate change in business reporting.

Major Recommendations From 1972 Through 1995 and Actions Taken to Improve Auditing and Financial Reporting

Table II.1: Auditor Independence

Issue: Auditor Independence			
Recommendation	**Action taken**	**Recommendation made by/date**	**Recommendation directed to**
1-6. The SEC should promulgate rules necessary to assure that		Moss Subcommittee (1976)	
1. ...a director of a publicly owned corporation receives compensation and independent staff sufficient to perform responsibly his board duties.	No action taken.		SEC
2. ...a majority of the board is independent of senior management and operating executives and from any other conflicts of interest.	See action taken for recommendations 4 and 63.		SEC
3. ...the board reviews and approves the corporation's code of business conduct and system of internal controls.	No action taken.		SEC
4. ...the board's auditing and nominating committees are comprised of a majority of independent directors.	NYSE listing requirements mandate independent audit committees. NASD requires all national market system companies to have audit committees with a majority of independent directors, as does the AMEX. FDICIA requires independent audit committees for certain large banks and thrifts. The AICPA believes that SEC registrants and other publicly accountable entities should be required to have independent audit committees whenever practicable. (See June 1993 policy statement of the AICPA Board of Directors.)		SEC
5. ...the board's auditing committee has available to it independent expert advisors.	No action taken by the SEC. FDICIA specifies certain resources for audit committees of large banks and thrifts.		SEC
6. ...the board has the authority to hire and fire the independent accountant, legal counsel, the general counsel, and senior operating executives.	Media accounts have reported situations where boards have exercised their clear authority in this respect. For example, since 1991, "activist boards have forced out more than two dozen chief executives of major U.S. corporations" (The Wall Street Journal, June 15, 1994).		SEC

(continued)

Issue: Auditor Independence			
Recommendation	**Action taken**	**Recommendation made by/date**	**Recommendation directed to**
7. The Congress should consider methods of increasing competition among accounting firms for selection of independent auditors for major corporations. One alternative is mandatory change after a given period of years or after any finding by the SEC that the CPA firm failed to exercise independent action to protect investors and the public. Another alternative could be to require more than one accounting firm be on the ballot at annual stockholders' meetings.	No action taken. Since this recommendation was issued, the environment in which accounting firms practice has changed substantially. The abolition of ethical prohibitions against advertising and solicitation, intense fee pressure, and disagreements that damage auditor/client relationships lead hundreds of companies to change auditors each year. See action taken for recommendation 29 for information about requirements and studies related to auditor rotation.	Metcalf Subcommittee Staff Study (1977)	Congress
8. The federal government should require the 15 largest accounting firms to report basic and operational data annually.	No action taken. However, key information about the largest firms is widely reported in the trade press.	Metcalf Subcommittee Staff Study (1977)	Federal government
9. The federal government should act to relieve excessive concentration in the supply of auditing and accounting services to major publicly owned corporations.	No action taken.	Metcalf Subcommittee Staff Study (1977)	Federal government
10. The Department of Justice and the Federal Trade Commission should determine whether violations of federal antitrust laws have resulted from excessive concentration in the supply of auditing and accounting services among all industries or within specific industries.	The Department of Justice and the Federal Trade Commission have made investigations that have resulted in changes in AICPA's Code of Professional Conduct, but not in determinations of any violations of federal antitrust laws in the supply of auditing and accounting services.	Metcalf Subcommittee Staff Study (1977)	Department of Justice and Federal Trade Commission
11. The Congress should consider other methods of reducing concentration in the supply of auditing and accounting services to major corporations.	No action taken.	Metcalf Subcommittee Staff Study (1977)	Congress
12. The federal government should retain accounting firms that act as independent auditors only to perform auditing and accounting services and not to perform management advisory services or other consulting services.	No action taken.	Metcalf Subcommittee Staff Study (1977)	Federal government

(continued)

Issue: Auditor Independence

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
13. The accounting profession or the SEC should immediately require that publicly owned corporations establish independent audit committees composed of outside directors as a condition for being accepted as a client by an independent auditor.	NYSE listing requirements mandate independent audit committees. NASD requires all national market system companies to have audit committees with a majority of independent directors, as does AMEX. FDICIA requires independent audit committees for large banks and thrifts. The AICPA believes that SEC registrants and other publicly accountable entities should be required to have independent audit committees whenever practicable. (See June 1993 policy statement of the AICPA Board of Directors.)	Metcalf Subcommittee (1977)	Accounting profession or SEC
14. Audit committee members should be free of any significant involvement with the management of a corporation, such as commercial or investment banking relationships, outside legal counsel, management consulting, or major commercial relationships.	See action taken for recommendation 13.	Metcalf Subcommittee (1977)	Public companies or SEC
15. Rotating the audit committee's chairman could increase its independence.	No action taken.	Metcalf Subcommittee (1977)	Public companies or SEC
16. Corporate audit committees should establish sound policies to prevent hidden remuneration of executives through use of corporate assets for housing, personal loans, club memberships, and personal travel or pleasure.	The Good Practice Guidelines for the Audit Committee suggested in Appendix I to the Treadway Report call for a review of the in-house policies and procedures for regular review of officers' expenses and perquisites. (Recent media accounts reporting abuses in this area that were detected by audit committees should have the positive effect of focusing other audit committees on those guidelines.)	Metcalf Subcommittee (1977)	Public companies or SEC
17. Accounting firms which audit publicly owned corporations should be required to publicly disclose financial data and important operating information.	The disclosure of financial data, with which some firms experimented, tends to focus attention on a firm's perceived ability to pay damages in litigation rather than on its quality controls. However, substantive operating information about, e.g., personnel, number of SEC clients, pending litigation, the composition of fees, management advisory services fees for SEC clients, and mergers, is required to be reported and is in the SECPS public files.	Metcalf Subcommittee (1977)	Accounting profession

(continued)

Issue: Auditor Independence

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
18. Reports by accounting firms should include sufficient information on client relationships so that the accounting organization and the SEC can monitor compliance with appropriate standards.	The SECPS membership requirements specify that the annual reports of member firms include statistical information about fees and the nature of services rendered that AICPA believes meet the information needs of the SEC.	Metcalf Subcommittee (1977)	Accounting profession
19. An audit committee should have sole authority to hire and fire the independent auditor and set the auditor's fee.	Although AICPA believes audit committees generally have this authority, it has not been mandated.	Metcalf Subcommittee (1977)	SEC
20. The audit committee should meet privately with the independent auditor, receive full reports from the auditing firm on its findings, and be informed of all services being provided to the corporation by the auditing firm.	SECPS membership requirements (SECPS Reference Manual §1008.(i)) mandate an annual report to the audit committee of each SEC client on the total fees received from the client for management advisory services during the year under audit and a description of the types of such services rendered. Also, see discussions of communications requirements in SAS 53 on errors and irregularities, SAS 54 on illegal acts by clients, and SAS 61 on communication with audit committees, and note that "Information and Communication" is one of the five components of internal control under the COSO.	Metcalf Subcommittee (1977)	Accounting profession or SEC
21. The primary mission of the organization of accounting firms (see recommendation 20 in "Audit Quality" section), as envisioned by the subcommittee, will be to assure that the two essential qualities of independent auditors—professionalism and independence—are not sacrificed through such practices as unrealistic cost cutting and time constraints in pursuit of commercial success.	The primary purpose of the SECPS is to maintain and improve the quality of practice before the Commission. The SEC's 1994 Annual Report indicates that this objective is being achieved. As part of this program of improvement, in March 1980, the SECPS issued the Position Paper of Task Force on Certain Aspects of the Auditor's Work Environment. The SECPS membership requirements also mandate the preparation and dissemination to all personnel of a "Statement of Firm Philosophy." The illustrative statement provided by the SECPS Reference Manual §1000.42 emphasizes the need for an overriding commitment to high-quality professional performance.	Metcalf Subcommittee (1977)	Accounting profession

(continued)

Issue: Auditor Independence

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
22. Public advocacy on behalf of a client, receiving gifts and discounts from clients, and maintaining relationships which detract from the appearance of arm's-length dealings with clients are not appropriate activities for independent auditors.	Public advocacy on behalf of a client is not proscribed, but the AICPA's Professional Ethics Executive Committee has issued an Interpretation (Interpretation 102-6 — August 1995) that calls attention to applicable ethical precepts when members advocate a client's position, and an ethics ruling (see ET §191.008 of the AICPA Professional Standards looseleaf service) states that acceptance of a gift of more than token value may impair the appearance of independence. Also, the Code of Professional Conduct is constantly updated to deal with new situations or concerns. An important recent action was the proscription of most loans from clients. Finally, the SEC's Staff Report on Auditor Independence states on page 34 that "the problem of an appearance of 'client advocacy' may not be susceptible to correction through additional, objective independence interpretations or rules."	Metcalf Subcommittee (1977)	Accounting profession
23. There must be a requirement that independent auditors of publicly owned corporations perform only services directly related to accounting. Nonaccounting management services, such as executive recruitment, marketing analysis, plant layout, product analysis, and actuarial services, are incompatible with the public responsibilities of independent auditors and should be discontinued. Management services relating to accounting are confined to the limited area of providing certain computer and systems analyses that are necessary for improving internal control procedures of corporations.	For the reasons stated in its report, Scope of Services by CPA Firms, the POB rejected the notion of arbitrary and sweeping restrictions on useful services provided by CPA firms. However, the SECPS does prohibit member firms from performing the following services for SEC audit clients: psychological testing, public opinion polls, merger and acquisition assistance for a finder's fee, and certain executive recruitment and actuarial services.	Metcalf Subcommittee (1977)	Accounting profession

(continued)

Issue: Auditor Independence

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
24. Independent auditors should discontinue all placement of departing employees with their corporate clients.	The AICPA believes, generally, that such employment from time to time is an inevitable consequence of the training and experience that the public accounting profession provides to its staff; is beneficial to all concerned, including society in general; and should not be proscribed. However, the June 1993 policy statement of the AICPA Board of Directors does call on the SEC and other regulatory bodies to prohibit public companies and other organizations with public accountability from hiring the partner responsible for their audit for one year after the partner ceases to serve that client. (ET §191.154 provides guidance to a firm when an individual participating in an engagement is considering or has accepted employment with the client.)	Metcalf Subcommittee (1977)	Accounting profession
25. Public disclosure would be enhanced by stating whether competitive bidding practices are used in contracting for services with independent auditors.	The AICPA does not believe disclosure would be enhanced by adoption of this recommendation. Some users would assume that auditor selection is enhanced by a competitive bidding process, while others would fear that process has led or will lead to a reduction in the scope or quality of services. With no more facts than this at their disposal, users would only be confused. The AICPA believes the focus should be on quality, not fees, and for that reason agrees with the POB that the SEC should require SEC registrants to disclose whether their auditors have had a peer review, the date of the most recent review, and its results.	Metcalf Subcommittee (1977)	Accounting profession and SEC
26. The problems of appearing to audit one's own work and unfair competition can arise even when independent auditors provide accounting-related management services for audit clients. Because so many parties outside the accounting profession are directly interested, the SEC should use public rule-making to consider proposals for surmounting such problems and to implement public policy in the area of management services.	This was done via ASR 250 and 264, issued in 1978 and 1979, respectively. For the reasons stated in ASR 296 and 297, the SEC rescinded these releases in 1981. For additional background and information, see the SEC's Staff Report on Auditor Independence, March 1994. That report notes (see p. 34) that there has been no dramatic increase in the management advisory services provided to SEC clients, which suggests that "a fundamental change in SEC regulations is not necessary at this time."	Metcalf Subcommittee (1977)	SEC

(continued)

Issue: Auditor Independence

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
27. Concerned directors and audit committees should carefully review the policies of their corporations to assure that the auditor's independence does not appear to be compromised.	As indicated on page 30 of the SEC's Staff Report on Auditor Independence, March 1994, the SEC has found that "audit committees consisting principally of nonemployee directors actively were reviewing management advisory activities and auditors generally were not performing those services believed to have an impact on their independence."	Metcalf Subcommittee (1977)	Public companies or SEC
28. There must be an immediate end to artificial professional restrictions against advertising, talking with another firm's clients, and talking with another firm's employees about possible employment without first informing that firm. Prohibitions by accounting organizations in some states against competitive bidding should also be removed.	The AICPA has removed those proscriptions from its Code of Professional Conduct, and firms freely advertise and solicit clients and the employees of other firms. Such proscriptions are still maintained by some state boards of accountancy, but the AICPA has no authority over these independent regulatory agencies.	Metcalf Subcommittee (1977)	Accounting profession
29. Rotation should be studied more by the accounting profession and the SEC in order to better determine potential benefits and problems. At a minimum, personnel assigned to a specific audit within an accounting firm should be rotated.	SECPS membership requirements require that the audit partner-in-charge of an SEC engagement be rotated after he or she has served in that capacity for 7 consecutive years. (Recognizing the problems of smaller firms, and with the concurrence of SEC staff, this requirement does not apply to such firms if they audit less than five SEC clients.) In addition, the SECPS has studied this recommendation extensively and in 1992 issued a Statement of Position regarding mandatory rotation of audit firms of publicly held companies, which explains why that proposal is neither necessary nor appropriate. Finally, after discussing the various costs and benefits of audit firm rotation, the SEC's Staff Report on Auditor Independence advises against mandatory rotation by legislation or rule-making at this time.	Metcalf Subcommittee (1977)	Accounting profession and SEC
30. Public accounting firms should not engage in employment recruiting or placement of individuals who would be directly involved in the decision to select or retain independent auditors.	These services are proscribed by the membership requirements of the SECPS.	Cohen Commission (1978)	Accounting profession

(continued)

Issue: Auditor Independence

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
31. The auditor's standard of care when he uses a specialist who is an employee of his firm should be extended beyond what is required under existing standards on the use of a specialist to treat the work of that employee no differently than the work of a qualified employee of the client.	A 1979 interpretation (AU §9336.04-05) confirms that when a specialist employed by the audit firm provides advisory services to a client and the auditor uses that work, the guidance in SAS 11 should be followed. SAS 11 was subsequently superseded by SAS 73, issued in July 1994, and that guidance is embodied in the revision.	Cohen Commission (1978)	Accounting profession
32. No prohibition of management services is warranted (other than the limitation on placement and recruitment noted in 30 above).	Although the SECPS proscribes certain other services (psychological testing, public opinion polls, and merger and acquisition assistance for a finder's fee), the SECPS and the profession concur with this recommendation. (See section in the POB report on Scope of Services by CPA Firms, 1979.)	Cohen Commission (1978)	Accounting profession
33. The board of directors (or its audit committee) should consider all the services provided by the independent auditor. The independent auditor should inform the board or audit committee of all the services provided to the company; the relationship of those services, or lack thereof, to the audit function; the fees for those services; and the fact that information acquired in providing the other services must be considered by the auditor in fulfilling his audit responsibilities.	SECPS membership requirements (SECPS Reference Manual §1008.(i)) mandate an annual report to the audit committee of each SEC client on the total fees received from the client for management advisory services during the year under audit and a description of the types of such services rendered. Also, see discussions of communications requirements in SAS 53, on errors and irregularities; SAS 54, on illegal acts by clients; and SAS 61, on communication with audit committees, and note that "Information and Communication" is one of the five components of internal control under the COSO report.	Cohen Commission (1978)	Public companies and accounting profession
34. Professional standards should require that public accounting firms establish policies and procedures to assure that knowledge gained from other services is made available to the partner in charge of the audit so that he can consider its implications for the audit function, including assuring that consulting personnel who are not CPAs are made aware of the public accounting firm's professional responsibility as an independent auditor.	SAS 22 includes as a planning procedure discussing matters that may affect the audit with firm personnel responsible for nonaudit services to the client, and an interpretation (AU §9311.01-.03) addresses that subject.	Cohen Commission (1978)	Accounting profession

(continued)

Issue: Auditor Independence			
Recommendation	**Action taken**	**Recommendation made by/date**	**Recommendation directed to**
35. Professional standards should be expanded to cover the provision of advice on accounting principles. They should identify appropriate considerations in order to avoid activities which do, or appear to, jeopardize independence.	SAS 50 provides performance and reporting standards for reports on the application of accounting principles. The statement requires communication with the continuing accountant to ascertain relevant facts so as to provide additional assurance about the quality of the advice given.	Cohen Commission (1978)	Accounting profession
36. All companies should disclose in their management reports information on the nature of other services provided to them by their independent auditors.	This was done via ASR 250 and 264, issued in 1978 and 1979, respectively. For the reasons stated in ASR 296 and 297, the SEC rescinded these releases in 1981. For additional background and information, see the SEC's Staff Report on Auditor Independence, March 1994.	Cohen Commission (1978)	Public companies or SEC
37. The board of directors, through its outside directors or audit committee if such exist, should be responsible for recommending to shareholders the appointment of independent auditors and for evaluating the relationship between the auditor and management.	Although AICPA believes audit committees generally have and exercise this authority, it has not been mandated. As indicated on page 30 of the SEC's Staff Report on Auditor Independence, March 1994, the SEC has found that "audit committees consisting principally of nonemployee directors actively were reviewing management advisory activities and auditors generally were not performing those services believed to have an impact on their independence."	Cohen Commission (1978)	Public companies or SEC
38. The type of disclosure in financial statements required by the SEC in ASR 194 concerning disagreements when a change of auditors is made should be required for all financial statements.	SAS 61 para. 11 requires all significant disagreements to be discussed with the audit committee. SAS 7 para. 6-7 requires the predecessor auditor to "respond promptly and fully" to certain inquiries made by the successor auditor, including "disagreements with management as to accounting principles, auditing procedures, or other similarly significant matters." SAS 50 provides performance standards and reporting guidance with respect to written reports and oral advice on the application of accounting principles.	Cohen Commission (1978)	Accounting profession

(continued)

Issue: Auditor Independence			
Recommendation	**Action taken**	**Recommendation made by/date**	**Recommendation directed to**
39. Rotation of firms should not be required. Many of the asserted advantages of rotation can be achieved if the public accounting firm systematically rotates the personnel assigned to the engagement.	SECPS membership requirements require that the audit partner-in-charge of an SEC engagement be rotated after he or she has served in that capacity for 7 consecutive years. After discussing the various costs and benefits of audit firm rotation, the SEC's Staff Report on Auditor Independence advises against mandatory rotation by legislation or rule-making at this time.	Cohen Commission (1978)	Accounting profession
40. Public accounting firms should not abandon time budgets, but they must improve current methods, particularly for the evaluation of variances and their effect on the evaluation of personnel.	In March 1980, the SECPS issued the Position Paper of Task Force on Certain Aspects of the Auditor's Work Environment. The SECPS membership requirements also mandate the preparation and dissemination to all personnel of a "Statement of Firm Philosophy." The illustrative statement provided by the SECPS Reference Manual (§1000.42) emphasizes the need for an overriding commitment to high-quality professional performance.	Cohen Commission (1978)	Accounting profession
41. Individual accounting firms should immediately undertake to conduct studies to determine the extent of excessive time and budget pressures and the effects on their practices.	See action taken for recommendation 40.	Cohen Commission (1978)	Accounting profession
42. To reduce client pressures, a brief statement should be required on each page of the press release or other dissemination of early earnings release that might read as follows: "The accompanying results have been prepared by management; they may be subject to significant revision upon examination by the independent auditors."	No action taken.	Cohen Commission (1978)	SEC
43. Auditors should carefully assess the effect of time/deadline pressures on their work and refuse to accept such deadlines when they are imposed in opposition to their judgment.	See action taken for recommendation 40.	Cohen Commission (1978)	Accounting profession
44. Accepting an audit engagement with the expectation of offsetting early losses or lower revenues with fees to be charged in future audits represents a threat to independence. Consequently, the Ethics Division of the AICPA should consider this problem.	Antitrust considerations precluded ethics action on this recommendation. However, the SECPS peer review standards address the substance of the concern by requiring the selection of some initial audits in a firm's peer review (SECPS Reference Manual §2000.70(c)).	Cohen Commission (1978)	Accounting profession

(continued)

Issue: Auditor Independence			
Recommendation	**Action taken**	**Recommendation made by/date**	**Recommendation directed to**
45. All firms should develop for their staffs carefully drawn rules on gifts and discount purchases from clients, and the AICPA should provide more definitive guidance on what amounts can be considered "token."	This broad area has been left to firms, although the SECPS membership requirement for a "Statement of Firm Philosophy" draws the attention of personnel to the special importance of independence. The professional ethics division did not find it necessary to define "token," believing that term is clear in itself.	Cohen Commission (1978)	Accounting profession
46. Experimentation with disclosure of financial and nonfinancial data by firms is encouraged, but there is no overriding need for a requirement in that regard.	The disclosure of financial data, with which some firms experimented, tends to focus attention on a firm's perceived ability to pay damages in litigation rather than on its quality controls, and has not been required. However, SECPS member firms are required to disclose substantive operating information about, e.g., personnel, number of SEC clients, pending litigation, the composition of fees, management advisory fees for SEC clients, and mergers in the annual reports included in the SECPS public files.	Cohen Commission (1978)	Accounting profession
47. The auditor should be required to be present and available to answer questions at the annual meeting of the shareholders.	Disclosure of whether the auditor is expected to be present at the shareholders' meeting and available to answer questions is required in the proxy statement.	Cohen Commission (1978)	Accounting profession
48. There are many potential benefits to be realized by permitting auditors to perform management advisory services for audit clients that should not be denied to such clients without a strong showing of actual or potential detriment. The profession, therefore, should be careful not to impose unnecessarily broad prophylactic rules with respect to management advisory services and independence.	No broad proscriptions have been established, and none, in the AICPA's opinion, are required.	POB (1979)	Accounting profession

(continued)

Issue: Auditor Independence

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
49. Mandatory limitations on scope of services should be predicated only on the determination that certain services, or the role of the firm performing certain services, will impair a member's independence in rendering an opinion on the fairness of a client's financial statements or present a strong likelihood of doing so. Recognizing that independence in an absolute sense cannot be achieved, when evaluating whether certain services should be prohibited, it is necessary to consider the potential benefits derived from the service and balance them against the possible to apparent impairment to the auditor's objectivity.	See action taken for recommendation 48.	POB (1979)	Accounting profession
50. At this time no rules should be imposed to prohibit specific services on the grounds that they are or may be incompatible with the profession of public accounting, might impair the image of the profession, or do not involve accounting or auditing related skills.	See action taken for recommendation 48.	POB (1979)	Accounting profession
51. The existing limitations on management advisory services concerning independence contained in professional standards and the Code of Professional Ethics embrace several provisions that are helpful in ensuring that independence will be maintained. Compliance with those applicable provisions should be made a condition of membership in the SECPS, and peer reviews should be required to test for compliance.	See the SECPS membership requirement in the SECPS Reference Manual (§1000.08(h)), which specifically proscribes providing for SEC audit clients the following types of services: psychological testing, public opinion polls, merger and acquisition assistance for a finder's fee, certain executive recruitment services, and certain actuarial services to insurance companies.	POB (1979)	Accounting profession
52. SECPS members should be required to include in their annual disclosure statements filed with the SECPS disclosure of gross fees both for management advisory services and tax services performed for audit clients expressed as a percentage of aggregate fees charged during the reporting period.	See the SECPS membership requirements in the SECPS Reference Manual (§1000.08(g)(12) and (13)) and the additional disclosure requirements in the SECPS Reference Manual (§1000.08(g)(15)).	POB (1979)	Accounting profession
53. An accounting firm should not provide actuarial services for an insurance company audit client unless those services are supplemental to primary actuarial advice furnished by another actuary not associated with the accounting firm.	See the SECPS membership requirement in the SECPS Reference Manual (§1000.08(h)(5)).	POB (1979)	Accounting profession

(continued)

Issue: Auditor Independence			
Recommendation	**Action taken**	**Recommendation made by/date**	**Recommendation directed to**
54. The POB accepts the recent action of the executive committee proscribing certain executive recruiting services inasmuch as the services proscribed are perceived by others as having a strong likelihood of impairing independence, are available from other responsible sources, and do not otherwise produce sufficient countervailing benefits. In general, however, the POB is reluctant to support prohibitions against useful services which are based primarily on appearance without an adequate basis in fact.	The proscription referenced in this recommendation has been maintained. See SECPS Reference Manual (§1000.08(h)(4)).	POB (1979)	Accounting profession
55. Nonattest services should not be limited by imposition of arbitrary restrictions. Rather, the acceptability of an activity must be determined by AICPA members in keeping with the spirit of the Code of Professional Ethics.	See action taken for recommendation 48.	Anderson Committee (1986)	Accounting profession
56. To provide further guidance, the Standards of Professional Conduct require that members should:		Anderson Committee (1986)	Accounting profession
(a) practice in firms that have in place internal quality-control procedures to ensure that services are delivered in a competent manner and are adequately supervised;	Participation in an AICPA-approved practice monitoring program, which is mandatory, provides reasonable assurance as to a firm's compliance with the quality control standards of the profession in the conduct of its accounting and auditing practice. This was also specifically implemented in Article VI in ET §57.		
(b) determine whether, in their individual judgments, the nature or magnitude of other services provided to an audit client over time might create, or appear to create, conflicts of interest in the performance of the audit function for that client; and	Specifically implemented in Article VI in ET §57 and Rule 102 and its interpretation.		
(c) assess whether, in their individual judgments, an activity is consistent with their role as professionals—for example, it is a reasonable extension or variation of existing services offered by the member or others in the profession.	Specifically implemented in Article VI in ET §57.		

(continued)

Issue: Auditor Independence

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
57. In order to make professional standards more relevant and effective, the structure of the Institute's Code of Professional Ethics should be recast into two basic sections: (a) Standards of Professional Conduct, which will be enforceable, and (b) Rules of Performance and Behavior.	This recommendation was implemented in the revised Code of Professional Conduct, adopted January 12, 1988. Broad standards cannot be enforced, per se. However, they serve as guides to the professional ethics division in evaluating the significance of infractions of specific rules.	Anderson Committee (1986)	Accounting profession
58. The Standards of Professional Conduct will contain six articles. (a) Purpose (b) Applicability (c) Responsibilities (d) Explicit standards (dealing with the public interest, integrity, objectivity and independence, due care, and scope and nature of services) (e) Performance standards (f) Compliance	 See Preamble to Code of Professional Conduct (ET §51.02). See Introduction to Code of Professional Conduct, as well as the Applicability section (ET §91.02). See Article I of the Code of Professional Conduct (ET § 52.01). See Articles II, III, IV, V, and VI of the Code of Professional Conduct (ET §53.04 to 57.03). Performance standards are set forth in Rule 201 (ET §201.01-.02). Compliance with standards is covered by Rule 202 (ET § 202.01).	Anderson Committee (1986)	Accounting profession

(continued)

Issue: Auditor Independence			
Recommendation	**Action taken**	**Recommendation made by/date**	**Recommendation directed to**
59. The Rules of Performance and Behavior should include:		nderson A Committee (1986)	ccounting profession
(a) independence,	See Rule 101 and related A interpretations and rulings in ET §100.		
(b) general standards,	See Rule 202 in ET §200.		
(c) compliance with standards,	See Rule 202 in ET §200.		
(d) accounting principles,	See Rule 203 in ET §200.		
(e) confidential client information,	See Rule 301 in ET §300.		
(f) contingent fees,	See Rule 302 in ET §300.		
(g) acts discreditable,	See Rule 501 in ET §500.		
(h) advertising and other forms of solicitation,	See Rule 502 in ET §500. This rule and its interpretations bar only false, misleading, or deceptive acts in advertising or solicitation.		
(i) commissions, and	See Rule 503 in ET §500. This rule bars commissions only when a member also performs a review or examination of historical or prospective information or performs a compilation of financial statements expected to be used by third parties and does not disclose a lack of independence, all pursuant to an agreement with the Federal Trade Commission.		
(j) form of practice and name.	See Rule 505 in ET §500.		
60. Current rule 504 in the Code of Professional Ethics on incompatible occupations should be deleted.	There is no rule on incompatible occupations.	Anderson Committee (1986)	Accounting profession
61. The accounting profession should enhance the public's perception of the independence and objectivity of auditors.	The ASB issued SAS 61 on communication with audit committees, and the POB issued a report in 1979 on its study of management advisory services.	Big 7 (1986)	Accounting profession

(continued)

Issue: Auditor Independence

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
62. Eliminate the potential abuse of “opinion shopping” by such steps as the following: (a) The SEC should strengthen the Form 8-K requirement on auditor changes as to the level of disclosures and the degree of follow-up when there are reported differences as to accounting or auditing matters. (b) Regulatory agencies other than the SEC should require disclosures concerning auditor changes similar to those required by the SEC in Form 8-K. (c) Peer reviewers should scrutinize all engagements assumed since the last peer review where there were disclosures (in Form 8-K and similar filings) of a significant disagreement or the former accounting firm resigned. (d) Auditing standards should require a successor auditor to focus more sharply on auditor-change circumstances where there is no Form 8-K or similar filing.	The SEC revised its Form 8-K requirement. Moreover, firms that are members of the SEC Practice Section must notify the chief accountant of the SEC within 5 business days when they resign or are terminated as auditors of an SEC registrant. FDICIA requires large banks and thrifts to provide written notification to the FDIC and other appropriate federal or state banking regulatory agencies of the resignation or dismissal of an auditor or the engagement of a new auditor, including reasons for the change, within 15 calendar days of the change. Section (g)(5) requires any independent public accountant performing services required by FDICIA to notify the FDIC if the accountant ceases to perform those services. This requirement is now a part of the SECPS Standards for Performing and Reporting on Peer Reviews. SAS 53 identifies a situation where there is not sufficient information available from the predecessor auditor as one of the factors that should be considered in assessing risk at the financial statement level. Also SECPS peer review standards contain specific requirements for reviewing client acceptance documentation on SEC clients as part of the process of selecting engagements for review. The Private Securities Litigation Reform Act of 1995 (§301) requires a registrant to notify the SEC when an auditor reports to the registrant’s board of directors that it has become aware of certain illegal acts of the registrant that are material to its financial statements. If the registrant fails to provide that notice, then the auditor must send to the SEC a copy of the report it gave to the board.	Big 7 (1986)	Accounting profession, SEC, and other regulators

(continued)

Issue: Auditor Independence

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
63. The boards of directors of all public companies should be required by SEC rule to establish audit committees composed solely of independent directors.	NYSE listing requirements mandate independent audit committees. Following this recommendation, the SEC wrote to the other exchanges and the NASD, encouraging them to review their audit committee requirements. In response, the NASD strengthened its recommendation that all national market system companies have audit committees with a majority of independent directors into a requirement, and the AMEX adopted a similar requirement. FDICIA requires independent audit committees for large banks and thrifts. The AICPA believes that SEC registrants and other publicly accountable entities should be required to have independent audit committees whenever practicable. (See June 1993 policy statement of the AICPA Board of Directors.)	Treadway Commission (1987)	SEC
64. Audit committees should be informed, vigilant, and effective overseers of the financial reporting process and the company's internal controls.	The COSO report adequately describes the roles and responsibilities of audit committees and the report has been widely publicized with a special effort to reach corporate directors. However, this must be an ongoing effort because media reports indicate a need to continue to enhance compliance with this recommendation.	Treadway Commission (1987)	Public companies or SEC
65. All public companies should develop written charters setting forth the duties and responsibilities of their audit committees. The boards of directors should approve the charters, review them periodically, and modify them as necessary.	The AICPA has no specific information as to implementation of this recommendation; however, see the action taken for recommendation 64.	Treadway Commission (1987)	Public companies
66. Audit committees should have adequate resources and authority to discharge their responsibilities.	The AICPA has no specific information as to implementation of this recommendation; however, this notion is implicit throughout the COSO report.	Treadway Commission (1987)	Public companies
67. All public companies should be required by SEC rule to include in their annual reports to stockholders letters signed by the chairmen of the audit committees describing the committees' responsibilities and activities during the year.	This recommendation has been discussed with the SEC, but no formal action has been taken yet. See the action taken for recommendation 82.	Treadway Commission (1987)	SEC

(continued)

Issue: Auditor Independence

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
68. Management should advise the audit committee when it seeks a second opinion on a significant account issue.	SAS 61 requires that the auditor, when he or she is aware that management has consulted with another auditor, discuss with the audit committee significant matters that were the subject of the consultation.	Treadway Commission (1987)	Public companies
69. Audit committees should oversee the quarterly reporting process.	The AICPA has no specific information as to implementation of this recommendation; however, the roles and responsibilities of the audit committee are discussed in the COSO report and quarterly reporting is covered by that report.	Treadway Commission (1987)	Public companies
70. The audit committee should review management's evaluation of factors related to the independence of the company's public accountant. Both the audit committee and management should assist the public accountant in preserving his independence.	No specific action has been taken on this recommendation. However, see the action taken for recommendation 71. Also, there are a number of SECPS membership requirements designed to foster independence, such as peer review, concurring partner review, audit partner rotation, reporting certain firmwide data on management advisory services, proscriptions of certain services, and publication of a statement of firm philosophy.	Treadway Commission (1987)	Public companies
71. Before the beginning of each year, the audit committee should review management's plans for engaging the company's independent public accountant to perform management advisory services during the coming year, considering both the types of services that may be rendered and the projected fees.	As indicated on page 30 of the SEC's Staff Report on Auditor Independence, the SEC has found that "audit committees consisting principally of nonemployee directors actively were reviewing management advisory activities and auditors generally were not performing those services believed to have an impact on their independence."	Treadway Commission (1987)	Public companies

(continued)

Issue: Auditor Independence			
Recommendation	**Action taken**	**Recommendation made by/date**	**Recommendation directed to**
72. When a public company changes independent public accountants, it should be required by SEC rule to disclose the nature of any material accounting or auditing issue discussed with both its old and new auditor during the 3-year period preceding the change.	The SEC revised its Form 8-K requirements to provide for increased disclosure and speedier notification when there is a change of auditors. Also, SAS 61 requires discussion with the audit committee of significant accounting policies and any disagreements with management. SAS 50 provides tightened standards on reports on the application of accounting principles. Finally, SECPS membership requirements (SECPS Reference Manual §1000.08(m)) requires that the SEC be notified within 5 business days when there is a change of auditors. The Private Securities Litigation Reform Act of 1995 requires auditors to report to the SEC certain uncorrected illegal acts committed by registrants.	Treadway Commission (1987)	SEC
73. The SEC should reverse its decision to not require all public companies to establish an audit committee and adopt a requirement for public companies to establish such committees.	The SEC has not changed its requirements, but has written to the NASD and to all stock exchanges (except the NYSE) to urge them to upgrade their listing requirements in this regard. As a result the AMEX and the NASD have strengthened their audit committee requirements.	GAO (1989)	SEC
74. The AICPA, or the SEC if it concludes it has the authority, should require accountants to report directly to the SEC when they resign or are terminated. However, if the AICPA or the SEC does not adopt such a requirement, legislation would be necessary to require direct notification to the SEC.	See the SECPS membership requirement in the SECPS Reference Manual (§1000.08(m)), which requires that the SEC be notified within 5 business days when there is a change of auditors. The Private Securities Litigation Reform Act of 1995 (§301) requires auditors to report to the SEC certain uncorrected illegal acts committed by registrants.	GAO (1989)	AICPA, SEC, or Congress
75. The Congress should amend securities laws to require public companies and insured depository institutions to have audit committees made up of outside directors who are totally independent in fact and appearance and have no impairment which would keep them from acting in the best interest of stockholders and the public.	Securities laws were not amended; however, FDI Act §36(g)(1) addresses audit committee requirements for large banks and thrifts (1990).	GAO (1990)	Congress
76. The Congress should amend securities laws to require auditors to promptly inform appropriate regulatory authorities when they resign or are terminated.	No action taken.	GAO (1990)	Congress

(continued)

Issue: Auditor Independence

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
77. The Congress should enact legislation requiring that as a condition for federal depository insurance, depository institutions have truly independent audit committees made up solely of outside directors with duties that include reviewing with management and the independent accountant the basis for the reports of management and the independent accountant.	See FDI Act §36(g)(1).	GAO (1991)	Congress
78. The Congress should enact legislation that requires large institutions to maintain audit committees that (a) include members with banking or related financial management expertise, (b) include an attorney member or have their own outside counsel, and (c) do not have members that are large customers of the institutions.	See FDI Act §36(g)(1).	GAO (1991)	Congress
79. Organizations should be required to establish totally independent audit committees made up solely of outside directors. These committees would review the basis for internal control assessments and reports of both management and the independent auditors.	FDI Act §36 (g)(1) includes audit committee requirements for large banks and thrifts. Stock exchanges also mandate audit committee requirements. See action taken for recommendation 13.	GAO (1991)	Congress
80. Audit committees should have written charters that are approved and reviewed periodically by the organizations' boards of directors, and have adequate resources and authority to discharge their responsibilities.	No action taken.	GAO (1991)	Congress
81. The Congress should enact legislation requiring that independent public accountants acting as auditors of federally insured financial institutions be required to notify the regulators of the timing and reasons for changes in their status as auditors of federally insured financial institutions.	FDI Act §36(g)(5) requires independent accountants of large banks and thrifts to notify FDIC if they cease to be accountants for the institutions (U.S.C. 1831m(g)(5)). Institutions are required by FDI Act §36(h)(2)(B) to notify regulators (see U.S.C. 1831m(h)(2)(B)).	GAO (1991)	Congress

(continued)

Issue: Auditor Independence

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
82. The SEC should require each registrant to include in a document containing the annual financial statements a statement by the audit committee (or by the board if there is no audit committee) that describes its responsibilities and tells how they were discharged. This disclosure should state whether the audit committee members (or board members) (a) have reviewed the annual financial statements, (b) have conferred with management and the independent auditor about them, (c) have received from the independent auditor all information that the auditor is required to communicate under auditing standards, (d) believe that the financial statements are complete and consistent with information known to them, and (e) believe that the financial statements reflect appropriate accounting principles.	This recommendation was discussed in a meeting between AICPA representatives and the Chairman of the SEC on December 15, 1993. Under SEC rules, companies making proxy solicitations must describe the functions performed by the audit committee. Also, when a company changes auditors, certain disclosures are required regarding whether the audit committee recommended or approved the change and whether it consulted with the former accountant concerning disagreements with management and certain other matters. No further action was taken.	POB (1993)	SEC
83. Audit committees (or the boards if there are no audit committees) should assume the following responsibilities relating to an SEC registrant's preparation of annual financial statements: (a) review the annual financial statements, (b) confer with management and the independent auditor about them, (c) receive from the independent auditor all information that the auditor is required to communicate under auditing standards, (d) assess whether the financial statements are complete and consistent with information known to them, and (e) assess whether the financial statements reflect appropriate accounting principles.	This recommendation was discussed in a meeting between AICPA representatives and the Chairman of the SEC on December 15, 1993. No further action was taken.	POB (1993)	Public companies
84. The AICPA should undertake a project to sharpen further the distinction between client advocacy and client service and incorporate that distinction into the profession's Code of Professional Conduct. Individual accounting firms should constantly review their programs regarding client advocacy and client service to strengthen the desire of each audit partner to protect the firms' independence.	The professional ethics division issued Interpretation 102-6 in August 1995 that sharpens that distinction, and the POB believes it is responsive to its recommendation.	POB (1993)	Accounting profession

(continued)

Issue: Auditor Independence

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
85. Accounting firms should take special care to ensure that their participation in the standard-setting process is characterized by objectivity and professionalism. Standard setters and leaders of the profession should discuss and address the issues related to client advocacy in the standard-setting process and establish ways of identifying and correcting aberrant behavior when it occurs.	Representatives of the SECPS and the POB have met with the chairmen of FASB, the ASB, and AcSEC to discuss this subject. The chairmen of the ASB and AcSEC have reminded their members of the need to insure that objectivity is maintained in the standard-setting process. Also, see action taken for recommendation 84.	POB (1993)	Accounting profession
86. Accounting firms' consultation policies and procedures should ensure that client accounting issues are not discussed with SEC staff without the benefit of consultation at the appropriate level within the firms.	Following a meeting with the SEC chief accountant and his staff in January 1994, the POB decided to withdraw this recommendation because it appears such consultation is taking place before firms discuss issues with SEC staff.	POB (1993)	Accounting profession
87. The concurring partner, whose participation in an audit is a membership requirement of the SECPS, should be responsible for assuring that those consulted on accounting matters are aware of all of the relevant facts and circumstances, including an understanding of the financial statements in whose context the accounting policy is being considered. The concurring and consulting partners should know enough about the client to ensure that all of the relevant facts and circumstances are marshalled, and also possess the increased detachment that comes from not having to face the client on an ongoing basis.	The SECPS adopted an amendment to its concurring partner review membership requirements in April 1994 in response to this recommendation. When such consultation occurs, the concurring reviewer must be satisfied that the conclusions reached are appropriate in light of all the relevant facts and circumstances. See SECPS Reference Manual (§1000.39(b)).	POB (1993)	Accounting profession
88. The audit committee or the board of directors should be satisfied that the audit fee negotiated by it or management for the entity's audit is sufficient to assure the entity will receive a comprehensive and complete audit.	See action taken for recommendation 83.	POB (1993)	Public companies
89. SEC registrants and other publicly accountable entities should be required to have audit committees composed entirely of independent directors whenever practicable.	This recommendation was discussed at a meeting between the AICPA's leadership and the Chairman of the SEC at a meeting on December 15, 1993. See action taken for recommendation 63.	AICPA Board of Directors (1993)	SEC
90. The SEC should require audit committees to include statements in annual reports describing their responsibilities and how these responsibilities were discharged.	See action taken for recommendation 83. Under SEC rules, companies making proxy solicitations must describe the functions performed by the audit committee.	AICPA Board of Directors (1993)	SEC

(continued)

Issue: Auditor Independence

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
91. The audit committee members should be charged with specific responsibilities, including overseeing the financial reporting process and recommending appointment of the entity's auditors.	See action taken for recommendation 83.	AICPA Board of Directors (1993)	Public companies
92. Public companies and other organizations with public accountability should be prohibited from hiring the partner responsible for their audit for 1 year after the partner ceases to serve that client.	This recommendation was discussed at a meeting between the AICPA's leadership and the Chairman of the SEC at a meeting on December 15, 1993. No further action was taken.	AICPA Board of Directors (1993)	Public companies
93. Financial regulators should establish specific requirements for independent, knowledgeable audit committees.	Regulators do not believe it is appropriate to mandate the composition of audit committees.	GAO (1994)	Financial regulators
94. The SEC should ensure that SEC registrants that are major end users of complex derivative products establish and implement corporate requirements for independent, knowledgeable audit committees.	The SEC does not believe it is appropriate to adopt a federally imposed mandate governing the composition of audit committees for all public companies.	GAO (1994)	SEC
95. The POB, the SEC, and others should support proposals to enhance the independence of boards of directors and their accountability to shareholders. Stronger, more accountable corporate boards of directors will strengthen the professionalism of the outside auditor, enhance the value of the independent audit, and serve as the investigating public.	The AICPA supports this recommendation. See action taken for recommendation 63.	Kirk Panel (1994)	POB, SEC, and public companies
96. Independent auditing firms, regulators, and overseers of the public accounting profession need to focus on how the audit function can be enhanced and not submerged in large multiline public accounting/management consulting firms.	The AICPA has appointed a Special Committee on Assurance Services (Elliott Committee) in recognition of the special significance of the CPA's responsibility and ability to provide independent assurance and the need to consider how to improve that function in a rapidly changing environment.	Kirk Panel (1994)	Accounting profession
97. To increase the value of the independent audit, corporate boards of directors and their audit committees must hear from independent auditors their views as professional advisors on the appropriateness of the accounting principles used or proposed to be adopted by the company, the clarity of its financial disclosures, and the degree of aggressiveness or conservatism of the company's accounting principles and underlying estimates.	The SECPS Response to the POB Advisory Panel on Auditor Independence was published in August 1995. It endorses this recommendation.	Kirk Panel (1994)	Public companies

(continued)

Issue: Auditor Independence

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
98. The accounting profession should look to the representatives of the shareholders—the board of directors—as the client, not corporate management. Boards and auditors are, or should be, natural allies in protecting the shareholder interest.	The SECPS Response to the POB Advisory Panel on Auditor Independence was published in August 1995. It recognizes the important stewardship responsibilities of boards of directors and notes that to be effective, communications on accounting matters must involve the board and its audit committee, management, and the independent auditor.	Kirk Panel (1994)	Accounting profession
99. Auditors must assume the obligation to communicate qualitative judgements about accounting principles, disclosures, and estimates. By doing so, independent auditors can add to the effectiveness of boards of directors in monitoring corporate performance on behalf of shareholders and in assuring that shareholders receive relevant and reliable financial information about company performance and financial condition.	The SECPS Response to the POB Advisory Panel on Auditor Independence was published in August 1995. It endorses this recommendation.	Kirk Panel (1994)	Accounting profession
100. Because they share the objective of providing the public with relevant and reliable financial information, the public accounting profession, the standard setters, and the SEC must have more cooperative, less adversarial relationships. CPA firms should be careful in how they communicate their views to FASB, the SEC, their clients, and the public at large. The SEC should help identify accounting practice problems and look to the private sector standard setters to solve them—only being a standard setter of “last resort” and only after appropriate due process.	The AICPA and FASB are committed to working in a cooperative way with the SEC. Although from time to time relationships have been strained, the process of resolving conflict is a positive one. In that connection, the POB report itself is a response to criticisms voiced by the former chief accountant of the SEC and the stock compensation issues have been addressed by FASB. Also, the new AICPA Financial Reporting Coordinating Committee, formed to follow up on the recommendations of the Jenkins Committee, has already met with the SEC to exchange ideas and views on key issues.	Kirk Panel (1994)	Accounting profession, AICPA, FASB, and SEC

Table II.2: Audit Quality

Issue: Audit Quality			
Recommendation	**Action taken**	**Recommendation made by/date**	**Recommendation directed to**
1. The AICPA's Auditing Standards Executive Committee should consider restating those sections of SAS 1 which relate to the auditor's responsibility for detection of fraud. The auditing profession should, on an ongoing basis, continue to improve the efficiency of customary audit procedures to the end that probability of discovery of material frauds continues to increase within the limits of practicality.	SAS 53 para. 5, which superseded the earlier SAS 16, makes it clear that the auditor has a responsibility to "design the audit to provide reasonable assurance of detecting errors and irregularities that are material to the financial statements." Moreover, the June 1993 policy statement of the AICPA Board of Directors is unequivocal in articulating the profession's position: "The public looks to the independent auditor to detect fraud, and it is the auditor's responsibility to do so." In May 1996, the ASB exposed for comment a proposed standard that would amend SAS 53 to provide better guidance to auditors in detecting fraud.	AICPA Special Committee on Equity Funding (1975)	Accounting profession
2. The AICPA's Auditing Standards Executive Committee should consider whether the Life Insurance Audit Guide requires clarification with regard to the confirmation of policies with policyholders.	The AICPA industry audit guide on stock life insurance companies identifies the circumstances in which the auditor should ordinarily confirm insurance policies in force with policyholders.	AICPA Special Committee on Equity Funding (1975)	Accounting profession
3. Circumstances such as those which were present...highlight the fact that transactions between related parties pose serious problems. The committee did not attempt to reach any conclusions regarding the problems inherent in auditing such transactions since the auditing standards executive committee of the AICPA is currently studying the need for additional auditing procedures in connection with related-party transactions.	AU §334 of the AICPA Professional Standards was last modified in 1983. Interpretation 6 (AU §9334.16), issued in 1986, provides additional guidance on the nature and extent of auditing procedures for examining related-party transactions. Also, audit risk alerts and industry audit and accounting guides frequently focus on audit problems with respect to related parties and related-party transactions.	AICPA Special Committee on Equity Funding (1975)	Accounting profession
4. A CPA who falsifies or contributes to the falsification of books and records should be suspended from practicing before the SEC.	This is the responsibility of the SEC Division of Enforcement, and both individuals and firms have been suspended from practice before the SEC as a result of the Division's activities.	Moss Subcommittee (1976)	SEC
5. The SEC should prescribe by rule standards of conduct for independent accountants and auditors and for accounting firms practicing before the SEC and should take disciplinary action as may be necessary to assure adherence to such standards.	Although the SEC has not issued a rule in this respect, the objectives of this recommendation are being achieved because the SEC does speak on independence matters and enforces compliance with the technical standards of the profession and audit-related SECPS membership requirements in disciplinary hearings involving CPAs.	Moss Subcommittee (1976)	SEC

(continued)

Issue: Audit Quality

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
6. Legislation amending section 10(b) of the Securities and Exchange Act of 1934 is needed to protect the public against negligence by accountants and others, regardless of intent to deceive or defraud.	See action taken for recommendation 39.	Moss Subcommittee (1976)	Congress
7. To inform the public of the nature and extent of illegal and questionable activities in which corporations may be engaged, more detailed public disclosure in communications to the shareholders and the media is necessary of all companies, including detailed descriptions of the nature and purpose of the payments and the basis of their illegality and how much corporate employees and management knew about the payments.	No action taken. However, SAS 54 provides guidance on the auditor's consideration of the financial statement effect of illegal act(s) and on the adequacy of disclosure in the financial statements. In addition, the SAS states that the auditor should consider the implications of an illegal act on other aspects of the audit, particularly the reliability of representations by management.	Moss Subcommittee (1976)	SEC
8. The SEC should refer to the Justice Department cases where the senior management or the corporation's independent auditors had knowledge of, or participated in, illegal payments that were not truthfully disclosed in the corporate books or records.	The SEC consults with the Justice Department when appropriate.	Moss Subcommittee (1976)	SEC
9. The Congress should amend federal securities laws to restore the right of damaged individuals to sue independent auditors for negligence under the fraud provisions of the securities laws.	The Private Securities Litigation Reform Act of 1995 (§201) allows damaged individuals to sue auditors jointly and severally if the auditor knowingly committed a violation of the securities laws and proportionately if the auditor was found negligent.	Metcalf Subcommittee Staff Study (1977)	Congress
10. The federal government itself should periodically inspect the work of independent auditors for publicly owned corporations. This could be done by GAO, the SEC, or by a special audit inspection agency.	The SEC oversees the AICPA's SECPS peer review program. See action taken for recommendation 31.	Metcalf Subcommittee Staff Study (1977)	Federal government
11. The federal government should promulgate and enforce strict standards of conduct for auditors who verify the accuracy of corporate financial statements under the federal securities laws. The SEC is the appropriate agency to promulgate and enforce the standards of conduct.	The SEC monitors auditor compliance with professional standards through its oversight of the AICPA's SECPS activities and the actions of the SEC Enforcement Division.	Metcalf Subcommittee Staff Study (1977)	Federal government

(continued)

Issue: Audit Quality			
Recommendation	**Action taken**	**Recommendation made by/date**	**Recommendation directed to**
12. The SEC should treat all independent auditors equally in disciplinary and enforcement proceedings under the federal securities laws. Large firms should receive the same sanctions as small firms. The SEC and other federal agencies should conduct compliance reviews themselves rather than rely on private parties and organizations to conduct the reviews.	The AICPA believes the SEC treats all independent auditors equally in disciplinary and enforcement proceedings. The SEC, through the POB and its own oversight of the SECPS peer review program, has not considered it necessary to undertake its own compliance reviews.	Metcalf Subcommittee Staff Study (1977)	SEC
13. The independent auditor's report accompanying corporate financial statements should be more descriptive of the auditor's work. However, an expanded description of the functions and limitations in the audit process must not become a list of disclaimers which substitute for the auditor's overall professional opinion that the financial statements fairly represent business activities and that appropriate standards have been consistently applied.	The auditor's standard report was revised by SAS 58 (superseded by SAS 79) to include a positively worded description of the auditor's procedures. The new report refers to "reasonable assurance" and "in all material respects," but it does not include language intended to disclaim responsibility.	Metcalf Subcommittee (1977)	Accounting profession
14. Any illegal activities discovered by an independent auditor must be reported immediately to a corporation's audit committee and the appropriate government authorities.	SAS 54 requires the auditor to know whether the audit committee is adequately informed about possible illegal acts and advises the auditor that a duty to notify parties outside the client may exist. Withdrawal from the audit engagement is a possible action under SAS 54, and SECPS membership requirements (SECPS Reference Manual §1000.08(m)) specify that the auditor report that fact to the SEC within 5 business days. Also, under §301 of the Private Securities Litigation Reform Act of 1995, auditors are required to report the illegal act to the SEC if the company does not take appropriate action.	Metcalf Subcommittee (1977)	Accounting profession
15. Questionable activities must be reported immediately to the audit committee and should be closely followed by the independent auditor to determine if public disclosure and notification of government authorities are required.	See action taken for recommendation 14.	Metcalf Subcommittee (1977)	Accounting profession

(continued)

Issue: Audit Quality

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
16. The standard of materiality which governs public disclosure of specific corporate activities must be reviewed to assure that it is properly serving the public.	Paragraphs 13-15 of SAS 54 provide guidance to the auditor on evaluating the materiality of illegal acts, noting that the auditor should consider both the quantitative and qualitative materiality of the act. Paragraphs 16-17 discuss implications for the audit and required communication with audit committees of all but inconsequential acts.	Metcalf Subcommittee (1977)	Accounting profession
17. Auditors should apply high professional standards in forming an opinion on questionable acts and should not rely solely on a strict list of rules to determine whether an act is right or wrong.	Through the Foreign Corrupt Practices Act of 1977, SAS 54 (which discusses the implications of illegal acts on the audit, particularly on the reliance that can be placed on management representations), and the AICPA's annual audit risk alerts, auditors have been sensitized to the significance of questionable acts.	Metcalf Subcommittee (1977)	Accounting profession
18. Research into improved auditing and detection of management fraud should be increased.	This is an ongoing effort. Major AICPA activities include the work of the SECPS QCIC, summarized in each SECPS annual report; the information provided in the annual general and industry-specific audit risk alerts; the new series of practice alerts being issued by the SECPS; and articles in the Journal of Accountancy, including two titled "Lessons Auditors Ignore at Their Own Risk" by the chairman and staff of the QCIC. The June 1993 policy statement of the Board of Directors describes the AICPA's commitment to continued efforts in this area.	Metcalf Subcommittee (1977)	Accounting profession
19. Independent auditors should monitor compliance with policies established by corporate audit committees to prevent hidden remuneration of executives through use of corporate assets for housing, personal loans, club memberships, and personal travel or pleasure, and should assure that amounts and types of all management compensation are reported to shareholders and the public.	The independent auditor would be guided by various SASs, especially SASs 8, 53, 54, and 55. However, unless aggregate management compensation was material to the financial statements, specific work in this area would normally have to be dealt with in the engagement arrangements.	Metcalf Subcommittee (1977)	Accounting profession
20. A program realistically designed to meet public concerns should start with an organization of accounting firms that serve or want to serve as independent auditors for publicly owned corporations.	The AICPA established the SECPS of the AICPA's Division for CPA Firms in 1977 for that purpose.	Metcalf Subcommittee (1977)	Accounting profession

(continued)

Issue: Audit Quality			
Recommendation	**Action taken**	**Recommendation made by/date**	**Recommendation directed to**
21. Every facet of the organization of accounting firms (see recommendation 20) activities should be governed by an executive board comprised of persons from a broad spectrum of interests and backgrounds, including those outside the accounting profession.	All SECPS activities are under the oversight of the independent POB, only one of whose five members has an accounting background.	Metcalf Subcommittee (1977)	Accounting profession
22. The organization of accounting firms (see recommendation 20) must have the capability to establish and enforce minimum standards of auditor performance and behavior which will satisfy the need for independent assurance that corporate financial reports fairly reflect corporate activities.	The SECPS Executive Committee has the authority to establish enforceable membership requirements that can and do deal with professional practice matters.	Metcalf Subcommittee (1977)	Accounting profession
23. The organization of accounting firms (see recommendation 20) must include all accounting firms that audit publicly owned corporations.	AICPA members may engage in the practice of public accounting with a firm that audits one or more SEC clients only if that firm is a member of the SECPS. Over 1,260 firms are now SECPS members; they audit the financial statements of about 16,000 SEC clients, representing the vast majority of publicly traded SEC registrants. There are approximately 200 CPA firms not associated with the SECPS or the AICPA that serve as auditors for about 300 generally small or inactive SEC clients.	Metcalf Subcommittee (1977)	Accounting profession
24. The organization of accounting firms (see recommendation 20) must have the power to impose sanctions on errant members that directly affect their continued ability to audit such corporations.	The SECPS has been effective in achieving compliance with its membership requirements and, although sanctions have been imposed on firms, has generally found the threat of sanctions sufficient to obtain compliance by member firms. However, the SECPS does not have the power to suspend or terminate a member firm's right to practice before the SEC.	Metcalf Subcommittee (1977)	Accounting profession

(continued)

Issue: Audit Quality

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
25. No accounting firm should be able to audit publicly owned corporations without meeting the organization of accounting firms' (see recommendation 20) performance and behavior standards.	A corrective action available to the SECPS and one that has been used 58 times as of June 30, 1994, the date of the most recent SECPS annual report, is a requirement to employ an outside consultant acceptable to the SECPS peer review committee to perform preissuance reviews of all or selected financial statements or other specified procedures, to provide substantive assurance that the firm will perform quality audits for its SEC clients. However, there are approximately 200 CPA firms not associated with the SECPS or the AICPA that serve as auditors for about 300 generally small or inactive SEC clients.	Metcalf Subcommittee (1977)	Accounting profession
26. The SEC should be responsible for oversight of the organization of accounting firms (see recommendation 20) to protect the public interest.	The SEC's 1994 Annual Report to Congress states that the SEC continued its oversight of the SECPS and comments favorably on the peer review and QCIC activities of the SECPS.	Metcalf Subcommittee (1977)	SEC
27. The SEC should periodically inform the Congress of the organization of accounting firms' (see recommendation 20) activities.	The SEC issues an annual report to the Congress which briefly mentions SECPS peer review and QCIC activities. Also, the SECPS and the POB issue separate annual reports.	Metcalf Subcommittee (1977)	SEC
28. The organization of accounting firms (see recommendation 20) should establish a program of external quality review for member firms to be performed every 3 years or as shown to be necessary.	According to the SECPS's annual report for the year ended June 30, 1994, the SECPS had conducted and accepted 2,911 peer reviews of member firms. Eleven percent of the reports were qualified or adverse. As a result of those reviews, 414 firms, or 14 percent of the firms reviewed, were required to take additional corrective measures to provide added assurances that quality control deficiencies have been or are being remedied.	Metcalf Subcommittee (1977)	Accounting profession

(continued)

Issue: Audit Quality

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
29. The quality review program for independent auditors of publicly owned corporations should be mandatory.	As of January 1990, AICPA members may engage in the practice of public accounting with a firm that audits one or more SEC clients only if that firm is a member of the SECPS and complies with the peer review membership requirements. Over 1,260 firms are now SECPS members; they audit the financial statements of about 16,000 SEC clients, representing the vast majority of publicly traded SEC registrants. There are approximately 200 CPA firms not associated with the SECPS or the AICPA that serve as auditors for about 300 generally small or inactive SEC clients.	Metcalf Subcommittee (1977)	Accounting profession
30. Quality reviews should be conducted by broad-based teams appointed by the executive board of the organization of accounting firms (see recommendation 20), and should include members from outside the accounting organization and some who are not accountants.	Peer reviews are conducted by teams appointed by the SECPS or by firms that meet SECPS criteria in the circumstances. All reviews are subject to POB oversight, including visits during the course of the review. The POB reports annually on the results of its oversight activities.	Metcalf Subcommittee (1977)	Accounting profession
31. The reports of the quality review teams (see recommendation 30) should be submitted to the SEC and made available to the public.	Peer review reports are maintained in a public file at AICPA headquarters in New York and can be obtained upon written or telephone request. All reports of firms with SEC clients are sent to the SEC for review. The SEC staff randomly inspects peer review reports and working papers and the POB's oversight files.	Metcalf Subcommittee (1977)	Accounting profession
32. The primary mission of the organization of accounting firms (see recommendation 20) will be to assure that the two essential qualities of independent auditors—professionalism and independence—are not sacrificed through such practices as unrealistic cost cutting and time constraints in pursuit of commercial success.	A primary objective of the SECPS is to maintain and improve the quality of practice before the SEC. The SEC's 1994 Annual Report indicates this objective is being achieved. As part of this program of improvement, in March 1980, the SECPS issued the Position Paper of Task Force on Certain Aspects of the Auditor's Work Environment. The SECPS membership requirements also mandate the preparation and dissemination to all personnel of a "Statement of Firm Philosophy." The illustrative statement provided by the SECPS Reference Manual (§1000.42) emphasizes the need for an overriding commitment to high-quality professional performance.	Metcalf Subcommittee (1977)	Accounting profession

(continued)

Issue: Audit Quality

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
33. Disciplinary actions should be expedited and should be based on failure to follow high professional standards rather than violation of legal standards.	The committees and staff of the professional ethics division have been increased to deal with cases, especially cases referred by governmental entities, in a more expeditious way. In May 1993, the AICPA Council authorized the division to resolve ethics complaints by settlement in addition to its existing authority to refer matters to the Joint Trial Board. Further, in June 1994, the Professional Ethics Executive Committee agreed to amend its operating policies, with respect to cases in litigation, to require firms to provide on a timely basis the name of the partner(s) involved and evidence that litigation exists that could be unfairly prejudiced by an ethics investigation.	Metcalf Subcommittee (1977)	Accounting profession
34. The identities of offenders must be disclosed to the public.	The names of individuals whose membership in the AICPA is suspended or terminated by the Joint Trial Board or pursuant to a settlement agreement are published in The CPA Letter. The SEC also publishes the results of its enforcement proceedings.	Metcalf Subcommittee (1977)	Accounting profession
35. Independent auditors should have access to significant financial data concerning the corporation being audited, even though held by other corporations and individuals, when it is shown to be necessary.	The auditor has no contractual arrangement with third parties in connection with an audit that would require them to provide information. However, if, in the auditor's professional judgment, information is required that is not made available, professional standards require the auditor to treat that as a scope limitation and to consider whether an unqualified report can be issued, thus effectively achieving the objective of the recommendation.	Metcalf Subcommittee (1977)	Accounting profession
36. Under certain conditions, direct communication among auditors should be facilitated and responses to audit confirmation requests should be required.	See action taken for recommendation 35. In addition, SAS 70 provides guidance on the factors an auditor should consider when auditing the financial statements of an entity that uses a service organization to process certain transactions.	Metcalf Subcommittee (1977)	Accounting profession
37. The professionalism of auditors would be enhanced considerably by requiring the individuals in charge of the audit for each corporate client to sign their names personally on the auditor's report to the public, along with the name of the accounting firm they represent.	The Cohen Commission considered and rejected this recommendation. The fact is that in today's environment, the auditor's report more than ever is a report by a firm, given concurring review partners, consulting partners, etc., and all the partners of a firm are held liable for the statements in that report.	Metcalf Subcommittee (1977)	Accounting profession

(continued)

Issue: Audit Quality

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
38. The preparatory education of individuals who enter the profession of independently auditing publicly owned corporations should be strengthened through such means as the establishment of professional schools of accounting.	The AICPA has worked diligently to improve the quality of accounting education. Numerous graduate professional schools and programs of accounting now exist. Those applying for AICPA membership who first become eligible after the year 2000 to take the CPA examination will be required to have obtained 150 semester hours of education, including a bachelor's degree or its equivalent.	Metcalf Subcommittee (1977)	Accounting profession
39. Independent auditors of publicly owned corporations should be liable for their negligence to private parties who suffered damages as a result.	The Private Securities Litigation Reform Act of 1995 holds auditors proportionately liable for negligently violating the securities laws.	Metcalf Subcommittee (1977)	Congress and SEC
40. Access to the judicial process for parties claiming damages must be allowed.	The securities laws, including the Private Securities Litigation Reform Act of 1995 do not interfere with this right for cases having merit. It is entirely appropriate to "screen out" frivolous cases.	Metcalf Subcommittee (1977)	Congress and SEC
41. Auditors found negligent should not have their liability artificially limited by law.	See action taken for recommendation 39.	Metcalf Subcommittee (1977)	Congress
42. The organization of accounting firms envisioned by the subcommittee (see recommendation 20) and the SEC should focus attention on both domestic and international operations of independent auditors when formulating appropriate standards and a responsive quality review program.	SECPS peer review standards (SECPS Reference Manual §2000.137) state that "(t)he review should be concerned with the accounting and auditing engagements performed by the U.S. offices of the reviewed firm selected for review and with the supervision and control, in accordance with U.S. professional standards, on work of segments of such engagements performed by foreign offices...." The SECPS made significant efforts to obtain agreement by other countries to an extension of peer review to the work performed in those countries, but was unable to overcome the legal and other barriers to access by a U.S. organization to the foreign accountant's confidential work product.	Metcalf Subcommittee (1977)	Accounting profession and SEC
43. In performing its enforcement functions, the SEC should apply equal sanctions for similar offenses to all independent auditors without regard to size of accounting firms.	The AICPA believes the SEC applies sanctions in a consistent manner.	Metcalf Subcommittee (1977)	SEC
44. The SEC must play an important role in improving the performance of independent auditors for publicly owned corporations.	The SEC works closely with the ASB. The SEC highlights areas that need improvement in its Accounting and Auditing Enforcement Releases.	Metcalf Subcommittee (1977)	SEC

(continued)

Issue: Audit Quality

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
45. The SEC must enforce the federal securities laws and exercise close oversight of the accounting organization (see recommendation 20) to assure that the public policy goals in this report are implemented.	The SEC has reported to the Congress annually on the exercise of its responsibilities.	Metcalf Subcommittee (1977)	SEC
46. The auditor's standard report should be revised and should also clearly describe the work of the auditor and his findings and avoid unclear terminology concerning details.	The auditor's standard report, as revised by SAS 58 and since superseded by SAS 79, is responsive to this recommendation.	Cohen Commission (1978)	Accounting profession
47-49. An auditor's report should state its messages explicitly. Specifically, it should state that		Cohen Commission (1978)	
47. ...financial statements are the representation of management.	See AU §508.8(c).		Accounting profession
48. ....accounting principles appropriate in the circumstances were used.	AU §508.8(f)(2) requires the auditor to state in the auditor's report that "an audit includes... assessing the accounting principles used and significant estimates made by management."		Accounting profession
49. ...the auditor used judgment in auditing.	See AU §508.8(g).		Accounting profession
50-54. The acceptance and discharge of added responsibilities should be communicated by the auditor to users of his work. The additional messages, for example, should cover		Cohen Commission (1978)	
50. ...other information in documents accompanying the audited financial statements.	See action taken for recommendation 72 for the auditor's responsibilities. The auditor's report was not modified to report on the execution of those responsibilities. To do so in today's environment would unduly expose the auditor to additional liability. However, SAS 61 requires the auditor to explain his or her responsibility for other information accompanying the financial statements to the audit committee.		Accounting profession
51. ...association with interim information.	Interim information accompanying audited financial statements of public companies is marked as "unaudited" but is required to be reviewed under SAS 71. However, the auditor's report is not modified unless the information is omitted or the auditor has not made such a review. These requirements are believed to be acceptable to the SEC.		Accounting profession

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Issue: Audit Quality

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
52. ...internal accounting controls.	As noted in responses to numerous recommendations above, neither management nor the auditor of an entity, with the exception of certain federally insured depository institutions, is required to issue a public report on an entity's internal controls. (SAS 60 does mandate a report, generally to the audit committee, on reportable conditions noted during an audit of financial statements.) The AICPA has recommended that such a requirement be enacted by the SEC.		Accounting profession
53. ...corporate codes of conduct.	There is no requirement for the auditor to review the company's code of conduct. SAS 78, which amended SAS 55 to conform to the COSO report, Internal Control—Integrated Framework, requires the auditor to obtain an understanding of all of the elements of the internal control structure. COSO's report (issued in 1992 and amended in 1994) has drawn the attention of preparers, auditors, and regulators to the significance of internal controls. That document points out that the codes of conduct are widely used and may be part of the control environment, but properly warns that "existence of a written code of conduct, and even documentation that employees received and understand it, does not ensure that it is being followed. Compliance with ethical standards...is best ensured by top management's actions and examples..." Full implementation of this recommendation is therefore contingent on a requirement for written codes of conduct which, for that reason, may not be necessary for all companies, and on implementation of the recommendation in the June 1993 policy statement of the AICPA Board of Directors for management and auditor reports on the system of internal control over financial reporting.		Accounting profession
54. ...meetings with the audit committee.	The auditor is required under SAS 61 to communicate certain matters to the audit committee, but those communications are not mentioned in the auditor's report.		Accounting profession

(continued)

Issue: Audit Quality

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
55. The auditor's report should omit reference to consistency.	The auditor's standard report no longer includes a reference to consistency. However, SAS 58 para. 11 (superseded by SAS 79) requires an explanatory paragraph (not a qualification of the auditor's opinion), pursuant to SEC wishes, when there has been a material change in accounting principles or in the method of their application.	Cohen Commission (1978)	Accounting profession
56. The present method of referring to other auditors should be eliminated. Either one of two methods would provide users with sufficient information on the responsibilities taken: (a) the auditor can do enough additional work so that he does not need to refer to the other auditor or (b) management could present (or in some cases list) the reports of the other auditors.	SAS 1 §543 was reviewed but not revised in this regard. In part, there was concern by smaller firms that a change would unfairly cause their displacement.	Cohen Commission (1978)	Accounting profession
57. The auditor should be required to be present and available to answer questions at the annual meeting of the shareholders.	Disclosure of whether the auditor is expected to be present at the shareholders' meeting and available to answer questions is required in the proxy statement.	Cohen Commission (1978)	Accounting profession
58. The phrase "present fairly" should be deleted from the auditor's report.	The SEC objected to this proposal and the phrase is retained in the auditor's standard report. However, SAS 69 clarifies the meaning of the phrase, discusses the considerations pertinent to a decision as to whether financial statements "present fairly," and establishes a hierarchy of GAAP to assist the auditor in reaching conclusions in that regard.	Cohen Commission (1978)	Accounting profession
59. An audit should be designed to provide reasonable assurance that the financial statements are not affected by material fraud.	Specifically implemented in SAS 53 para. 5.	Cohen Commission (1978)	Accounting profession
60. Since an auditor cannot be expected to detect all frauds, a standard of professional skill and care is needed to evaluate the performance of auditors.	SAS 53 para. 8 establishes the standard of due care, and para. 9-25 provide guidance on the considerations applicable and procedures appropriate to meet that standard.	Cohen Commission (1978)	Accounting profession
61-68. The standard of skill and care (referred to in recommendation 60) would call upon the auditor to		Cohen Commission (1978)	

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Issue: Audit Quality

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
61. ...establish an effective client investigation program.	Required by Statement on Quality Control Standards No. 1, System of Quality Control for a CPA Firm, communicated in, for example, the AICPA's 1993 General Audit Risk Alert para. 123-124.		Accounting profession
62. ...take immediate steps if evidence indicates that management is untrustworthy, including, if necessary, resigning from the engagement.	See SAS 53 para. 26-29 for a discussion of circumstances in which withdrawal from an existing engagement is required or might be appropriate. The Private Securities Litigation Reform Act of 1995 also requires notification responsibilities.		Accounting profession
63. ...observe conditions suggesting predispositions to management fraud.	Although efforts to improve guidance on fraud detection are and must be ongoing, this matter has been fully addressed. See, for example, SAS 53 para. 12; the AICPA's 1993 General Audit Risk Alert para. 90-92; and The CPA Letter, January 1994, "The Auditor's Responsibility to Detect Fraud."		Accounting profession
64. ...maintain an understanding of a client's business and industry.	See SAS 53 para. 10; SAS 22, as amended (AU §311.06-.10); and the AICPA's General Audit Risk Alert.		Accounting profession
65. ...extend the study and evaluation of internal controls to all controls that have a significant bearing on the prevention and detection of fraud.	The objectives of this recommendation have been achieved to a large degree by the clear statement of the auditor's responsibility in SAS 53 (para. 11-12), which also discusses internal control problems in the context of the assessment of audit risk. In addition, SAS 78 requires the auditor to obtain an understanding of the internal control structure, including the accounting system and control procedures, and identifies certain types of procedures designed to prevent fraud. Finally, implementation of the recommendation in the June 1993 policy statement of the AICPA Board of Directors for management and auditor reports on the system of internal control would result in full implementation of this recommendation.		Accounting profession

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Issue: Audit Quality

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
66. ...seek, through a formal procedure developed by the profession, information on methods of perpetrating, concealing, and detecting fraud.	The work of the QCIC and the PITF, as well as the efforts to revise SAS 53 (in May 1996, the ASB exposed for comment a standard that would revise SAS 53), is responsive to this recommendation. In addition to information in the SECPS's annual report, the QCIC has published two articles titled "Lessons Auditors Ignore at Their Own Risk" and the PITF is issuing a series of practice alerts. Other AICPA publications on this subject, in addition to the new series of audit risk alerts, include: (a) "Red Flags" (1979), (b) EDP-Related Fraud in the Banking and Insurance Industries (1984), and (c) Repurchase Transactions (1985).		Accounting profession
67. ...be aware of possible deficiencies in audit techniques and steps.	Auditing standards are continually being updated (see, e.g., SAS 67 on the confirmation process, which is directly responsive to the specific problem identified by the Cohen Commission). Also, the AICPA General Audit Risk Alert (1993) focuses on the risk that the auditor may fail to detect problems and emphasizes the need for professional skepticism.		Accounting profession
68. ...understand the limitations of incomplete audits.	See SAS 53 para. 32.		Accounting profession
69. The auditor should be expected to detect those illegal or questionable acts that the exercise of professional skill and care would normally uncover. In that connection, it is noted that the auditor will not always be able to detect material fraud, and illegal or questionable payments present even greater problems because the amounts are typically small in relation to financial statement amounts and collusion is common.	The auditor's responsibilities for the detection of errors, irregularities, and illegal acts are described in SAS 53 and SAS 54 in a manner consistent with this recommendation.	Cohen Commission (1978)	Accounting profession

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Issue: Audit Quality

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
70. Detection of illegal or questionable acts should be considered by the auditor without regard to traditional standards of materiality. The auditor should consider each illegal or questionable act in light of the circumstances. This involves three steps: (a) determination of the extent to which the item might affect the financial statements, (b) comparison of the act with the standards of corporate conduct established by the board of directors, and (c) consideration of the need for public disclosure.	Paragraphs 13-15 of SAS 54 provide guidance to the auditor on evaluating the materiality of illegal acts, noting that the auditor should consider both the quantitative and qualitative materiality of the act. Paragraphs 16-17 discuss implications for the audit and required communication with audit committees of all but inconsequential acts. Paragraphs 15 and 23 discuss disclosure to outside parties, through the financial statements and otherwise. SAS 19 para. 5 makes it clear that limitations based on materiality are not applicable to certain management representations, specifically, those related to irregularities. SAS 54 para. 11(c) identifies additional auditing procedures that should be considered when the auditor encounters possible illegal acts; determining whether an act was properly authorized is one. Paragraph 22 says that withdrawal from the engagement may be necessary when the client does not take appropriate remedial action. The combination of these two provisions gives the auditor a basis for considering the standards of conduct prevalent in practice within the entity.	Cohen Commission (1978)	Accounting profession
71. The auditor has only limited ability to evaluate the quality and completeness of disclosure of legal matters. Thus, the information now provided by management, substantiated by the assurances given by counsel to the auditor, should be presented directly to users of financial information.	SAS 12 has not been changed. The Cohen Commission indicated that the structure and division of responsibilities in this area are not efficient or effective. However, the AICPA is not aware of instances of misleading disclosures that would have been prevented if this recommendation had been implemented.	Cohen Commission (1978)	Accounting profession
72. The auditor should read all of the other information accompanying audited financial statements and compare it to the information in the financial statements and his audit workpapers to assure himself that it is not inconsistent with anything he knows as a result of his audit. His report should include a description of the work performed and his conclusions.	SAS 8 was not modified for this recommendation. The SAS requires the auditor to read the other information and if it is materially inconsistent with the financial statements and not corrected, to include an explanatory paragraph in the audit report, withhold the use of the report, or withdraw from the engagement. The auditor is advised to consult with legal counsel with respect to material misstatements that are not inconsistent with the financial statements. Also, SAS 61 requires the auditor to explain his or her responsibility for the other information to the audit committee.	Cohen Commission (1978)	Accounting profession

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Issue: Audit Quality

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
73. Professional standards should require that if information acquired in performing other services indicates a material deficiency in unaudited financial information issued by an audit client, the independent auditor should persuade the client to correct the information or, failing that, assure that the necessary disclosure is made.	SAS 71 addresses this matter in the context of interim financial information. Professional standards do not explicitly address misstatements of other types of unaudited financial disclosures discovered in the course of performing other services.	Cohen Commission (1978)	Accounting profession
74. The guidance in SAS 5 for evaluation of financial statements should be expanded when no established accounting principle is prescribed for a specific transaction or event.	FASB statements, interpretations, and technical bulletins; EITF consensuses; and AcSEC statements of position and practice alerts have significantly reduced the number of situations in which there is no established accounting principle for a specific transaction or event.	Cohen Commission (1978)	Accounting profession
75. The guidance in SAS 5 for evaluation of financial statements should be expanded when two or more alternative principles are generally accepted and criteria for selecting among them are insufficient.	The hierarchy of GAAP set forth in SAS 69 elevates most forms of published guidance, including AICPA industry audit guides and statements of position and EITF consensuses over industry practices, thus narrowing further the range of acceptable alternatives. Paragraph 6 reminds auditors to “consider whether the substance of transactions or events differs materially from their form.” In addition, an auditing interpretation (see AU §9411.11-15) was issued in March 1995 that provides guidance when management adopts accounting principles for new transactions or events.	Cohen Commission (1978)	Accounting profession
76. The guidance in SAS 5 for evaluation of financial statements should be expanded when the auditor makes an evaluation of the cumulative effect of the appropriateness of accounting principles selected and estimates made by management.	This recommendation is addressed in authoritative literature (see AU §312.27-32) and in nonauthoritative guidance (Practice Alert 94-1 on dealing with audit differences).	Cohen Commission (1978)	Accounting profession
77. Appropriate legislation should be enacted to empower, but not require, courts to assess costs when, by objective standards, the complaint was frivolous or had little chance of success at trial.	The Private Securities Litigation Reform Act of 1995 provides that a court may assess plaintiffs with the costs of defending against litigation in very limited circumstances.	Cohen Commission (1978)	Congress
78. Some form of statutory limitation of monetary damages is essential to the continued healthy existence of the public accounting profession in the private sector.	The Private Securities Litigation Reform Act of 1995 provides for proportionate liability when the CPA firm has not knowingly committed a violation of the securities laws.	Cohen Commission (1978)	Congress

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Issue: Audit Quality

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
79. The use of court appointed masters to make impartial expertise available to the court should be increased.	No action taken.	Cohen Commission (1978)	Congress
80. There should be no differences in the standards that apply to the performance of audits, whether the audits are of public or private entities. However, present guidance on the application of auditing standards to audits of different size entities is inadequate. Both users and clients would be better served by more guidance on accounting and related services and on the application of auditing standards to audits of smaller entities.	In response to this recommendation, the AICPA mounted a research effort that resulted in the publication of an audit research monograph. This was followed by a major task force effort that resulted in SAS amendments and interpretations as well as an audit procedures study on audits of small businesses. Also, SAS 61 is applicable only to SEC clients and clients that have audit committees, and other standards, such as those on the internal control structure and audit sampling, implicitly or explicitly recognize that the procedures followed to comply with GAAS may differ depending on the size and related characteristics of an entity. In addition, the AICPA has issued a series of Statements on Standards for Accounting and Review Services that address the special needs of private companies for nonaudit financial statement services.	Cohen Commission (1978)	Accounting profession
81. Many auditing pronouncements could usefully provide more specific guidance.	After substantial study, no action was taken with respect to the recommendation. However, SAS 65 provides more detailed guidance on using the work of an internal auditor. Also, many recent auditing standards go into significant detail in explaining their application.	Cohen Commission (1978)	Accounting profession
82. Many, if not most, of the technological and methodological advances in auditing have been developed by accounting firms. Such innovations should be quickly and widely disseminated.	Firms are willing to share experiences so as to improve the quality of professional guidance, but still view product development as proprietary and useful in distinguishing their services from those provided by other firms.	Cohen Commission (1978)	Accounting profession

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Issue: Audit Quality			
Recommendation	**Action taken**	**Recommendation made by/date**	**Recommendation directed to**
83. The standards for the audit function should have broader scope than the present standards. They should be applicable whenever a CPA undertakes an audit engagement. The restructuring should include a statement of the independent auditor's role.	Rule 201 of the Code of Professional Conduct establishes general standards of professional competence, due professional care, planning and supervision, and sufficient relevant data that are applicable to all services provided by all AICPA members. The ASB initiated a new series of attest standards to govern services that do not involve financial statements. Also, the ASB has dealt with and will continue to deal with matters, such as compliance auditing and special reports, that go beyond the boundaries of the financial statements.	Cohen Commission (1978)	Accounting profession
84. The requirement to express a "subject to" qualification for significant uncertainties should be eliminated.	SAS 58, issued in 1988, provided for an explanatory paragraph in the auditor's report when, for example, there are material uncertainties or substantial doubt about the entity's ability to continue as a going concern. SAS 79, issued in December 1995 and which supersedes SAS 58, eliminated the extra paragraph for uncertainties.	Cohen Commission (1978)	Accounting profession
85. It is important to develop some high-quality graduate professional schools of accounting. The timing and length of the program will be determined by the educational institutions involved. It may be a 2- or 3-year program after obtaining a bachelor's degree, a 2- or 3-year program after 3 years of general education for business, or some other variation. However, the option of a 4-year liberal arts undergraduate program and a quality graduate professional program, similar to that of the law, is necessary to permit accounting to compete on an equal footing for students who make their career decisions near or after college graduation.	The AICPA has worked diligently to improve the quality of accounting education. Numerous graduate professional schools and programs of accounting now exist. Those applying for AICPA membership who first become eligible after the year 2000 to take the CPA examination will be required to have obtained 150 semester hours of education, including a bachelor's degree or its equivalent.	Cohen Commission (1978)	Accounting profession
86. The AICPA and state CPA societies should develop a form of membership, such as associate membership, that will permit accounting educators who are not CPAs to take part in state society and Institute activities. Appropriate criteria should be developed that should include passage of the uniform CPA examination, membership on the faculty of an accredited institution, and an advanced degree in accounting.	All AICPA programs directed to accounting educators include those who are not CPAs. They are invited to participate in conferences and workshops on accounting education, efforts to recruit quality students, and committee activities, and are eligible for the AICPA's Outstanding Educator Award.	Cohen Commission (1978)	Accounting profession

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Issue: Audit Quality

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
87. Public accounting firms should not abandon time budgets, but they must improve current methods, particularly for the evaluation of variances and their effect on the evaluation of personnel.	In March 1980, the SECPS issued the Position Paper of Task Force on Certain Aspects of the Auditor's Work Environment. The SECPS membership requirements also mandate the preparation and dissemination to all personnel of a "Statement of Firm Philosophy." The illustrative statement provided by the SECPS Reference Manual (§1000.42) emphasizes the need for an overriding commitment to high-quality professional performance.	Cohen Commission (1978)	Accounting profession
88. Individual accounting firms should immediately undertake to conduct studies to determine the extent of excessive time and budget pressures and the effects on their practices.	See action taken for recommendation 87.	Cohen Commission (1978)	Accounting profession
89. Auditors should carefully assess the effect of time/deadline pressures on their work and refuse to accept such deadlines when they are imposed in opposition to their judgment.	See action taken for recommendation 87.	Cohen Commission (1978)	Accounting profession
90. The profession must continually monitor performance, deal quickly with substandard performance, and attempt to anticipate future problems.	This has been implemented through mandatory peer and quality review, the activities of the QCIC, accelerated ethics division efforts, and the institution of a new procedure for settlement agreements.	Cohen Commission (1978)	Accounting profession
91. A voluntary program consisting of the following three elements would provide effective professional oversight: (a) independent peer reviews of accounting firms, (b) detailed reports of the results of peer review (a "long form report") made available to concerned parties, and (c) appointment by individual accounting firms of independent oversight groups, analogous to corporate audit committees, concerned with oversight including the peer review process.	The AICPA now has a mandatory practice monitoring requirement. To comply with that requirement, firms that audit SEC clients are required to be members of the SECPS and have a peer review every 3 years as well as comply with a number of other membership requirements. The report and letter of comments on the peer review, the firm's response, and other specified documents are available for public inspection. All of the activities of the SECPS, including its peer review program, come under the active oversight of the independent POB. For several years, the SEC has reported in its annual report to the Congress that "the peer review process contributes significantly to maintaining the quality control systems of member firms and, therefore, enhances the consistency and quality of practice before the SEC."	Cohen Commission (1978)	Accounting profession

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Issue: Audit Quality

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
92. Uniformity [of state board regulation] is needed to prevent harmful interference with firms that operate on a national basis with national clients.	This is an ongoing effort. The AICPA, in cooperation with the National Association of State Boards of Accountancy, advocates uniformity in state regulation and publishes a uniform accountancy act. Nevertheless, there are still substantial variations in state statutes, and rules and problems involving interstate and international reciprocity have still not been resolved.	Cohen Commission (1978)	Accounting profession
93. Once a duly constituted disciplinary body begins its work, those who initiate ethics actions should be informed of the status of the complaint. The practitioner should also be informed of the source of the complaint. After the disciplinary body completes its work, all resulting penalties should be well-publicized, along with the practitioner's name. Unless the practitioner requests, his name should not be published upon an acquittal. However, the initiator of an ethics action should be informed of the acquittal.	The results of ethics investigations are still subject to confidentiality requirements and properly so because a CPA's most valued asset is his or her professional reputation. Therefore, complainants are advised that the matter will be considered and investigated if necessary. Of course, the names of individuals found guilty by the Joint Trial Board are published when the discipline is suspension or termination of membership or when a settlement agreement includes such suspension or termination. Practitioners are not advised of the source of the complaint because that would have a chilling effect on those who have legitimate complaints.	Cohen Commission (1978)	Accounting profession
94. The profession's disciplinary mechanism should be restrained only when the member demonstrates that pending litigation is directly related to the misconduct charges and there is some likelihood that litigation will be unduly influenced by disciplinary action. The burden of demonstrating the need for restraint should fall on the member. The disciplinary mechanism should not be restrained during appeals in litigated cases unless the member can demonstrate that the appeal proceeding could result in the introduction of new evidence and would be affected by disciplinary action.	The Professional Ethics Executive Committee agreed at its May 1994 meeting that firms that seek deferral of a disciplinary proceeding because of pending litigation should be required to provide the names of the member(s) involved and evidence that there is litigation that could be prejudiced by a concurrent ethics investigation.	Cohen Commission (1978)	Accounting profession
95. Punishing a firm is appropriate only when a firm fails to provide or enforce acceptable professional standards.	This concept is embodied in the SECPS's Statement of Policy on the Imposition of Sanctions (SECPS Reference Manual §1000.36).	Cohen Commission (1978)	Accounting profession

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Issue: Audit Quality

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
96. The AICPA, with the cooperation of accounting firms and through the use of court and SEC documents, should establish a mechanism for timely and continuing analyses of individual cases as they move through the judicial or regulatory system.	The work of the SECPS's QCIC is responsive to this recommendation. In addition to information in the SECPS annual report, the QCIC has published one article titled "Lessons Auditors Ignore at Their Own Risk," and the PITF is issuing a series of practice alerts. Other AICPA publications on this subject include: (a) "Red Flags" (1979), (b) EDP-Related Fraud in the Banking and Insurance Industries (1984), and (c) Repurchase Transactions (1985).	Cohen Commission (1978)	Accounting profession
97-98. The accounting profession should affirmatively acknowledge that the auditor has the responsibility to search for management fraud that is material to the financial statements through the application of professional auditing standards designed to reduce the risk that such fraud will go undetected; accordingly,	SAS 53 superseded SAS 16 to clarify the auditor's responsibility to detect fraud. Moreover, the AICPA Board of Director's June 1993 Policy Statement reaffirmed that auditors have a responsibility to detect fraud, and in May 1996, the ASB exposed for comment revisions to SAS 53.	Price Waterhouse (1985)	Accounting profession
97. ...existing accounting standards should be expanded to include a requirement that the auditor review and evaluate the company's system of management controls, including conducting an audit process to more adequately address the company's financial condition as well as its financial position.	This recommendation has not been adopted in this form. However, SAS 78 (supersedes SAS 55), concerning consideration of internal controls in a financial statement audit, and SAS 59 concerning the auditor's consideration of an entity's ability to continue as a going concern, focus the auditor's attention on the control environment and require the auditor to consider whether there is substantial doubt about the entity's ability to continue as a going concern. Also see SAS 64 and 77, which supersede SAS 59.		Accounting profession
98. ...existing accounting standards should be expanded to include a requirement that the auditor identify symptoms within the company's business environment that would indicate a higher risk of management fraud and consider performing certain substantive tests if such symptoms are present.	SAS 53 and SAS 78 (which supersedes SAS 55) address this recommendation.		Accounting profession
99. The public must be provided with increased assurance as to the effectiveness of the quality control and peer review process through which the profession assesses levels of performance, independence, and adherence to audit standards.	The AICPA does not endorse the recommendation for a statutory self-regulatory organization (SRO). It has established an effective self-regulatory system with independent oversight of the reviews of firms that audit SEC registrants and believes that a statutorily mandated SRO is not necessary or desirable.	Price Waterhouse (1985)	Accounting profession

(continued)

Issue: Audit Quality

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
100. The profession should develop a plan of priority options to provide liability relief, with the objective of effecting a more equitable approach to the determination of liability.	The Private Securities Litigation Reform Act of 1995 was passed to among other things, provide a more equitable approach to the determination of liability.	Price Waterhouse (1985)	Accounting profession
101. In order to make professional standards more relevant and effective, the structure of the Institute's Code of Professional Ethics should be recast into two basic sections: (a) Standards of Professional Conduct, which will be enforceable, and (b) Rules of Performance and Behavior.	This recommendation was implemented in the revised Code of Professional Conduct, adopted January 12, 1988. Broad standards cannot be enforced, per se. However, they serve as guides to the professional ethics division in evaluating the significance of infractions of specific rules.	Anderson Committee (1986)	Accounting profession
102. The Standards of Professional Conduct will contain six articles. (a) Purpose (b) Applicability (c) Responsibilities (d) Explicit standards (dealing with the public interest, integrity, objectivity and independence, due care, and scope and nature of services) (e) Performance standards (f) Compliance	 See Preamble to Code of Professional Conduct (ET §51.02). See Introduction to Code of Professional Conduct as well as the Applicability section (ET §91.02). See Article I of the Code of Professional Conduct (ET §52.01). See Articles II, III, IV, V, and VI of the Code of Professional Conduct (ET §53.04 to 57.03). Performance standards are set forth in Rule 201 (ET §201.01-.02). Compliance with standards is covered by Rule 202 (ET §202.01).	Anderson Committee (1986)	Accounting profession

(continued)

Issue: Audit Quality

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
103. The Rules of Performance and Behavior should include		Anderson Committee (1986)	Accounting profession
(a) independence,	See Rule 101 and related interpretations and rulings in ET §100.		
(b) general standards,	See Rule 202 in ET §200.		
(c) compliance with standards,	See Rule 202 in ET §200.		
(d) accounting principles,	See Rule 203 in ET §200.		
(e) confidential client information,	See Rule 301 in ET §300.		
(f) contingent fees,	See Rule 302 in ET §300.		
(g) acts discreditable,	See Rule 501 in ET §500.		
(h) advertising and other forms of solicitation,	See Rule 502 in ET §500. This rule and its interpretations bar only false, misleading, or deceptive acts in advertising or solicitation.		
(i) commissions, and	See Rule 503 in ET §500. This rule bars commissions only when a member also performs a review or examination of historical or prospective financial information or performs a compilation of financial statements expected to be used by third parties and does not disclose a lack of independence, all pursuant to an agreement with the Federal Trade Commission.		
(j) form of practice and name.	See Rule 505 in ET §500.		
104. The AICPA should establish a quality review program and make participation in that program or in the peer review programs of the division for CPA firms a membership requirement for members in the public practice.	Participation in an AICPA-approved practice monitoring program was made a condition of membership in January 1988. (See BL §220.01.)	Anderson Committee (1986)	Accounting profession

(continued)

Issue: Audit Quality

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
105. The AICPA should adopt a requirement for AICPA members who practice in firms that audit one or more SEC registrants that would require those firms to be members of the SECPS.	This requirement was adopted in January 1990. (See BL §230.01.)	Anderson Committee (1986)	Accounting profession
106-114. The AICPA should establish more effective procedures for handling complaints and assuring compliance with performance standards by all members. Specifically, the committee recommends a restructuring that will		Anderson Committee (1986)	
106. ...assign to the appropriate quality review or peer review committees responsibility for investigating complaints against firms and members in public practice that involve compliance with technical performance standards.	This recommendation was not implemented, largely because it would be seen as evidence of a reluctance to take disciplinary measures against members who violate technical or ethical standards, and because it would change the perceived focus of quality review from educational, corrective, and remedial actions to disciplinary measures.		Accounting profession
107. ...assign responsibility to the Institute's Quality Review Executive Committee (QREC) for taking disciplinary action against enrolled firms when they fail to cooperate or commit an egregious act that could lead to dismissal from the Quality Review program or to other forms of punitive sanctions.	The QREC has this authority. (See QR §3000.75.)		Accounting profession
108. ...modify the authority of the Professional Ethics Executive Committee and the professional ethics division in a manner consistent with the restructured Code and assign the Professional Ethics Executive Committee the responsibility for dealing with complaints against members that involve national interests and multijurisdictional issues and for oversight of complaints disposed of by state society ethics committees.	The Joint Ethics Enforcement Program manual is consistent with the responsibilities of the professional ethics division, and the division, rather than state CPA societies, investigates complaints that involve "national interests" (including referrals from government agencies) and multijurisdictional issues.		Accounting profession

(continued)

Issue: Audit Quality

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
109. ...encourage state society ethics committees to take a more active role in dealing with complaints against members in their jurisdictions that do not involve national interest or multijurisdictional issues and to interface with the Quality Review program in the same way as the Institute's Professional Ethics Executive Committee.	State CPA society ethics enforcement procedures have improved, but it is the view of the professional ethics division that such procedures are more effectively applied at the national level. Accordingly, the AICPA has offered to investigate all cases received by state societies, and over 20 states accepted that offer. One state society, California, refers all complaints it receives directly to the state board of accountancy.		Accounting profession
110. ...establish procedures for coordinating the handling of complaints in the professional ethics division and in the programs for monitoring practice.	See action taken for recommendation 106.		Accounting profession
111. ...reconstitute the National Review Board as a national trial board to serve as the hearing body in disciplinary proceedings against members.	See BL §360.01 for the composition and authority of the reconstituted National Joint Trial Board.		Accounting profession
112. ...modify the contractual agreements with the state CPA societies under the Joint Ethics Enforcement Programs to eliminate the Regional Trial Boards.	See the Joint Ethics Enforcement Programs manual.		Accounting profession
113. ...establish procedures for public disclosure of information on the disposition of complaints.	See BL §760.01.		Accounting profession
114. ...enforce the concept that the public interest is best served through educational and remedial or corrective actions and only secondarily through other disciplinary measures.	This is done through the AICPA quality review program and the peer review programs of the two sections of the AICPA's Division for CPA Firms.		Accounting profession
115. The National Trial Board will serve as the hearing body to dispose of cases arising from complaints that are not resolved by the Institute's Professional Ethics Executive Committee or by state society ethics committees. The sanctions for failure to take corrective action and for egregious violations or violations undertaken with the intent to mislead would include (a) public censure and disclosure of specified remedial actions, with or without a monetary fine to defray the cost of the proceedings, and (b) public notice of suspension or termination of membership.	See BL §760.01. While the bylaws do not presently give the Joint Trial Board the authority to impose monetary fines, the two sections of the AICPA's Division for CPA Firms have that authority.	Anderson Committee (1986)	Accounting profession

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Issue: Audit Quality

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
116. Achieve membership in the SECPS for all CPA firms practicing before the SEC.	The AICPA requires that all firms with AICPA members among their partners or employees that audit companies practicing before the SEC be members of the SECPS. However, the SEC does not mandate that all CPA firms that audit SEC registrants belong to the SECPS.	Big 7 (1986)	Accounting profession
117. If and when the Congress extends SEC jurisdiction to all classes of entities justified by the public interest, these newly covered classes of companies should be subject to SECPS jurisdiction.	The Congress has not acted on this recommendation.	Big 7 (1986)	Accounting profession
118. Enhance public confidence in the Special Investigations Committee.	The SEC's 1994 Annual Report to Congress comments favorably on QCIC activities.	Big 7 (1986)	Accounting profession
119. The accounting profession should be improving its efforts in determining whether companies are complying with laws and regulations.	SAS 54 discusses the consideration an auditor should give to the possibility of illegal acts. Although the SAS states that an audit normally does not include procedures specifically designed to detect illegal acts, para. 9 provides examples of specific information that may raise a question concerning possible illegal acts. The SAS includes guidance on audit procedures in response to possible illegal acts, as well as the auditor's response to detected acts. Also, SAS 68 deals with compliance auditing applicable to governmental entities and other recipients of governmental financial assistance. FDI Act §36(e) requires auditors to report on large banks' and thrifts' compliance with laws and regulations.	GAO (1986)	Accounting profession
120. The accounting profession should make sure that internal controls and accounting systems are in place that will help prevent fraud and mismanagement in the companies being audited.	The revision of SAS 53 that was exposed for comment in May 1996 provides more specific guidance for the auditor's use in assessing the risk of fraud.	GAO (1986)	Accounting profession

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Issue: Audit Quality

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
121. The accounting profession should provide better disclosure and early warnings regarding the condition of companies that are in precarious positions.	SAS 59 required the auditor who concludes that there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time to reflect that conclusion in the report and provides guidance on relevant disclosures. However, SAS 77, issued in November 1995 and which supersedes SAS 59, precludes the auditor from using conditional language in the auditor's conclusion about an entity's ability to continue as a going concern.	GAO (1986)	Accounting profession
122. The accounting profession should reduce the secrecy that surrounds the peer review process, and make the process mandatory for all public accounting firms that audit public corporations and government entities.	Peer review is mandatory for all firms that perform audits whose partners or employees are members of the AICPA. The results of peer reviews undertaken to meet SECPS membership requirements are maintained in a public file.	GAO (1986)	Accounting profession
123. The ASB should revise the auditor's standard report to describe the extent to which the independent public accountant has reviewed and evaluated the system of internal accounting control. The ASB also should provide explicit guidance to address the situation where, as a result of his knowledge of the company's internal accounting controls, the independent public accountant disagrees with management's assessment as stated in the proposed management report.	The AICPA has been reluctant to assume these additional responsibilities and the related risk of additional liability without a legislative or regulatory mandate. An auditing interpretation (AU §9550.03) provides guidance to the auditor who disagrees with management's published assessment of the company's internal controls.	Treadway Commission (1987)	Accounting profession
124. The ASB should revise standards to restate the independent public accountant's responsibility for detection of fraudulent financial reporting, requiring the independent public accountant to (a) take affirmative steps in each audit to assess the potential for such reporting and (b) design tests to provide reasonable assurance of detection. Revised standards should include guidance for assessing risks and pursuing detection when risks are identified.	SAS 53 on errors and irregularities was issued in response to this recommendation.	Treadway Commission (1987)	Accounting profession
125. The ASB should establish standards to require independent accountants to perform analytical review procedures in all audit engagements and should provide improved guidance on the appropriate use of these procedures.	SAS 56 on analytical procedures was issued in response to this recommendation.	Treadway Commission (1987)	Accounting profession

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Issue: Audit Quality

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
126. The SEC should require independent public accountants to review quarterly financial data of all public companies before release to the public.	The SEC issued a release on the subject of timely auditor involvement with quarterly reports. However, a regulation was not issued.	Treadway Commission (1987)	SEC
127. The ASB should revise the auditor's standard report to state that the audit provides reasonable but not absolute assurance that the audited financial statements are free from material misstatements as a result of fraud or error.	SAS 58 on reports on audited financial statements was issued in 1988 in response to this recommendation. SAS 79 was issued in 1995 and supersedes SAS 58.	Treadway Commission (1987)	Accounting profession
128. The SEC should have the authority to impose civil money penalties in administrative proceedings (including Rule 2(e) proceedings) and to seek civil money penalties from a court directly in an injunctive proceeding.	The SEC has the authority to impose civil money penalties in certain administrative proceedings, but not in Rule 2(e) proceedings. The Commission may seek civil money penalties in injunctive proceedings.	Treadway Commission (1987)	Congress
129. Criminal prosecution of fraudulent financial reporting cases should become a higher priority. The SEC should conduct an affirmative program to promote increased criminal prosecution of fraudulent financial reporting cases by educating and assisting government officials with criminal prosecution powers.	The SEC has participated in a number of programs to coordinate enforcement activities by the various federal and state administrators charged with this responsibility.	Treadway Commission (1987)	SEC
130. The SEC must be given adequate resources to perform existing and additional functions that help prevent, detect, and deter fraudulent financial reporting.	This is a judgment only the SEC and the Congress can make.	Treadway Commission (1987)	Congress and SEC
131. The Office of the Comptroller of the Currency, the Federal Reserve Bank, the Federal Deposit Insurance Corporation, and the Federal Home Loan Bank Board should adopt measures to carry out their own regulatory responsibility relating to financial reporting under the federal securities laws.	The environment has changed substantially since the Treadway Commission issued its report, and FDICIA imposes many new responsibilities on financial institutions, their auditors, and the regulatory system, some of which go beyond present SEC requirements.	Treadway Commission (1987)	Financial institution regulatory agencies
132. The AICPA's SECPS should strengthen its peer review program by increasing review of audit engagements involving public company clients new to a firm. For each office selected for peer review, the first audit of all such new clients should be reviewed.	Required by SECPS Standards for Performing and Reporting on Peer Reviews; see SECPS Reference Manual §2000.70(c).	Treadway Commission (1987)	Accounting profession

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Issue: Audit Quality

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
133. The AICPA's SECPS requirement for a concurring, or second partner, review of the audit report should be revised as part of an ongoing process of review of this requirement. Standards for the concurring review should, among other things, (a) require concurring review partner involvement in the planning stage of the audit in addition to the final review stage, (b) specify qualifications of the concurring review partner to require prior experience with audits of SEC registrants and familiarity with the client's industry, and (c) require the concurring review partner to consider himself a peer of the engagement partner for purposes of the review.	Revised SECPS guidance on the scope of the concurring review requirement (SECPS Reference Manual §2000.39) is appropriately responsive to this recommendation.	Treadway Commission (1987)	Accounting profession
134. Public accounting firms should recognize and control the organizational and individual pressures that potentially reduce audit quality.	In March 1980, the SECPS issued the Position Paper of Task Force on Certain Aspects of the Auditor's Work Environment. The SECPS membership requirements also mandate the preparation and dissemination to all personnel of a "Statement of Firm Philosophy." The illustrative statement provided by the SECPS Reference Manual (§1000.42) emphasizes the need for an overriding commitment to high-quality professional performance.	Treadway Commission (1987)	Accounting profession
135. The SEC should require all public accounting firms that audit public companies to be members of a professional organization that has peer review and independent oversight functions and is approved by the SEC, such as that specified by the SECPS of the AICPA's Division for CPA Firms.	The SEC considered but has not implemented such a requirement. However, AICPA members may engage in the practice of public accounting with a firm that audits one or more SEC clients only if that firm is a member of the SECPS. Over 1,260 firms are now SECPS members; they audit the financial statements of about 16,000 SEC clients, representing the vast majority of publicly traded SEC registrants. There are approximately 290 CPA firms not associated with the SECPS or the AICPA that serve as auditors for about 460 generally small or inactive SEC clients.	Treadway Commission (1987)	SEC
136. The SEC should take enforcement action when a public accounting firm fails to remedy deficiencies cited by the public accounting profession's quality assurance program.	The SEC can do this, and it has done it once against a member firm whose membership in the SECPS was terminated pursuant to an SECPS disciplinary proceeding.	Treadway Commission (1987)	SEC

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Issue: Audit Quality

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
137. The financial institution regulatory agencies and the public accounting profession should provide for the regulatory examiner and the independent public accountant to have mutual access to information they develop about examined financial institutions.	This recommendation has been implemented by regulatory action and by the issuance of SOP 90-5 by the AICPA Auditing Standards Division.	Treadway Commission (1987)	Financial institution regulatory agencies and accounting profession
138. State boards of accountancy should implement positive enforcement programs that periodically would review the quality of by services rendered by the independent public accountants they license.	This has been done by 25 state boards. More important is the fact that participation in an AICPA-approved practice monitoring program is now mandatory for all firms that have partners or employees who are AICPA members.	Treadway Commission (1987)	State boards of accountancy
139. Parties charged with responding to various tort reform initiatives should consider the implications that the perceived liability crisis holds for long-term audit quality and the independent public accountant's detection of fraudulent financial reporting.	The AICPA believed there was a pressing need for reform and supported passage of the Private Securities Litigation Reform Act of 1995.	Treadway Commission (1987)	Congress
140. Business and accounting students should be well-informed about the regulation and enforcement activities by which government and private bodies safeguard the financial reporting system and thereby protect the public interest.	A number of auditing texts discuss the regulatory scheme, quality control standards, and practice monitoring programs. Also, AICPA curriculum recommendations specify coverage of the regulatory and legal framework that is designed to protect the public interest.	Treadway Commission (1987)	Educators
141. Throughout the business and accounting curricula, educators should foster knowledge and understanding of the factors that may cause fraudulent financial reporting and the strategies that can lead to a reduction in its incidence.	The issuance of the "expectation gap" SASs and the COSO report has drawn the attention of educators, including textbook authors, to matters related to fraudulent financial reporting. In addition, in part through grants by certain individuals, there has been a renewed interest in academia (and in the business community) in business ethics. Specific steps taken to address fraud prevention and detection in the classroom are (a) development of an educator workshop on fraud, (b) a fraud session for the 1995 Accounting Educators Mini-Conference, and (c) solicitation of teaching cases on fraud which are distributed to all accounting program administrators. Also, auditors' responsibility for fraud detection is included in the content specification outline for the Uniform CPA Examination.	Treadway Commission (1987)	Educators

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Issue: Audit Quality

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
142. The business and accounting curricula should promote a better understanding of the function and the importance of internal controls, including the control environment, in preventing, detecting, and deterring fraudulent financial reporting.	See action taken for recommendation 141. The COSO report has been widely distributed to college libraries and academics.	Treadway Commission (1987)	Educators
143. The business and accounting curricula should help students develop stronger analytical, problem-solving, and judgment skills to help prevent, detect, and deter fraudulent financial reporting when students become participants in the financial reporting process.	The Accounting Education Change Commission, funded by accounting firms, has experimented with innovative educational approaches and is working to disseminate the results throughout the academic community. It plans to issue final recommendations in about a year. The AICPA's curriculum recommendations specify development of analytical and problem-solving skills as essential components of accounting education.	Treadway Commission (1987)	Educators
144. The business and accounting curricula should emphasize ethical values by integrating their development with the acquisition of knowledge and skills to help prevent, detect, and deter fraudulent financial reporting.	See action taken for recommendation 143. The development of ethical values is specifically addressed throughout AICPA curriculum recommendations. In addition, teaching cases on ethics issues have been distributed to all accounting program administrators.	Treadway Commission (1987)	Educators
145. Business schools should encourage business and accounting faculty to develop their own personal competence as well as classroom materials for conveying information, skills, and ethical values that can help prevent, detect, and deter fraudulent financial reporting. Business school faculty reward systems should recognize and reward the contribution of faculty who develop such competence and materials.	See action taken for recommendations 141 and 142.	Treadway Commission (1987)	Educators
146. Professional certification examinations should test students on the information, skills, and ethical values that further the understanding of fraudulent financial reporting and that promote its reduction.	The Institute of Internal Auditors and the AICPA have undertaken practice surveys, the results of which have been used to evaluate the appropriateness of their respective examinations. The Institute of Management Accountants and the Institute of Internal Auditors agreed to place greater emphasis on ethics in their professional examinations. However, the national CPA examination does not address ethics.	Treadway Commission (1987)	Accounting profession

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Issue: Audit Quality

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
147. As part of their continuing professional education, independent public accountants, internal auditors, and corporate accountants should study the forces and opportunities that contribute to fraudulent financial reporting, the risk factors that may indicate its occurrence, and the relevant ethical and technical standards.	The sponsoring organizations of the Treadway Commission, acting both separately and together, have developed training programs that respond to this recommendation.	Treadway Commission (1987)	Accounting profession
148. Management of banks and bank holding companies with securities affiliates should report on the adequacy of the entities' internal controls and on compliance with laws and regulations. Moreover, as part of the annual financial audit, independent auditors should be required to review and report on management assertions regarding internal controls and compliance.	FDI Act §36(c) and (e) require internal control and compliance reporting for large banks and thrifts.	GAO (1988)	Congress and regulators
149. The AICPA should expeditiously revise the AICPA Audit and Accounting Guide for Savings and Loan Associations to include specific steps for ensuring that those audits are performed in a quality manner. The guide should include detailed discussion and specific requirements for, among other things,		GAO (1989)	Accounting profession
(a) identifying the nature and related inherent risks of land and ADC loans,	See para. 6.10 and Chapter 9 of the revised guide.		
(b) following up on the work of federal examiners,	See para. 1.31-.32 of the revised guide.		
(c) ensuring that regulatory violations and formal regulatory actions are disclosed, and	See para. 1.47-.55 and para. 2.17 of the revised guide.		
(d) properly reporting all material weaknesses in internal controls.	See para. 1.47 and para. 2.26 of the revised guide.		

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Issue: Audit Quality

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
150. The AICPA should communicate the results of GAO's review of the savings and loan (S&L) audits and others' reviews of S&L problems. CPA firms performing S&L audits should review the quality of those audits to help ensure that	The full text of the GAO report was published in the March 1989 issue of the Journal of Accountancy, which is distributed to all AICPA members, along with an appropriate commentary.	GAO (1989)	Accounting profession
(a) staff performing the audits have sufficient knowledge in S&L operations,	See para. 5.04, 7.12, and 16.03 of the revised guide.		
(b) audit methodologies are specifically tailored to take into account changes in the operations of their individual S&L clients and the S&L industry environment,	See para. 2.18-19 of the revised guide.		
(c) evidence of all audit work is properly documented in the working papers, and	See the AICPA's 1993 General Audit Risk Alert, section on working paper requirements.		
(d) financial risks, regulatory violations and formal regulatory actions, and internal control weaknesses are fully disclosed in audit reports.	See para. 2.17 and para. 2.24-.26 of the revised guide.		
151. The SEC should adopt a requirement that all firms practicing before the SEC be subject to periodic peer reviews. If the SEC determines that it does not have sufficient authority to do this, legislation would be necessary.	The SEC proposed but never implemented such a requirement. However, AICPA members may engage in the practice of public accounting with a firm that audits one or more SEC clients only if that firm is a member of the SECPS. Over 1,260 firms are now SECPS members; they audit the financial statements of about 16,000 SEC clients, representing the vast majority of publicly traded SEC registrants.	GAO (1989)	SEC or Congress
152. The QCIC (formerly, the Special Investigations Committee) should provide the SEC with access to all required information about the cases it investigates.	The SEC now has access to closed case summaries prepared by the QCIC and related POB files. The SEC has concluded (in its 1994 annual report) that the QCIC process provides added assurances, as a supplement to the SECPS peer review process, that major quality control deficiencies, if any, are identified and addressed on a timely basis.	GAO (1989)	Accounting profession

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Issue: Audit Quality

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
153. The AICPA should issue the industry audit guides currently under revision as quickly as possible and undertake an effective program to keep all guides current.	All of the guides mentioned in the GAO report have been updated. The AICPA has devoted substantial resources to a program to keep guides current for recent development, including a loose-leaf service, a separate staff, compensated authors for selected guide projects, and a series of annual audit risk alerts for existing guides, in addition to the general audit risk alerts.	GAO (1989)	Accounting profession
154. The Congress should amend securities laws to require direct reporting to the SEC of illegalities if the management and/or board of directors or audit committee of the issuer does not promptly terminate and correct an illegality.	FDI Act §36(c) and (e) contain provisions for internal control and compliance reporting for large banks and thrifts. The Private Securities Litigation Reform Act of 1995 (§301) provides for auditor reporting of illegalities to the SEC under certain circumstances.	GAO (1990)	Congress
155. The Congress should amend banking laws as well as securities laws to strengthen both management's and the auditor's responsibilities for evaluating and reporting on internal controls (including those directly and not directly related to the financial statements) and compliance with laws and regulations.	These matters were addressed in FDI Act §36(c) and (e). The Private Securities Litigation Reform Act of 1995 (§301) requires auditors to perform procedures to detect illegal acts and to identify related-party transactions (but does not require auditors to evaluate and report on internal controls).	GAO (1990)	Congress
156. The Congress should amend securities laws to require regulators to share reports and information with independent public accountants concerning regulators' knowledge of potential mismanagement, fraud, or abuse by companies.	No action taken.	GAO (1990)	Congress
157. The Congress should amend securities laws to strengthen auditing procedures in three areas: related-party transactions, compliance with laws and regulations, and early warning of the collapse or demise of a company.	The Private Securities Litigation Reform Act of 1995 (§301) requires audit procedures for identifying related parties, detecting illegal acts, and evaluating the ability of the issuer to continue as a going concern.	GAO (1990)	Congress
158. The Congress should amend securities laws to require all auditors auditing public companies and insured depository institutions to obtain a peer review.	Securities laws were not amended. However, see action taken for recommendations 122 and 166.	GAO (1990)	Congress

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Issue: Audit Quality			
Recommendation	**Action taken**	**Recommendation made by/date**	**Recommendation directed to**
159. The accounting rules and audit procedures for related- party transactions should be enhanced to clarify that related-party transactions are required to be accounted for and reported based on their economic substance. Also, guidance should be provided on how to determine economic substance.	Accounting standards have not been changed. However, SAS 45 states that the independent accountant should be aware that the substance of a particular transaction could be significantly different from its form, and that the financial statements should recognize the substance of particular transactions rather than merely their legal form. SAS 69 states that the auditor should consider whether the substance of transactions or events differs materially from their form.	GAO (1991)	Accounting profession
160. The Congress should enact legislation requiring that independent public accountants acting as auditors of federally insured financial institutions be required to report to the institution and the regulators on the institution's compliance with (a) laws and regulations that are identified by the regulators as relating to safety and soundness where compliance can be objectively determined and (b) special regulatory directives as defined by the regulators to maintain prudent operations or to restore the financial health of the institution.	FDI Act §36(e) requires auditor reporting on an institution's compliance with laws and regulations. However, legislative proposals have been introduced to repeal this requirement.	GAO (1991)	Congress
161. The Congress should enact legislation requiring that independent public accountants acting as auditors of federally insured financial institutions be required to immediately pursue indications of illegality by the institution and inform an officer authorized to sign management's annual internal control report and the audit committee of the institution if the accountant determines that an illegality likely occurred and, then, inform the institution's board of directors in a timely manner.	See the Private Securities Litigation Reform Act of 1995 (§301). Also, SAS 53 and 54 provide guidance in this area.	GAO (1991)	Congress
162. The Congress should enact legislation requiring that independent public accountants acting as auditors of federally insured financial institutions be required to resign from the audit engagement or report to the regulators on the illegality, or both, if the illegality is substantial and the institution does not take corrective action.	SAS 53 and 54 provide guidance in this area. The Private Securities Litigation Reform Act of 1995 (§301) includes requirements for reporting to the SEC illegal acts that have not been properly addressed by the company.	GAO (1991)	Congress

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Issue: Audit Quality

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
163. To encourage better compliance with laws and regulations, auditors should be required to promptly and fully notify audit committees and appropriate regulatory authorities of significant illegal acts that are not corrected.	See action taken for recommendations 160 and 161.	GAO (1991)	Congress
164. The Congress should enact legislation that requires the regulators to periodically review the independent auditor's procedures and working papers for large institutions as a basis for regulatory reliance thereon.	FDI Act §36(g)(3)(A)(i) establishes access to working papers. However, legislation has not been enacted to require regulatory review or reliance.	GAO (1991)	Congress
165. The Congress should enact legislation requiring that the regulators biennially report to the Congress on the effectiveness of the auditing and management reforms at large institutions and that GAO review the regulators' evaluation and report to the Congress.	No action taken.	GAO (1991)	Congress
166. Independent public accountants acting as auditors of federally insured financial institutions should be required to undergo periodic peer review, such as that prescribed by the AICPA's self-regulatory program, or another such quality assurance program acceptable to the regulators.	The Congress required peer review for auditors of large banks and thrifts. See FDI Act §36(g)(3)(B).	GAO (1991)	Congress
167. The Congress should enact legislation (a) requiring that federal regulators of depository institutions share with the institution's independent public accountant their knowledge of potential illegal acts by the institution, with exceptions for ongoing litigation and investigations, and (b) authorizing the regulators to remove the auditors for cause with appropriate due process.	Sharing of information under the FDI Act is incumbent on auditors and management, but not regulators. FDI Act §36(g)(4) addresses removal of auditors.	GAO (1991)	Congress
168. The AICPA should clarify audit requirements in its audit guide of employee benefit plans to strengthen audits of employee benefit plans.	The AICPA revised its audit guide on employee benefit plans and publicized the results of GAO's review of CPA audits of pension plans (GAO/AFMD-92-14) to its membership in a 1991 industry risk alert.	GAO (1992)	AICPA
169. The AICPA should communicate to its membership the results of investigations of deficient employee benefit plan audits.	The AICPA publicized the results of GAO's review of CPA audits of pension plans (GAO/AFMD-92-14) to its membership in a 1991 industry risk alert. Also, the AICPA's December 1991 Journal of Accountancy provided information about the investigations of employee benefit plan audits.	GAO (1992)	AICPA

(continued)

Issue: Audit Quality

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
170. Accounting firms should assure that auditors more consistently implement, and be more sensitive to the need to exercise the professional skepticism required by, the auditing standard that provides guidance on the auditor's responsibility to detect and report errors and irregularities.	The new series of PITF practice alerts, articles that will be placed in the Journal of Accountancy illustrating actual frauds, and the AICPA audit risk alert series put firms and members on notice as to their responsibilities and the need for professional skepticism.	POB (1993)	Accounting profession
171. The ASB, the Executive Committee of the SECPS, or some other appropriate body should develop guidelines to assist auditors in assessing the likelihood that management fraud, which may affect financial information, may be occurring and to specify additional auditing procedures when there is a heightened likelihood of management fraud.	See action taken for recommendation 170. In addition, in May 1996, the ASB exposed for comment revisions to SAS 53 on errors and irregularities and changes to other standards in response to this recommendation.	POB (1993)	Accounting profession
172. The AICPA's AcSEC should promptly adopt a Statement of Position providing guidance on, and requiring disclosure of information about, the nature of risks and uncertainties associated with the reporting entity's operations and financial condition.	SOP 94-6 was issued in December 1994.	POB (1993)	Accounting profession
173. The accounting profession should support carefully drafted legislation requiring auditors to report to the appropriate authorities, including the SEC, suspected illegalities discovered by the auditor in the course of an audit if the client's management or board of directors fails to take necessary action with respect to such suspected illegalities and the auditor believes that they are or may be significant to the entity. The profession should seek adequate guidance as to the types of illegalities that would be encompassed by this requirement.	See the Private Securities Litigation Reform Act of 1995 (§301).	POB (1993)	Accounting profession
174. The ASB should revise the auditor's standard report to make the prospective nature of certain accounting estimates clear, including a caveat that the estimated results may not be achieved. This communication should not be written as a defensive retrenchment by the auditing profession, but rather as a more realistic and reasonable explanation of the limitation of assurance that can be provided on certain accounting estimates.	This recommendation was not adopted by the ASB. However, SOP 94-6 on risks and uncertainties does require disclosure of the use of estimates in financial statements.	POB (1993)	Accounting profession

(continued)

Issue: Audit Quality

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
175. The following recommendation of the Macdonald Commission should be adopted by ASB in the United States: "When new accounting policies are adopted in response to new types of transactions or new kinds of assets or obligations, the auditor should be satisfied that the accounting policies adopted properly reflect the economic substance of the transaction, asset, or liability in accordance with the broad theory governing present-day financial reporting and the established concept of conservatism in the face of uncertainty."(Report of the Commission to Study the Public's Expectations of Audits, (Macdonald Commission), June 1988.)	An auditing interpretation (see AU §9411.11-15) was issued in March 1995 that provides guidance when management adopts accounting principles for new transactions or events.	POB (1993)	Accounting profession
176. Peer reviewers should evaluate a CPA firm's consultation process by which it reaches specific accounting conclusions, and should also inquire whether that process leads to accounting that is appropriate in the circumstances. In testing compliance with a firm's consultation policies and procedures, a firm's peer review team should evaluate the quality of the conclusions reached.	Amended guidance addressing this revision has been developed and adopted by the SECPS peer review committee.	POB (1993)	Accounting profession
177. The concurring partner, whose participation in an audit is a membership requirement of the SECPS, should be responsible for assuring that those consulted on accounting matters are aware of all of the relevant facts and circumstances, including an understanding of the financial statements in whose context the accounting policy is being considered. The concurring and consulting partners should know enough about the client to ensure that all of the relevant facts and circumstances are marshalled, and also possess the increased detachment that comes from not having to face the client on an ongoing basis. The concurring partner should have the responsibility to conclude whether the accounting treatment applied is consistent with the objectives of recommendation 175.	The SECPS adopted an amendment to its concurring partner review membership requirements in April 1994 in response to this recommendation. When such consultation occurs, the concurring reviewer is required to be satisfied that the conclusions reached are appropriate in light of all the relevant facts and circumstances. (See SECPS Reference Manual (§1000.39(b)), revised in November 1995.)	POB (1993)	Accounting profession

(continued)

Issue: Audit Quality

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
178. Financial responsibility among those involved in a financial failure or in fraudulent financial reporting should be allocated in proportion to responsibility for losses suffered. Accordingly, "separate and proportionate" liability legislation applicable to both federal and state claims should be enacted by the Congress. The civil liability provisions of RICO should be amended to eliminate treble damages in cases that arise under the federal securities laws.	The Private Securities Litigation Reform Act of 1995 (§201) provides for proportionate liability for auditors found to have negligently violated the securities laws.	POB (1993)	Congress
179. The Congress should adopt preemptive legislation to permit the practice of accountancy in a form that appropriately limits the liability of individual members of the firm.	There is no federal law to achieve this objective. However, most states allow firms to practice as limited liability partnerships which limits the liability of partners not at fault.	POB (1993)	Congress
180. The SEC should amend its rules to require SEC registrants to disclose whether their auditors have had a peer review, the date of the most recent peer review, and its results.	Although suggested as a possible alternative within SEC's 1987 rule proposed on peer review, no action was taken.	POB (1993)	SEC

(continued)

Issue: Audit Quality

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
181. The SECPS's membership requirements should be changed to require member firms to modify their quality control systems to specify that they take the following steps in response to allegations of deficiencies in the conduct of an audit of financial statements of an SEC client (or another client encompassed by the QCIC process) that are made in litigation against the member firm or its personnel, or in any public proceeding or investigation by a regulatory agency. (a) perform a complete internal analysis of the audit; review all relevant work papers, correspondence, and other files; and interview members of the engagement team, (b) assess the capabilities of the senior audit personnel and determine whether the firm should monitor, reassign, or terminate such personnel, (c) identify any problems with the firm's quality control system or training activities, (d) identify any implications of the allegations relating to the adequacy of auditing, quality control, or accounting standards, (e) identify any implications of the allegations relating to the adequacy of guidance with respect to the manner in which audits are conducted, including the evaluation of risks in audits, and relating to variations in practice and the interpretations of standards that should be resolved, and (f) communicate the implications identified in items (d) and (e) in a structured manner to the QCIC.	The SECPS Executive Committee formed the PITF. With the concurrence of the POB, the SECPS will not change its membership requirements but has requested that the QCIC revise its procedures to include determining that a firm that is the subject of such an allegation conducted the appropriate analysis. The QCIC has approved in concept procedures for ensuring that its proceedings determine that member firms have appropriately undertaken actions responsive to items one through five of the POB recommendations.	POB (1993)	Accounting profession
182. The peer review performance standards should be amended to require peer reviewers to test firms' compliance with these modifications (see recommendation 181) to their quality control system.	In view of actions taken for recommendations 181 and 183 and the related QCIC involvement, no separate action by the peer review committee is necessary.	POB (1993)	Accounting profession

(continued)

Issue: Audit Quality

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
183. The QCIC procedures should be modified to require the QCIC to develop additional procedures to permit it, on the basis of its analysis of the QCIC cases and the information reported to it under the expanded membership requirements discussed above, to facilitate the resolution of unresolved audit practice issues and to formulate, either by itself or in collaboration with other appropriate bodies, practice and guidance directions to the accounting profession in a retrievable format, such as EITF Abstracts, which present issues considered by FASB's EITF.	The new series of practice alerts issued by the PITF is sent to all SECPS member firms and also published in The CPA Letter.	POB (1993)	Accounting profession
184. The SECPS's membership requirements relating to CPEs should be revised to require that a substantial number of the required hours of continuing education relate to accounting and auditing.	The SECPS has amended its requirements to specify that professionals spending 25 percent or more of their time in providing accounting or audit services or with supervisory or review responsibilities with respect to such engagements, except compilations, must obtain at least 40 percent of their annual CPEs on subjects or matters related to accounting or auditing. This change became effective for continuing professional years beginning on or after January 1, 1995.	POB (1993)	Accounting profession
185. Every participant in the financial reporting process should bring to the independent auditor's attention instances of suspected financial fraud. This includes management officials and advisors such as attorneys and government regulators.	This recommendation was discussed in a meeting between AICPA representatives and the Chairman of the SEC on December 15, 1993. No further action was taken.	AICPA Board of Directors (1993)	Management, advisors, and regulators
186. The system of joint and several liability should be replaced with proportionate liability except in cases of "knowing fraud."	See action taken for recommendation 178.	AICPA Board of Directors (1993)	Congress
187. A strengthened system should be established to discipline individual CPAs and firms that are guilty of substandard work or professional misconduct. This system should be national in scope and reside in the profession with oversight by the government. It should apply to auditors of SEC registrants and other publicly accountable entities.	A bill (S.1976, "Public Securities Reform Act of 1994"), introduced on March 24, 1994, by Senator Dodd and publicly supported by the AICPA, included provisions that would establish a "public auditing self-disciplinary board," which, as described in the bill, would accomplish the objective of timely and effective discipline. This legislation was not enacted.	AICPA Board of Directors (1993)	Accounting profession and Congress
188. Investigative and disciplinary actions should take place regardless of whether legal proceedings were also under way.	QCIC pursues quality control implications of alleged audit failures irrespective of ongoing litigation.	AICPA Board of Directors (1993)	Accounting profession

(continued)

Issue: Audit Quality			
Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
189. It is urgent that the SEC take the lead in helping the profession reduce exposure to unwarranted litigation. There are dangers, not just to the profession but to the investing public, if the current liability situation continues to drift without SEC leadership.	The SEC expressed qualified support for the Private Securities Litigation Reform Act of 1995.	Kirk Panel (1994)	SEC

Table II.3: Setting Accounting Standards

Issue: Setting Accounting Standards			
Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
1. A new foundation, to be called the Financial Accounting Foundation, should be established, separate from all existing professional bodies. It would be governed by a board of trustees composed of nine members, whose principal duty would be to appoint the members of a financial accounting standards board and to raise the funds for its operations.	FAF was created in 1972. The 16-member Board of Trustees is responsible for (a) selecting and evaluating the members of FASB and GASB, (b) seeing that the necessary funds are provided, and (c) overseeing the standard-setting process for fairness, neutrality, and openness.	Wheat Committee (1972)	Accounting profession
2. A financial accounting standards board should be established with seven (full-time, fully remunerated) members. The board's function would be to establish standards of financial accounting and reporting. The board of trustees would appoint members of the standards board and designate one of them as chairman. Members of the standards board would have no other affiliations. Four of them would be CPAs drawn from public practice. The other three would not need a CPA certificate but should possess extensive experience in the financial reporting field.	FASB was established in 1973. The members of FASB serve full-time and are fully remunerated. They are required to serve all ties with the institutions they served previously. Three members of the present board come from public accounting, two from financial management, one from the investment community, and one from academia. All possess extensive experience in the financial reporting field. The original recommendation that four members be drawn from public practice was intended to address an early AICPA concern and, over time, that concern faded.	Wheat Committee (1972)	Accounting profession
3. When a standard is adopted by the requisite majority, it should be published without dissents.	Dissents by members to the FASB statements are published. However, because AICPA members are required by Rule 203 of the Code of Professional Conduct to comply with the FASB statements and because the SEC requires compliance with those statements, the AICPA does not believe publishing dissents weakens the FASB statements.	Wheat Committee (1972)	Accounting profession

(continued)

Issue: Setting Accounting Standards

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
4. The standards board should, to the fullest extent possible, carry out its functions in public.	Since the late 1970s, all FASB meetings attended by three or more board members are open to the public. See also "The 'Process' in Due Process: A Behind-The-Scenes Look at Standards Setting," by. A. Clarence Sampson, the FASB Status Report 224, October 14, 1991, for an informative discussion of how FASB obtains public input and at the same time undertakes to educate the public concerning matters on its agenda.	Wheat Committee (1972)	Accounting profession
5. Interpretations, when necessary, should be issued with the full authority of the standards board.	Interpretations are issued by FASB, and FASB interpretations have the same authority as the FASB statements under SAS 69.	Wheat Committee (1972)	Accounting profession
6. The board of trustees should establish a financial accounting standards advisory council (about 20 members) to work with the standards board as advisors. Members would be appointed by the trustees for 1-year terms which could be renewed indefinitely. They would be entitled to reimbursement of expenses, but no remuneration, and would be drawn from a variety of occupations, but not more than one-fourth of the members should be drawn from any single sphere of activity. The chairman of the board would also be, ex officio, chairman of the advisory council.	FASAC was established and has evolved over the years. It presently consists of over 30 members, with its own chairman and executive director. Forty-three percent of the members either are involved in financial management or are the CEOs of their respective entities. CPA firms, the securities industry and other users of financial statements, and academics are also represented on FASAC.	Wheat Committee (1972)	Accounting profession
7. The functions of the advisory council would include providing advice to the standards board as to its priorities, helping it to set up task forces, reacting to proposed standards, and otherwise assisting the standards board when called upon to do so.	See FAF's 1994 Annual Report for details. Among other things, that report points out that FASAC conducts a formal annual survey of its members' views about FASB projects and priorities, considers how FASB is allocating its resources, and discusses not only active FASB technical projects but other issues currently facing the accounting profession.	Wheat Committee (1972)	Accounting profession
8. In the transition from the APB to the standards board, opinions that have reached the exposure draft stage should be carried through to completion by the APB. Other matters on the APB's agenda should be transferred to the standards board.	The last APB Opinion, no. 31, was issued in June 1973.	Wheat Committee (1972)	Accounting profession

(continued)

Issue: Setting Accounting Standards

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
9. Financial accounting research projects should be rigorously controlled by the standards board and by its research director to ensure that they are directly germane to the board's needs and are carried out expeditiously.	FASB has been very selective in its sponsored research reports in recent years and has restricted this activity to areas directly relevant to current and potential projects. FASB takes advantage whenever possible of the extensive academic research being done without FASB sponsorship, and has been successful in encouraging academic researchers to conduct research relevant to its projects.	Wheat Committee (1972)	FASB
10. Financial accounting research projects should be carefully defined to assure that what needs to be researched is researched.	See action taken for recommendation 9.	Wheat Committee (1972)	FASB
11. In financial accounting research projects, full use should be made of task forces established with the cooperation of the advisory council.	Project task forces have generally taken an advisory role in FASB-commissioned projects.	Wheat Committee (1972)	FASB
12. Authors of financial accounting research studies should be fully consulted in drafting proposed standards and their related history.	Authors are consulted as necessary and appropriate.	Wheat Committee (1972)	FASB
13. The basic objective of financial statements should be to provide information useful for making economic decisions.	The Trueblood report led FASB to embark on its conceptual framework project, a similar basic objective of financial reporting in CON 1 para. 34. The FASB concepts statements deal with the objectives of financial reporting, the qualitative characteristics of accounting information, and the elements of financial reporting. These statements deal with matters that are the subject of this recommendation.	Trueblood Committee (1973)	FASB
14. An objective of financial statements should be to serve primarily those users who have limited authority, ability, or resources to obtain information and who rely on financial statements as their principal source of information about an enterprise's economic activities.	The objectives of financial statements are set forth in CON 1 para. 28 and 30. CON 1 para. 24-27 discusses the users of financial statements.	Trueblood Committee (1973)	FASB
15. An objective of financial statements should be to provide information useful to investors and creditors for predicting, comparing, and evaluating potential cash flows to them in terms of amount, timing, and related uncertainty.	See CON 1 para. 37-39.	Trueblood Committee (1973)	FASB

(continued)

Issue: Setting Accounting Standards

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
16. An objective of financial statements should be to provide users with information for predicting, comparing, and evaluating enterprise earning power.	See CON 1 para. 42-48.	Trueblood Committee (1973)	FASB
17. An objective of financial statements should be to supply information useful in judging management's ability to utilize enterprise resources effectively in achieving the primary enterprise goal.	See CON 1 para. 50-53.	Trueblood Committee (1973)	FASB
18. An objective of financial statements should be to provide factual and interpretative information about transactions and other events that is useful for predicting, comparing, and evaluating enterprise earning power. Basic underlying assumptions with respect to matters subject to interpretation, evaluation, prediction, or estimation should be disclosed.	See CON 1 para. 54.	Trueblood Committee (1973)	FASB
19. An objective should be to provide a statement of financial position useful for predicting, comparing, and evaluating enterprise earning power. This statement should provide information concerning enterprise transactions and other events that are part of incomplete earnings cycles. Current values should also be reported when they differ significantly from historical cost. Assets and liabilities should be grouped or segregated by the relative uncertainty of the amount and timing of prospective realization or liquidation.	See CON 1 para. 41 and CON 5 para. 26-29 for concepts concerning the statement of financial position. See CON 5 para. 36-37 for concepts concerning incomplete cycles. See CON 5 para. 88-90 for discussion of recognition of current values. Controversy continues among users as well as preparers and auditors concerning adoption of a fair value accounting model, but disclosure of some kinds of current value data has been accepted. FASB has required disclosure of the current value of financial instruments (SFAS 107) and has required that certain debt and equity securities be reported at fair value (SFAS 115). SFAS 33, issued in 1979, required disclosure of supplementary information about the effects of inflation and changes in specific prices, but that requirement was changed to encouragement by SFAS 89.	Trueblood Committee (1973)	FASB

(continued)

Issue: Setting Accounting Standards

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
20. An objective should be to provide a statement of periodic earnings useful for predicting, comparing, and evaluating enterprise earning power. The net result of completed earnings cycles and enterprise activities resulting in recognizable progress toward completion of incomplete cycles should be reported. Changes in the values reflected in successive statements of financial position should also be reported, but separately, since they differ in terms of their certainty of realization.	See CON 5, para. 30-57 and para. 83-87 for a discussion of concepts of earnings and comprehensive income. This issue remains controversial. In June 1996, FASB issued an exposure draft, Reporting Comprehensive Income, of a proposed standard that would require explicit reporting of comprehensive income as well as net income. Comments on this exposure draft are due in October 1996. The Jenkins Committee has learned that users want information about the portion of a company's reported earnings that is stable or recurring and that provides a basis for estimating sustainable earnings.	Trueblood Committee (1973)	FASB
21. An objective should be to provide a statement of financial activities useful for predicting, comparing, and evaluating enterprise earning power. This statement should report mainly on factual aspects of enterprise transactions having or expected to have significant cash consequences. This statement should report data that require minimal judgment and interpretation by the preparer.	SFAS 95 regarding the statement of cash flows, issued November 1987, established standards for cash flow reporting. It superseded APB Opinion No. 19 and required a statement of cash flows as part of a full set of financial statements for all business enterprises in place of a statement of changes in financial position.	Trueblood Committee (1973)	FASB
22. An objective of financial statements should be to provide information useful for the predictive process. Financial forecasts should be provided when they will enhance the reliability of users' predictions.	Financial forecasts have not been required by FASB or others. The Jenkins Committee has learned that investors and creditors need forward-looking information on which to base their own projections, but they do not expect management to provide projections or forecasts. Users also want more information about operating opportunities and risks that are relatively near-term and relatively certain and quantifiable.	Trueblood Committee (1973)	FASB
23. An objective of financial statements should be to report on those activities of the enterprise affecting society that can be determined and described or measured and that are important to the role of the enterprise in its social environment.	Measuring and reporting on social interactions in financial statements is in its infancy. Some applications of existing GAAP deal with enterprise issues affecting society.	Trueblood Committee (1973)	FASB

(continued)

Issue: Setting Accounting Standards

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
24. The SEC should prescribe by rule a framework of uniform accounting principles.	The SEC continues to look to FASB to set accounting standards and exercises oversight over the process, as explained in its various annual reports to the Congress. The FASB concepts statements, statements of financial accounting standards, interpretations, and other guidance provide the framework contemplated in this recommendation. The SEC issues accounting guidance in the form of rules or interpretations when it thinks it necessary or appropriate.	Moss Subcommittee (1976)	SEC
25. The Congress should exercise stronger oversight of accounting practices promulgated or approved by the federal government and more leadership in establishing goals and policies.	Congressional committees exercise oversight of the SEC, other regulatory bodies, and the accounting profession. FASB representatives have appeared before various congressional committees.	Metcalf Subcommittee Staff Study (1977)	Congress
26. The federal government should directly establish financial accounting standards for publicly owned corporations. An alternative could be to use a board similar to the Cost Accounting Standard Board or to establish standards by GAO.	The Congress has not acted on this recommendation, relying on oversight by the SEC of standards set in the private sector by FASB. The SEC's annual reports to the Congress cover its oversight of the accounting standards-setting process.	Metcalf Subcommittee Staff Study (1977)	Federal government
27. The federal government should establish financial accounting standards, cost accounting standards, auditing standards, and other accounting practices in meetings open to the public.	See action taken for recommendation 26.	Metcalf Subcommittee Staff Study (1977)	Federal government
28. The nature of the standard-setting process requires the involvement of all those who might be affected. Therefore, FASB should lead its constituency and be prepared to follow when a constituent can demonstrate a better way for the constituency overall.	FASB involves its constituencies in all aspects of the standards-setting process, including the selection of its projects, the preparation of discussion memorandums and exposure drafts, and the conduct of field tests. FASB also has made a significant effort to communicate developments to its constituencies, including liaisons with interested professional and business groups. FASB's decisions are made in meetings open to the public and are widely reported. FASB frequently revises its proposals when constituents point out ways to achieve better standards.	FAF (1977)	FASB

(continued)

Issue: Setting Accounting Standards

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
29. The makeup of FASAC should be carefully reviewed to make sure that it includes a representative cross section of FASB's constituencies, including preparers, attestors, educators, analysts and advisors, creditors and investors, government, and the public. Further, the membership must be carefully reviewed to make sure that all are working members who will take the time and give the effort to consider FASB's technical concerns. FASAC should be headed by its own part-time chairman, a preeminent individual. The chairman would be responsible to see that FASAC acted as a "window to the world" in communicating the thoughts and progress of FASB to the constituency and feeding back ideas for improvement.	FAF appointed an independent chair to FASAC. As of May 1996, there were 33 FASAC members of whom 43 percent represented preparers, 27 percent represented auditors, 12 percent represented users, and 18 percent represented educators and others.	FAF (1977)	FASAC
30. FAF should be reconstituted to include as its "members" one representative of each of the six sponsoring organizations.	FAF replaced the AICPA as the sole elector of FAF trustees with a panel comprised of one representative from each of FAF's six sponsoring organizations. As of July 1996, the head of each sponsoring organization is an elector of FAF trustees.	FAF (1977)	FASB/FAF
31-33. The responsibilities of the four primary accounting standard-setting bodies would be		FAF (1977)	
31. ...FAF and the FAF Board of Trustees. (a) The members of FAF would no longer be the Board of Directors of the AICPA, but would be composed of individuals representing each of the sponsoring organizations. Their responsibility would be to elect the FAF Board of Trustees. (b) The FAF Board of Trustees would select their Chairman and establish their committees to recommend FASB members, fund FASB's activities, and perform the oversight role. The FAF Board of Trustees would elect FASB members. (c) The FAF Board of Trustees would meet with FASB at least quarterly to review performance against plan and discuss operating matters with FASB.	Recommendations were generally adopted and are reflected in current operating procedures.		FAF

(continued)

Issue: Setting Accounting Standards

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
32. ...the Advisory Council. (a) The Advisory Council members would be appointed by the Trustees, the same as at the present. However, the FASAC Chairman would be paid by and report to FAF. (b) FASAC would facilitate the work of FASB by suggesting from its membership participants to serve on task forces. Also, it would assist in obtaining staff and research help for FASB from among the constituency. (c) FASAC, either in whole or through committees, would become knowledgeable on the major issues under consideration by FASB. It would discuss those issues with its constituent groups and ultimately with FASB. The Chairman would see that those views were crystallized for FASB's consideration.	Recommendations were generally adopted and are reflected in current operating procedures.		FASAC

(continued)

Issue: Setting Accounting Standards

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
33. ...FASB. (a) FASB members would be appointed by the Trustees, based on their knowledge of accounting, finance, and business, and their concern for the public interest. The prior affiliation of a potential FASB member would be considered only to the extent of obtaining the proper mix of talent. (b) FASB would continue to have sole responsibility for the development and promulgation of standards, and would be responsible for selecting and managing the members of its organization required to do this work. To the extent the internal organization lacks the personnel resources to accomplish its work adequately and on time, FASB would be expected to delegate staff and research work outside the organization, retaining its decision-making authority over all that work. FASB would continue to pursue every opportunity to involve their constituents in the standard-setting process, soliciting their input, asking for their reactions, and looking for new ideas. FASB will carefully guard its independence but it will see its constituents as participants in the process. (c) FASB would maintain continuous communication with FASAC, as necessary to report FASB's views and progress and to gather FASAC's views and suggestions. FASB would not be bound by the views of FASAC, but would be expected to listen carefully. (d) FASB would meet at least quarterly with the FAF Board of Trustees to review operating results.	Recommendations were generally adopted and are reflected in current operating procedures.		FASB
34. FASB should improve its staff relationship. FASB should delegate as much work as possible to the staff, and it should remain in the decision-making mode. But FASB must have additional qualified staff so that the system can work, and then it must be careful to let the staff exercise the responsibility it has given them. FASB must work with the managers, helping them keep their projects moving, and helping the staff grow.	The resources were provided to strengthen the FASB staff, accelerate its work pace, and improve the effectiveness of FASB's operations. Since 1977, staff work for FASB, not individual members. Also in 1977, FASB began a recruiting program designed to double the size of the Research and Technical Activities Division staff. Also, efforts were under way to increase experience levels and abilities of the staff.	FAF (1977)	FASB

(continued)

Issue: Setting Accounting Standards

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
35. The role of FASB's Research Director should be more broadly defined, and his responsibilities should be put on a level at or almost equal to that of the FASB members. The entire research staff should be consolidated under the Research Director.	This recommendation was adopted in full by FASB in 1977. The Director of the Research and Technical Activities Division continues to perform that role.	FAF (1977)	FASB
36. An appropriately high authority within the FASB structure (probably the Research Director but perhaps his associate) should be specifically charged with the responsibility to develop the research staff.	The research and technical staff of FASB was substantially increased in size and was upgraded in terms of experience and knowledge through selective recruitment policies, including an increase in the number of FASB Fellowships, and an in-house professional development program.	FAF (1977)	FASB
37. FASB should be encouraging its staff people to accept speaking engagements and writing opportunities because those outside involvements have a number of benefits.	FASB continues to actively seek out speaking engagements and opportunities to issue publications.	FAF (1977)	FASB
38. FASB should continue its program of exploiting the resources available in the task forces. Specifically, the task forces should be asked to review and comment on all of the FASB issuances related to their projects, beginning with the discussion memo but also including the exposure draft and the final statement. The task force members should be enlisted in the campaign to take the pronouncement to the public, encouraging a public discussion of the issues and explaining the decision. Further, FASB should experiment with the task force idea to see if the task forces can be used to leverage FASB.	The other development of subtle but strong significance in 1979 was the broadening of public participation in FASB's research and decision-making processes. Since FASB began operation in 1973, there also has been recurring discussion of possible ways of "leveraging"—of making use of the work of other organizations and the expertise of outside individuals. Activities both before and after issuance of SFAS 33 are illustrative of increased constituent participation. FASB formed task groups in six industries to identify special measurement problems and propose solutions.	FAF (1977)	FASB
39. FASB has a positive responsibility to encourage and promote the broadest possible participation in the due process, and FAF has recommended several modifications in the present procedures to encourage a broader response. FASB should publish an action document, as the basis for the public hearing.	In 1977, FASB began having open meetings. In that year it began publishing a status report titled The Board's Plan for Work on Technical Projects and Other Technical Activities, which was meant to make public meetings more meaningful to FASB's constituency. FASB also began mailing of a Notice of Meetings. The Notice provides dates, times, and a brief summary of agendas. The above documents have evolved into a weekly Action Alert and generally a monthly Status Report that have grown and evolved since the FAF recommendations.	FAF (1977)	FASB

(continued)

Issue: Setting Accounting Standards

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
40. FASB should experiment with several different approaches to the public hearing process: (a) one alternative is that FASB consider sponsoring a public proceeding where proponents of a particular view on an issue could be invited to argue their position, debating it with others who have presented papers advocating an opposite point of view, or (b) FASB might select representative papers submitted to them and ask the preparers of those papers to engage in a public debate with FASB or staff expert on the subject.	FASB does hold public hearings, but the formats have changed over time and do not reflect the recommended format. Debates of the sort described do occur at FASAC and other forums.	FAF (1977)	FASB
41. To help FASB meet its own production plans, it should maintain a more explicit, more effective control system. We strongly recommend that FASB establish a more formal monitoring and follow-up program which will help FASB members follow the progress of projects and take appropriate remedial action when necessary.	This is a continuing effort of FASB and is part of its current strategic plan.	FAF (1977)	FASB
42. FASB should discuss the issues involved in the subjects under deliberation, in public forums and particularly with FASAC.	The most dramatic change in 1977 was emergence of meetings of FASB, FASAC, task forces, the Screening Committee on Emerging Problems, as well as the FAF Board of Trustees, into the “sunshine.”	FAF (1977)	FASB

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Issue: Setting Accounting Standards

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
43. An economic impact analysis should be included in important exposure drafts. Similarly each exposure draft and each final pronouncement should review FASB's tentative conclusions as to the objectives of financial statements and should explain how the proposed pronouncement fits into the overall framework.	In 1977, independent research studies were commissioned on the impact of FASB Statements 5 and 8, and three of those studies were published in 1978. Also, in 1977, a call was issued for independent research papers on the impact of financial accounting standards in general. Papers selected from among the submissions that resulted from that call were presented at a conference on economic consequences sponsored by FASB in 1978. It is anticipated that improvements in research techniques for measuring actual or potential economic impact of financial accounting standards will be a continuing concern of FASB. However, the FASB concepts statements emphasize neutrality in setting accounting standards. FASB does not set standards to achieve particular economic consequences, but wants to be aware of the consequences of its actions. The "Basis for Conclusions" sections of FASB exposure drafts and statements discuss, where appropriate, the concepts underlying those accounting standards.	FAF (1977)	FASB
44. When FASB votes on a pronouncement, a simple majority should suffice.	The voting requirement for adoption of pronouncements by FASB was reduced from five affirmative votes among the seven members to a simple majority. The FAF Board of Trustees subsequently revised the voting procedures to require a super majority effective in 1991 (switched back to five of seven members).	FAF (1977)	FASB
45. FASB should express its tentative views on the major issues instead of publishing a neutral discussion memorandum. FASB should, as a matter of policy, discuss in public the issues it is deliberating.	See action taken for recommendations 39 and 42. Also, FASB has, on occasion, used "Preliminary Views" documents or similar publications to obtain discussion on its initial conclusions.	FAF (1977)	FASB

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Issue: Setting Accounting Standards			
Recommendation	**Action taken**	**Recommendation made by/date**	**Recommendation directed to**
46. FASB must actively search for ways to gather informal but public input from concerned constituents. It has been suggested that FASB arrange for informal meetings on a regular basis in the major metropolitan areas among FASB members, staff, and constituents. It has also been suggested that FASB sponsor seminars dealing with general accounting problems as well as specific issues presently under consideration. Those informal contacts will help FASB members and staff deal more effectively with the issues on their agenda; in addition, they will help bring FASB closer to its constituency.	See action taken for recommendations 39, 42, and 45. Also, FASB frequently meets with groups of constituents.	FAF (1977)	FASB
47. FASB must have a coordinated campaign to convince the public of the validity of its statements once they are adopted.	FASB meets frequently with groups of constituents, but does not have a formal postissuance program to discuss views of constituents.	FAF (1977)	FASB
48. FASB should continue to maintain a close but open working relationship with the SEC, talking about major issues and agenda additions. The FASB staff should also maintain a day-to-day working relationship with the SEC staff, as one approach to the current practice.	As noted in its various reports to the Congress, the SEC and its staff work closely with FASB in an ongoing effort to improve the standard-setting process. The FASB liaison with the SEC includes regular staff communication, quarterly briefings for the Chief Accountant's office staff, and periodic meetings between FASB and SEC Commissioners.	FAF (1977)	FASB
49. FASB should continue to be available to hear appeals of issued pronouncements. FASB should also experiment with a formal postenactment review process. After the financial community has had 1 or 2 years' experience with a FASB pronouncement, FAF suggests that FASB take a retrospective look at the logic in that pronouncement and the implementation problems it may have created.	In 1977, FASB announced its intent to evaluate its statements that had been in effect for at least 2 years. For example, as a result of such evaluations, FASB's controversial SFAS 8 on foreign currency translation was rescinded and replaced by SFAS 52, and SFAS 96 on income taxes was rescinded and replaced by SFAS 109. FASB's operating procedures require all requests for reconsideration be evaluated in an open meeting. The EITF provides a forum for airing and resolving questions about FASB pronouncements.	FAF (1977)	FASB
50. A change in the funding system is important to maintain the credibility of FASB's independence and also to provide a sense of assurance for FASB and the staff.	In 1977, the FAF Board of Trustees adopted a resolution limiting contributions to FAF to $50,000 from any firm in a single year. That change took effect in 1978. In 1977, efforts to broaden the base of support for FAF were successful, especially in the industry sector.	FAF (1977)	FASB

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Issue: Setting Accounting Standards

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
51-58. Recommendations of the FAF Structure Committee (made in 1977) endorsed by the Metcalf Subcommittee		Metcalf Subcommittee (1977)	
51. ...open all aspects of FASB to public view.	All FASB meetings are open to the public. Also, see "The 'Process' in Due Process: A Behind-The-Scenes Look at Standards Setting," by A. Clarence Sampson, the FASB Status Report, 224, October 14, 1991.		FASB
52. ...increase the involvement in FASB from all segments of its broad constituency.	Involvement of all members of FASB's constituency in its work is reflected in the activities of FASAC, the various task forces appointed to assist FASB in the development of standards, the public hearings and comment process, and FASB's EITF. The FASB Status Report is a communications device that seeks, among other things, to encourage involvement by individuals who are not members of those groups.		FASB
53. ...strengthen the organization of FASB.	FASB is effectively organized and fully staffed to carry out its mission.		FASB
54. ...accelerate the FASB work pace.	FASB has issued 125 statements, as well as many interpretations, technical bulletins, and EITF consensuses. Some in the preparer community have complained that FASB is doing too much, too fast, but such complaints are the inevitable result of mandates for change.		FASB
55. ...establish planning goals.	The FASB technical plan is published in its Status Reports.		FASB
56. ...issue documents explaining proposed standards in layman's language before public hearings are held.	The FASB Status Reports and Action Alerts discuss current projects in layman's terms.		FASB
57. ...systematically review existing standards.	All requests to reconsider a standard are discussed by FASB in an open meeting. Also, the EITF addresses emerging issues in open meetings.		FASB
58. ...broaden the base of FASB financial support.	The FAF annual reports discuss the source of contributions.		FASB

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Issue: Setting Accounting Standards			
Recommendation	**Action taken**	**Recommendation made by/date**	**Recommendation directed to**
59. All segments of FASB's broad constituency must be fairly represented at all levels of FASB's operation—from FAF, FASB, and its staff to the advisory councils and task forces. FASB's broad constituency includes the public, the investors and creditors, the analysts, the investment advisers and underwriters, the preparers, the attestors, the educators, and the governments.	See FAF annual reports for the composition of FAF, FASB, and FASAC. Also, see action taken to recommendation 90. FAF believes that all constituencies are adequately represented. Also, efforts to enhance the involvement of preparers and users are ongoing. See, for example, the July 8, 1986, response of FASB Chairman Kirk to the Phase II report of the Special Review Committee of the FAF Board of Trustees.	Metcalf Subcommittee (1977)	FAF
60. FASB should adopt and strictly enforce new rules that will correct the deficiencies in its policies, which are designed to prevent FASB members and senior staff.	FAF has adopted, maintained, and enforced rules to ensure the fact and appearance of independence by FASB members and staff. Note that a July 1985 study conducted by Louis Harris and Associates, Inc., for FAF, consisting of personal interviews with 451 leaders in the financial, investment, and accounting communities, revealed that by an 81 to 15 margin, those leaders believe FASB is objective in its decision-making to ensure the neutrality of information resulting from its standards. According to FASB, most criticisms of FASB are that it is too independent, too conceptual, and too theoretical. FASB is not aware of any instances in which the personal or financial integrity of FASB or its staff has ever been criticized.	Metcalf Subcommittee (1977)	FASB
61. FASB should make a wide public distribution of information reported by individuals under its conflict-of-interest policies through such a medium as its annual report.	This information is reviewed by the FAF Board of Trustees, but is not available for public comment.	Metcalf Subcommittee (1977)	FASB
62. FASB should annually publish a list of the meetings held with various parties and interest groups, along with a synopsis of the topics discussed.	Meetings of FASB are announced in the Action Alert. Private meetings (meetings with staff and with one or two FASB members) are not published. Any meeting with outsiders that involves three or more FASB members is a public meeting.	Metcalf Subcommittee (1977)	FASB

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Issue: Setting Accounting Standards

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
63. Immediate recognition should be given to the financial reporting problems of small businesses and the accounting firms that serve them. Reporting requirements that are necessary for publicly owned corporations may be inappropriate for small businesses.	This is an area that has been frequently reviewed—and still is. FASB and AICPA actions in this area have focused on disclosures and on the use of other bases (tax, cash) of accounting, particularly when financial statements are not audited. In 1995, FASB began a project to evaluate disclosure effectiveness and issued a paper for public comment (FASB is currently considering comments received). FASB members and staff meet regularly with small business groups and hold regular meetings with the users of small business financial statements and with bankers who serve small businesses. FASB representatives have been active participants in the SEC Government Business Forum on Small Business Capital Formation since its founding over 10 years ago.	Metcalf Subcommittee (1977)	FASB
64. Increased representation in standard-setting bodies from small businesses and accounting firms must be achieved. Organization of standard-setting bodies should be improved to focus knowledgeable attention on the problems of small businesses and the accounting firms which serve them.	See action taken for recommendation 52. In particular, FASB members and staff do not represent any particular group. They meet with the PCPS Technical Issues Committee on a regular basis to obtain input about the special needs of private companies and the CPAs who serve them. Industry and small CPA firm representatives are included on AcSEC and on the various AICPA industry committees, and the ASB includes representatives of small CPA firms.	Metcalf Subcommittee (1977)	FASB and accounting profession
65. Uniformity in the development and application of accounting standards must be a major goal of the standard-setting system.	FASB concepts emphasize that similar transactions must be accounted for similarly. FASB statements, interpretations, and technical bulletins; EITF consensuses; and AcSEC statements of position and practice alerts, coupled with the GAAP hierarchy and related requirements established in SAS 69, have significantly narrowed the number of alternatives available to management. Also, AICPA industry audit and accounting guides are being used as a vehicle to achieve more uniform application of accounting principles. For example, the banking guide and the savings institutions guide, which differ in some respects, were combined into one guide (issued in April 1996).	Metcalf Subcommittee (1977)	FASB and accounting profession

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Issue: Setting Accounting Standards			
Recommendation	**Action taken**	**Recommendation made by/date**	**Recommendation directed to**
66. Until uniformity in the development and application of accounting principles is achieved, the public should be informed of the effect on financial statements from using a particular accounting standard to report a transaction, rather than using any of the acceptable alternatives.	See action taken for recommendation 65. Interestingly, users have informed the Jenkins Committee that information about a company that is consistent over time is valued more highly than information that is comparable between two or more companies—they believe differences in accounting principles and methods of application should be permitted as long as there is disclosure.	Metcalf Subcommittee (1977)	FASB and accounting profession
67. The SEC must vigorously oversee the present accounting standard-setting system on behalf of the public. The standards and operation of the system should not be accepted automatically by the SEC, but should be evaluated and questioned to determine if they meet the public policies set forth by the Congress.	See the SEC's annual reports to the Congress for a description of its oversight.	Metcalf Subcommittee (1977)	SEC
68. The SEC's annual report to the Congress on accounting matters should comment on progress made in reaching the public policies established by the Congress.	See the 1978 SEC staff report, The Accounting Profession and the Commission's Oversight Role, various SEC annual reports to the Congress, as well as SEC testimony in various congressional hearings over the years.	Metcalf Subcommittee (1977)	SEC
69. There is continued need for the SEC to exercise vigorously its own rule-making and enforcement activities in order to achieve reforms.	The SEC, through its programs and activities, has continued to oversee and regulate the securities markets and related financial disclosures.	Metcalf Subcommittee (1977)	SEC
70. A separate note, similar to that for accounting policies, should be required for uncertainties.	FASB did not agree that there was a need to amend SFAS 5 for this recommendation. Moreover, SOP 94-6 on disclosure of risks and uncertainties explains that the required disclosures "...are not mutually exclusive. The information required by some may overlap. Accordingly, they may be combined in various ways, grouped together, or placed in diverse parts of the financial statements, or included as part of the disclosures made pursuant to the requirements of other authoritative pronouncements."	Cohen Commission (1978)	Accounting profession
71. FASB should amend APB Opinion 20 to require a standard note to financial statements covering accounting changes (both changes in accounting principles and changes in accounting estimates).	FASB did not formally address this recommendation. Note, however, the present requirement imposed by the ASB for an explanatory paragraph in the auditor's report when there has been a material change.	Cohen Commission (1978)	FASB

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Issue: Setting Accounting Standards

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
72. While these efforts of FASB to reach a wider public are significant, more is needed. The FAF Board of Trustees, FASB, and FASAC should consider developing additional programs to increase public awareness of FASB, its current activities, plans, and accomplishments.	In 1981, FASB undertook three new activities to increase public awareness of its activities: (a) produced an audio/visual presentation stressing the openness and responsiveness of the FASB procedures, (b) distributed a book titled Understanding Inflation Accounting, and (c) started a new publication titled Highlights of Financial Reporting Issues, designed to help constituents who are not technically oriented understand the implications of major FASB projects. FASB has continued to do these kinds of public awareness steps and many more. Examples include FASB's recent series of special reports, scores of articles in magazines, an informational video, and a worldwide web site.	FAF (1979)	FAF, FASB, and FASAC
73. FASB should experiment more with hearings in other parts of the country. FASB might consider not having full attendance at all FASB hearings.	One development in 1979 was the broadening of public participation in FASB's research and decision-making processes. Activities both before and after issuance of SFAS 33 are illustrative of increased constituent participation. Following the issuance of a discussion memorandum in July 1979, arrangements were made with three societies of financial analysts and three chapters of Robert Morris Associates for them to sponsor seminars based on the discussion memorandum. FASB members and staff participated in each of the sessions. FASB has continued its efforts. A more recent example was in 1993 when FASB held a hearing in Silicon Valley, California on stock compensation.	FAF (1979)	FASB
74. It may be necessary for FASB to publicize further the availability of nontechnical summaries, such as discussion memorandums and exposure drafts. Additionally, FASB should continue its efforts to improve the format and style of its pronouncements.	Today, most FASB documents include an executive summary that is designed to communicate key provisions in everyday language. FASB is constantly striving to make its documents more accessible.	FAF (1979)	FASB
75. Communication of FASB members' leanings as early as possible is desirable by whatever vehicle is most appropriate at the time.	FASB members express their views in a variety of forums. However, it is important to recognize that FASB members strive to keep an open mind to opposing views throughout FASB's due process.	FAF (1979)	FASB

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Issue: Setting Accounting Standards			
Recommendation	**Action taken**	**Recommendation made by/date**	**Recommendation directed to**
76. FASAC should consider ways to improve its input to FASB on major technical matters. This is probably best accomplished through the use of committees.	FASAC has, from time to time, formed committees to assist FASB in its efforts.	FAF (1979)	FASAC
77. FASB has increased its use of task forces. FASB should continue the practice of meeting with members of task forces after the public hearings. FASB can continue to improve its use of task forces in all phases of a project, particularly during FASB's deliberative proceedings, although care should be taken to avoid slowing down decision-making processes.	Task force activity varies through the life of a technical project, and the best time to involve a task force varies from one project to the next.	FAF (1979)	FASB
78. FASB should consider the potential economic consequences in its standard-setting process, but in doing so it should recognize that one cannot set accounting standards based on an amalgam of opinions as to impact of a standard on individual entities. As in other areas of its work, FASB needs to search for additional ways to show the extent to which it considers economic consequences in making its pronouncements.	See action taken for recommendation 95.	FAF (1979)	FASB
79. The FAF Board of Trustees might be expanded by still another at-large trustee to increase constituency participation at the Trustee level.	See action taken for recommendation 90.	FAF (1979)	FAF
80. Where there appears to be continuing deep concern, FASB should advise its constituents that it is ready to consider requests to interpret or amend any pronouncement without waiting for formal periodic review.	This has been FASB's practice for several years. All requests for interpretation or amendment are considered in public FASB meetings.	FAF (1979)	FASB

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Issue: Setting Accounting Standards

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
81. FASB should give high priority to improving relations with its constituencies. This would include upgrading all support services that involve direct contact with members of FASB's constituencies, developing a long-range plan to educate the public, and providing the necessary staff and budget. The objective would be to fulfill FASB's educational mission, to broaden the public understanding of FASB's work and achievements, and to enhance the goodwill of FASB's constituents.	A statement of FASB's mission was developed and published in a new edition of Facts About FASB along with information about the standard-setting structure, how decisions are made to place items on FASB's agenda, and the due process required by the Rules of Procedure. More than 85,000 copies were distributed. Speeches delivered by FASB members exceeded 200. The newsletter Status Report was redesigned to incorporate viewpoints and highlights eliminating confusion. Efforts were made to identify special groups having an interest in particular technical projects and to establish two-way communication with them. FASB's current strategic plan includes an objective to build a broader acceptance for the FASB process among constituents.	FAF (1982)	
82. FASB should continue to follow its present due process procedures. Refinements of those procedures that should be considered are (a) increasing the use of task forces to work with staff in preparing recommendations for FASB consideration in connection with selected implementation and practice problem projects, (b) assisting respondents in preparing comments on a Discussion Memorandum or Invitation to Comment, and (c) identifying in exposure drafts key changes to present accounting practice that are expected to result, industries most likely to be impacted, and issues of particular sensitivity on which FASB is seeking comments.	(a) FASB's EITF provides input on implementation and practice problems. The work of other task forces is limited to specific projects. (b) FASB members and staff often meet with constituent groups during the comment period. Those meetings are designed to answer questions and explain documents. (c) Exposure Drafts now include a "Notice to Recipients" that identifies key issues. Many constituents use the series of questions raised in the Notice to structure their comment letters.	FAF (1982)	FASB
83. FASB should take steps to try to increase the number of responses to Discussion Memorandums, Invitations to Comment, and Exposure Drafts from small businesses, security analysts, investment advisors, bank credit officers, and nonfinancial executives.	FASB actively solicits comments from those groups and has made a number of attempts to encourage their participation. However, comment letters from those groups continue to represent a small fraction of the total comments received.	FAF (1982)	FASB

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Issue: Setting Accounting Standards

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
84. FASB should develop a plan, for consideration by the FAF Board of Trustees, to provide timely guidance for implementation questions and emerging issues.	In response to the recommendations of an earlier task force on timely financial reporting guidance, FASB formed the EITF, whose members are drawn primarily from public accounting firms but also include representatives of large companies and major associations of preparers and CPAs who serve small businesses. The chief accountant of the SEC attends regularly as an observer with the privilege of the floor. A FASB committee to review the EITF concluded in its 1995 report that the EITF serves a valuable function and satisfies many needs of a variety of constituents.	FAF (1982)	FASB
85. The process by which a subject is considered for addition to the FASB agenda should be better communicated to FASB's constituencies.	The process continues to evolve and frequently involves a wide cross section of FASB's constituencies.	FAF (1982)	FASB
86. Accelerate progress on the accounting recognition and the income, cash flows, and financial position projects. The concepts statements that are the objectives of these projects are important and should be published as quickly as is feasible.	CON 5, concerning the recognition and measurement in financial statements of business enterprises, was issued in 1984. It did not resolve all the issues, and work on these concepts continues at the standards level. SFAS 95, concerning the statement of cash flows, was issued in 1987.	FAF (1982)	FASB
87. Although the organizational structure of FASB and staff works well with the principal incumbents, FASB should review its internal organizational structure to ascertain whether it will continue to meet the long-term needs of FASB as incumbents are replaced.	FASB is constantly fine tuning its organization. The basic structure of FASB and staff remains similar to the structure that existed in 1982, although the number of activities has expanded considerably. For example, FASB's EITF was formed in 1984, and, since 1990, FASB has devoted much more effort to international issues.	FAF (1982)	FASB
88. (a) FASB and its staff should be asked to assess in the first half of 1986 the feasibility and desirability of shortening the due process and of modifying the "sunshine" rule within the original spirit of that rule, (b) a special committee of the FAF Board of Trustees should be appointed to consider these matters, (c) FASB should submit a report to the special committee by mid-1986, setting forth possible courses of action and pros and cons for each of them, and (d) the special committee should submit recommendations to the FAF Board of Trustees by year-end 1986.	FASB submitted a report to the Special Review Committee in July 1986. A Special Review Committee of the FAF Board of Trustees reviewed this report and issued a report in December 1986. In the report, the Special Review Committee concluded the following: "The Committee recommends that the FAF Board of Trustees accept and approve the responses received and recorded herein, and further recommends that the FAF Board of Trustees encourage and support the FASB staff in the follow-up commitments included in the responses."	FAF (1985)	FAF and FASB

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Issue: Setting Accounting Standards

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
89. FASB and its staff should be asked to consider in the first half of 1986 ways of broadening participation by and communication with corporate CEOs and users of financial information. FASB should report on its progress to the FAF Board of Trustees in the second half of 1986, specifying its recommendations for encouraging constituent involvement.	Actions taken to improve participation have included efforts to gain participation of users and CEOs on task forces, FASAC, and the FAF Board of Trustees; speeches to user groups; meetings of FASB members or staff with user groups; special mailings; telephone contacts with constituent groups; and informal meetings. Further plans for broadening user participation include: (a) expanding the number of speeches given to user groups, (b) considering modifying expense reimbursement policy so that contact may be made with user groups unwilling to pay expenses; and (c) expanding the number of general liaison meetings with user groups. Further plans for broadening CEO participation include: (a) expanding lists of CEOs and audit committees receiving copies of Status Report, (b) expanding use of personalized letters from FASB to CEOs, (c) formalizing and expanding use of regional and industry CEO groups; and (d) encouraging the FAF Board of Trustees to elect CEOs to the FAF Board of Trustees and FASAC. FASB's current strategic plan includes an objective to build a broader acceptance for the FASB process among constituents.	FAF (1985)	FASB
90. The FEI, NAA, and BRT have recommended greater representation on the FAF Board of Trustees from business and industry. The Special Review Committee recommends that the FAF Board of Trustees take the following steps: (a) accept the AICPA's offer to relinquish the ex officio seat on the FAF Board of Trustees heretofore held by the Institute's chief officer, (b) amend the FAF bylaws to increase the number of at-large trustees from two to three, and (c) elect to the unfilled at-large seats on the FAF Board of Trustees individuals with business, professional, government, or other experience who, in the judgment of the FAF Board of Trustees, can contribute to advancing the purpose of FAF. The Special Review Committee believes that a chief executive officer from business or industry would make a worthwhile contribution.	The FAF Board of Trustees accepted the AICPA's offer to relinquish the ex officio seat on the FAF Board of Trustees and amended FAF's bylaws to increase the number of at-large trustees from two to three. One of the two at-large seats has been filled by the election of a retired partner of a regional public accounting firm. The other was filled by election of a high-level corporate executive. Since then, in July 1996, FAF agreed to amend its bylaws to add two new at-large trustees, replacing a trustee position held by the accounting profession and a position held by FEI. In addition, FAF is in the process of filling two existing at-large vacancies with public representatives.	FAF (1985)	FAF

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Issue: Setting Accounting Standards

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
91. The Special Review Committee recommends that steps be taken to increase the FAF Board of Trustees' knowledge of FASB and GASB activities. The Special Review Committee recommends that (a) the FAF Board of Trustees should recognize that the chairs of FASB and GASB and their respective Advisory Councils have an educational role vis-a-vis the FAF Board of Trustees, (b) the FAF Board of Trustees should formalize what has been an informal program of trustee observation of meetings of the two standard-setting Boards, Advisory Councils, and FASB's EITF, and (c) in keeping themselves informed about the progress of specific technical projects undertaken by the two Boards, the FAF Board of Trustees should focus on the nature of controversies that may arise concerning those projects.	The Chairmen of FASB and GASB and the Advisory Councils, as a part of their educational role vis-a-vis the FAF Board of Trustees, are encouraged to bring to the FAF Board of Trustees candid assessments of nontechnical problems, both present and potential, on which the FAF Board of Trustees may be able to assist. The FAF Board of Trustees formalized a program of regular trustee observation of meetings of the two standard-setting Boards, their Advisory Councils, and FASB's EITF. (In the past, such observation has occurred only on an occasional basis.)	FAF (1985)	FAF, FASB, and GASB
92. The Special Review Committee recommends that the FAF Board of Trustees defer consideration of FASAC matters until the Special Review Committee on the Future Role of FASAC completes its work and submits it to FASAC in the first half of 1986. The FASAC chair then would be asked to submit recommendations for consideration by the FAF Board of Trustees at their meeting in July 1986.	The FAF Board of Trustees accepted recommendations at their July 1986 meeting, except for the recommendation to eliminate permanent FASAC seats of four sponsoring organizations.	FAF (1985)	FAF and FASB

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Issue: Setting Accounting Standards

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
93. The Special Review Committee recommends that FASB and its staff pay particular attention to the small business area in 1986 and urges FASB to meet with interested groups and then determine what reasonably can and what cannot be done to alleviate the problems of small businesses and small public accounting practitioners regarding GAAP, and finally to publish those conclusions and the reasons for them.	FASB and staff has responded with a special issue titled FASB Analyzes Small Business Concerns About Accounting Standards. The issue summarizes FASB's beliefs concerning alternatives to GAAP, simplification of standards, and differential measurement. FASB considers small business issues on every project, and seeks advice on such matters from organizations concerned with these issues. On all projects, FASB will seek answers to the following with regard to whether small businesses should be treated differently than corporations: (a) whether the different treatment would alleviate "standards overload," (b) whether a proposed solution would enhance or diminish the credibility of financial reporting, (c) whether there is persuasive evidence that user needs are different for different entities or that costs outweigh the benefits, and (d) whether there is a difference in the economic basis of a transaction for different entities.	FAF (1985)	FASB
94. While the EITF received general approval in both the Harris survey and the Special Review Committee's interviews, some constituents are concerned as to whether the Task Force is, in effect, establishing standards. Some also believe that there is insufficient representation in the membership of the Task Force by persons other than practicing CPAs. The Special Review Committee believes these matters should be the subject of a report by the Task Force chair to the FAF Board of Trustees in 1986.	At the July 1986 meeting of the FAF Board of Trustees, James J. Leisenring, as director of FASB research and technical activities and as EITF chair, reviewed for the FAF Board of Trustees a full report on EITF, dated June 27, 1986, developing the reasons the Task Force was established, the broad-range composition of membership, the purpose of EITF in assisting FASB in identifying financial reporting problems as they emerge, the accomplishments of EITF in suggesting solutions to problems, and the potential for solving problems through discussion and formation of consensus on appropriate accounting. It was the recommendation of the FAF Board of Trustees that the full report on EITF be made available to interested constituents. A FASB committee conducted a 10-year review of the EITF and concluded in its 1995 report that the EITF was serving a valuable function.	FAF (1985)	FASB

(continued)

Issue: Setting Accounting Standards

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
95. In its consideration of the costs/benefits of specific standards and proposed standards, FASB should be encouraged to find ways to articulate its positions to a greater degree and make them more visible to the constituency.	CON 2 para. 143 concluded that the following two actions should be taken: (a) before a decision is made to develop a standard, FASB needs to satisfy itself that the matter to be ruled on represents a significant problem and that a standard that is promulgated will not impose costs on the many for the benefit of a few and (b) FASB should explain the benefits of the resulting financial reporting, for example, if a standard is less costly and only slightly less effective. FASB attempts to do that in the basis for conclusions for each of its standards and will continue to do so.	FAF (1985)	FASB
96. FASB should discuss with appropriate constituents ways of making employment on the FASB technical staff more attractive to persons with professional or business careers. Among the ideas that might be explored are short-term assignments for persons at or near retirement and on leave or loan from their firms for specific assignments. The president of NAA has offered to form a coordinating committee for this purpose.	The FASB staff is complemented by Fellows, consultants, and task force members. To encourage participation in the Industry Fellow Program, FASB undertook an active campaign in 1984 and 1985. Current Industry Fellows were made available for speeches, the program was publicized in accounting periodicals, Industry Fellowship meetings were sponsored by accounting organizations, and FASB has encouraged one-on-one meetings with companies interested in the program. When appropriate, FASB has utilized executives upon retirement from industry or on loan from their companies.	FAF (1985)	FASB
97. Enhance the relevance of financial statements through improved disclosures of risks and uncertainties.	AcSEC issued SOP 94-6 in December 1994. It calls for increased disclosures of risks and uncertainties.	Big 7 (1986)	Accounting profession
98-101. A business enterprise should make disclosures beyond those now generally made in financial reports about the risks and uncertainties facing it as of the date of the financial reports. The disclosures should include		AICPA Task Force on Risks and Uncertainties (1987)	
98. ...a description of the kinds of products or services the enterprise sells, its principal markets, and the locations of those markets.	SOP 94-6 requires disclosure of these matters.		FASB
99. ...an explanation that the preparation of historical financial information requires the use of management's estimates.	See action taken for recommendation 98.		FASB

(continued)

Issue: Setting Accounting Standards			
Recommendation	**Action taken**	**Recommendation made by/date**	**Recommendation directed to**
100. ...a discussion of significant, change-sensitive estimates used by management to measure assets and liabilities at the reporting date. Disclosure would be required for any significant estimate used in the determination of the carrying amount of an asset or a liability at the current reporting date that based on facts and circumstances existing at that date, is particularly susceptible to changes that could result in material effects on near-term results of operations.	See action taken for recommendation 98.		FASB
101. ...information about current vulnerability to risk due to concentrations (for example, in the enterprise's assets, customers, or suppliers) other than those generally known to be associated with the industry or trade in which the entity operates would be required in the following circumstances: (a) concentrations existing at the report date make the enterprise vulnerable to the risk of severe impact on near-term cash flows or results of operations and (b) it is at least reasonably possible that the events that could cause the severe impact will occur.	See action taken for recommendation 98.		FASB
102. FASB should use a computerized log to record technical inquiries.	Adopted, after development in 1995.	FAF (1989)	FASB
103. The FAF Board of Trustees should review the standard-setting apparatus at some time within the next 5 years in order to determine whether actions taken as a consequence of this review have been effective and what other improvements should be made.	A standing oversight committee of trustees has been formed to evaluate on an ongoing basis whether FASB's standard-setting activities are consistent with the FASB mission statement.	FAF (1989)	FAF and FASB
104. The FAF Board of Trustees should consider changing the name of FAF to something like the "National Accounting Standards Foundation" to avoid having a name so similar to that of FASB.	Not under consideration.	FAF (1989)	FAF and FASB
105. FAF should hold confidential consultations with each member periodically during his or her term to discuss the member's performance.	Current practice through the FAF Selection Committee.	FAF (1989)	FAF and FASB
106. FAF should consider changing the end of FASB members' terms to June 30.	All terms now end on June 30.	FAF (1989)	FAF and FASB

(continued)

Issue: Setting Accounting Standards

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
107. FAF should be explicitly obligated to conduct a performance evaluation prior to the completion of a FASB member's initial term in order to determine the appropriateness of the member as a candidate for reappointment.	Current practice through the FAF Selection Committee.	FAF (1989)	FAF and FASB
108. Losses for problem loans should be taken if more likely than not, rather than probable. A problem loan should be accounted for as an in-substance foreclosure unless there is clear evidence of the lender's ability to collect the loan based on its contractual terms, as opposed to existing accounting rules that require probable nonpayment and clear evidence that the loan will default.	SFAS 114 para. 10 clarified the threshold for impairment. FASB and AcSEC support the "probable" threshold.	GAO (1991)	Accounting profession and FASB
109. The definition and determination of fair market value should be changed. The value of in-substance foreclosed loans and other real estate owned should be determined based on existing market conditions unless there is clear evidence to support projections of improved financial and economic conditions—for example, signed leases from responsible tenants. The carrying value for other real estate owned should be reduced by estimated carrying costs, including a cost of capital, to the expected date of sale.	Recently issued accounting standards, such as SFAS 121, 122, 123, and 124, define "fair value." Also, SOP 92-3 requires that foreclosed assets be reported (at foreclosure) at the lower of their (a) cost or (b) fair value less estimated costs to sell.	GAO (1991)	Accounting profession and FASB
110. The accounting rules and audit procedures for related- party transactions should be enhanced to clarify that related-party transactions are required to be accounted for and reported based on their economic substance. Also, guidance should be provided on how to determine economic substance.	Accounting standards have not been changed. However, SAS 45 states that the independent accountant should be aware that the substance of a particular transaction could be significantly different from its form, and that the financial statements should recognize the substance of particular transactions rather than merely their legal form. SAS 69 states that the auditor should consider whether the substance of transactions or events differs materially from their form.	GAO (1991)	Accounting profession and FASB

(continued)

Issue: Setting Accounting Standards

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
111. FASB should add to its agenda a project to study comprehensively the possibility of requiring the reporting of values and changes in values rather than historical transaction prices, either as a basis to propose changes to financial accounting standards or to explain publicly why such a change in accounting standards is impractical or otherwise inappropriate. In carrying out this effort, FASB should consider the conclusions of the AICPA, the FEI, and the AIMR studies with respect to the future of financial reporting.	FASB does not believe it is appropriate at this time to add this project to its agenda. The Jenkins Committee reported in 1994 that users oppose replacing the current historical cost-based accounting model with a comprehensive fair value accounting model. However, FASB continues to consider value-based reporting for certain kinds of assets and liabilities. FASB's June 1996 exposure draft, Accounting for Derivative and Similar Financial Instruments and for Hedging Activities, would require fair value for all derivatives (comments are due October 1996). Further extension of fair value is under discussion in FASB's financial instruments project and SFAS 107 requires disclosure of fair values for all financial instruments, subject to a practicability exception.	POB (1993)	FASB
112. Accounting firms should take special care to ensure that their participation in the standard-setting process is characterized by objectivity and professionalism. Standard setters and leaders of the profession should discuss and address the issues related to client advocacy in the standard-setting process and establish ways of identifying and correcting aberrant behavior when it occurs.	Representatives of the SECPS of the AICPA Division for CPA firms and the POB have met with the chairmen of FASB, the ASB, and AcSEC to discuss this subject. The chairs of the ASB and AcSEC have reminded their members of the need to ensure that objectivity is maintained in the standard-setting process. In August 1995, the Professional Ethics Division issued Interpretation 102-6 that addresses these recommendations to the satisfaction of the POB.	POB (1993)	Accounting profession
113. Strive for globally acceptable accounting principles, including disclosure standards.	In February 1996, FASB issued an Invitation to Comment on the recommendations of AIMR. Comments were due to FASB by July 31, 1996.	AIMR (1993)	FASB
114. Consider cost/benefit analysis from a user viewpoint (i.e., the shareholders and their financial advisors should best be able to advise standard-setting and regulating bodies as to the proper balance of costs and benefits associated with accounting and disclosure standards).	In February 1996, FASB issued an Invitation to Comment on the recommendations of AIMR. Comments were due to FASB by July 31, 1996.	AIMR (1993)	FASB
115. Appoint more representatives from the community of financial statement users in determining the form and content of financial statements.	In February 1996, FASB issued an Invitation to Comment on the recommendations of AIMR. Comments were due to FASB by July 31, 1996.	AIMR (1993)	FASB

(continued)

Issue: Setting Accounting Standards

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
116. FASB should proceed expeditiously to issue its existing exposure draft on disclosures of derivatives and fair value of financial instruments.	SFAS 119 concerning disclosure of derivatives and fair value of financial instruments was issued in October 1994.	GAO (1994)	FASB
117. FASB should proceed expeditiously to develop and issue an exposure draft that provides comprehensive, consistent accounting rules for derivatives products, including expanding disclosure requirements that provide additional needed information about derivatives activities.	FASB issued its exposure draft, Accounting for Derivative and Similar Financial Instruments and for Hedging Activities, in June 1996. Comments are due in October 1996.	GAO (1994)	FASB
118. FASB should consider adopting a market value accounting model for all financial instruments, including derivatives products.	This matter is under consideration as part of the Board's financial instruments project. The exposure draft issued in June 1996 (see action taken for recommendation 117) proposes to require that all derivatives be accounted for at fair value.	GAO (1994)	FASB
119. The SEC should ensure that FASB proceeds expeditiously to develop and adopt comprehensive, consistent accounting rules and disclosure requirements for derivative products.	The SEC is working closely with FASB on this issue. On December 28, 1995, the SEC proposed rules to require additional disclosures about registrants' accounting policies for derivatives products and risks inherent in these instruments. The comment period expires May 7, 1996. FASB's June 1996 exposure draft (see action taken for recommendation 117) proposes comprehensive accounting standards for derivatives and revised disclosures in line with this proposed accounting.	GAO (1994)	SEC
120. Because they share the objective of providing the public with relevant and reliable financial information, the public accounting profession and the SEC must have more cooperative, less adversarial relationships. CPA firms should be careful in how they communicate their views to FASB, the SEC, their clients, and the public at large. The SEC should help identify accounting practice problems and look to the private sector standard setters to solve them—only being a standard setter of "last resort" and only after appropriate due process.	The AICPA and FASB are committed to working in a cooperative way with the SEC. Although from time to time relationships have been strained, the process of resolving conflict is a positive one. In that connection, the POB's Kirk Panel report itself is a response to criticisms voiced by the former chief accountant of the SEC. Also, the new AICPA Financial Reporting Coordinating Committee, formed to follow up on the recommendations of the Jenkins Committee, has already met with the SEC to exchange ideas and views on key issues.	Kirk Panel (1994)	Accounting profession and SEC

(continued)

Issue: Setting Accounting Standards

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
121. Improve the disclosure of business segment information.	FASB has issued an Invitation to Comment addressing the Jenkins Committee recommendations (comments were due in July 1996). In January 1996, FASB issued an exposure draft of a proposed standard that would revise the requirements under which public entities report disaggregated information. The SEC will hold a symposium on these recommendations during 1996. Also, the Jenkins Committee found that users believe that current disaggregated disclosures do not provide adequate information to help them predict an entity's future earnings and cash flows. In January 1996, FASB issued an exposure draft of a proposed standard that would revise the requirements under which public entities report disaggregated information.	Jenkins Committee (1994)	FASB and SEC
122. Address the disclosures and accounting for innovative financial instruments.	See action taken for recommendation 121. As noted in the action taken for recommendation 119, the SEC has issued a rule proposal to require disclosures about derivative products.	Jenkins Committee (1994)	FASB and SEC
123. Improve the disclosures about the identity, opportunities, and risks of off-balance-sheet financing arrangements and reconsider the accounting for those arrangements.	See action taken for recommendation 122. Many off-balance-sheet financing arrangements are dealt with in FASB statement 125 issued in June 1996.	Jenkins Committee (1994)	FASB and SEC
124. Report separately the effects of core and noncore activities and events, and measure at fair value noncore assets and liabilities.	See action taken for recommendation 121.	Jenkins Committee (1994)	FASB, SEC, or public companies
125. Improve the disclosures about the uncertainty of measurements of certain assets and liabilities.	See action taken for recommendation 121. SOP 94-6 requires explanation that preparation of historical financial statements include use of estimates.	Jenkins Committee (1994)	FASB, SEC, or public companies
126. Defer attention to issues that have low priority according to current evidence of users' needs.	See action taken for recommendation 121.	Jenkins Committee (1994)	FASB and AICPA

(continued)

Issue: Setting Accounting Standards

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
127. Standard setters should search for and eliminate less relevant disclosures.	An SEC Task Force on Rule Simplification issued a proposed rule to simplify and reduce certain disclosures. The SEC is currently reviewing comments received on this proposed rule. In 1995, FASB issued an invitation to comment on disclosure effectiveness and is currently considering comments received. Recommendations of the Jenkins Committee were included in a FASB Invitation to Comment issued in February 1996 (comments were due by July 1996).	Jenkins Committee (1994)	FASB, AICPA, and SEC
128. National and international standard setters and regulators should increase their focus on the information needs of users, and users should be encouraged to work with standard setters to increase the level of their involvement in the standard-setting process.	The new AICPA Financial Reporting Coordinating Committee will follow up on this recommendation. FASB's current strategic plan includes an objective to develop and enhance the reporting model as a tool for decision-making in a rapidly changing economic and technological environment. Another one of the plan's objectives is to build a broader acceptance for the FASB process among constituents.	Jenkins Committee (1994)	FASB, AICPA, SEC, and international standard setters and regulators
129. U.S. standard setters and regulators should continue to work with their non-U.S. counterparts and international standard setters to develop international accounting standards, provided the resulting standards meet users' needs for information.	FASB, the SEC, and the AICPA are all actively involved in efforts to achieve international accounting standards that meet users' needs for information. For example, FASB meets regularly with standards setters from the United Kingdom, Australia, Canada, and the International Accounting Standards Committee and has jointly published studies with them about future events, hedge accounting, leases, and loss provisions. The International Accounting Standards Committee has set a goal of producing, by 1998, accounting standards sufficient in quality to be adopted by the International Organization of Securities Commissions, of which the SEC is a member, as suitable for financial statements supporting securities issuance in any country.	Jenkins Committee (1994)	FASB, AICPA, and SEC
130. U.S. standard setters should adopt a longer-term focus by developing a vision of the future business environment and users' needs for information in that environment. Standards should be consistent directionally with that long-term vision.	See action taken for recommendation 121.	Jenkins Committee (1994)	FASB and AICPA

Table II.4: Setting Auditing Standards

Issue: Setting Auditing Standards			
Recommendation	**Action taken**	**Recommendation made by/date**	**Recommendation directed to**
1. The SEC should prescribe by rule auditing standards to be followed by independent accountants who certify financial reports filed with the SEC.	The SEC continues to look to the ASB to set auditing standards and exercises oversight over the process, as explained in its various annual reports to the Congress.	Moss Subcommittee (1976)	SEC
2. The federal government should establish auditing standards used by independent auditors to certify the accuracy of corporate financial statements and supporting records. The standards could be established by the SEC, GAO, or by federal statute.	See action taken for recommendation 1.	Metcalf Subcommittee Staff Study (1977)	Federal government
3. The federal government should define the responsibilities of independent auditors so that they clearly meet the expectations of the Congress, the public, and courts of law.	See action taken for recommendation 1.	Metcalf Subcommittee Staff Study (1977)	Federal government
4. The federal government should establish financial accounting standards, cost accounting standards, auditing standards, and other accounting practices in meetings open to the public.	The SEC continues to look to private sector standard-setting bodies to set such standards and practices and exercises oversight over those bodies (which hold meetings open to the public) as explained in its various annual reports to the Congress.	Metcalf Subcommittee Staff Study (1977)	Federal government
5. The auditing and behavior standards of the organization of accounting firms (see recommendation 20, "Audit Quality" section) should be established in open meetings with broad representation of interests.	All AICPA senior technical committees adhere to open meeting policies. Meetings of the SECPS Executive Committee may be attended by representatives of member firms and all meetings are attended by members and staff of the POB.	Metcalf Subcommittee (1977)	Accounting profession
6. The organization of accounting firms (see recommendation 20, "Audit Quality" section) should have sufficient staff to assure that standards are well researched and can be handled on a timely basis.	The AICPA's vision of a more responsive organizational structure that will enable the AICPA to better achieve its objectives and fulfill its mission is encompassed in the AICPA's strategic planning process. For example, in 1995, the AICPA reorganized to better focus and utilize its resources to serve the needs of its members, including accounting firms; members in industry, government, and education; the state CPA Organizations; newly licensed CPAs; recruits; and retired members.	Metcalf Subcommittee (1977)	Accounting profession

(continued)

Issue: Setting Auditing Standards

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
7. The organization of accounting firms (see recommendation 20, "Audit Quality" section) should develop rules of procedure for standard setting that emphasize basic due process and periodic review of established standards.	All enforceable AICPA technical and ethical pronouncements are widely exposed for comment and are discussed in open meetings of the relevant board or committee, pursuant to operating policies approved by the Board of Directors.	Metcalf Subcommittee (1977)	Accounting profession
8. Standards developed by the organization of accounting firms (see recommendation 20, "Audit Quality" section) should not act to prevent new entry into the field of auditing publicly owned corporations or be overly burdensome on accounting firms with only a few publicly owned clients.	The AICPA believes that none of its technical or ethical pronouncements and none of the SECPS membership requirements prevent or make burdensome entry into the field of auditing public companies.	Metcalf Subcommittee (1977)	Accounting profession
9. The organization of accounting firms envisioned by the subcommittee (see recommendation 20, "Audit Quality" section) and the SEC should focus attention on both domestic and international operations of independent auditors when formulating appropriate standards and a responsive quality review program.	SECPS peer review standards (SECPS Reference Manual §2000.137) state that "(t)he review should be concerned with the accounting and auditing engagements performed by the U.S. offices of the reviewed firm selected for review and with the supervision and control, in accordance with U.S. professional standards, on work of segments of such engagements performed by foreign offices...." The SECPS made significant efforts to obtain agreement by other countries to an extension of peer review to the work performed in those countries, but was unable to overcome the legal and other barriers to access by a U.S. organization to the foreign accountant's confidential work product.	Metcalf Subcommittee (1977)	Accounting profession and SEC

(continued)

Issue: Setting Auditing Standards

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
10. There should be no differences in the standards that apply to the performance of audits, whether the audits are of public or private entities. However, present guidance on the application of auditing standards to audits of different size entities is inadequate. Both users and clients would be better served by more guidance on accounting and related services and on the application of auditing standards to audits of smaller entities.	In response to this recommendation, the AICPA mounted a research effort that resulted in the publication of an audit research monograph. This was followed by a major task force effort that resulted in SAS amendments and interpretations as well as an audit procedures study on audits of small businesses. Also, SAS 61 is applicable only to SEC clients and clients that have audit committees, and other standards, such as those on the internal control structure and audit sampling, implicitly or explicitly recognize that the procedures followed to comply with GAAS may differ depending on the size and related characteristics of an entity. In addition, the AICPA has issued a series of Statements on Standards for Accounting and Review Services that address the special needs of private companies for nonaudit financial statement services.	Cohen Commission (1978)	Accounting profession
11. Many auditing pronouncements could usefully provide more specific guidance.	After substantial study, no action was taken with respect to the recommendation. However, SAS 65 provides more detailed guidance on using the work of an internal auditor. Also, many recent auditing standards go into significant detail in explaining their applications.	Cohen Commission (1978)	Accounting profession
12. The present AudSEC should be replaced by a smaller, full-time group compensated only by the AICPA.	The 21-member AudSEC was reconstituted as the ASB. It consists of 15 AICPA members who are expected to devote 600-800 hours to ASB activities each year. ASB members who request compensation receive it, up to an annual maximum of $40,000. The ASB has issued more than 55 SASs since the Cohen Commission issued its report, or an average of three per year, and many interpretations. The AICPA believes the present ASB structure is working well.	Cohen Commission (1978)	Accounting profession
13. A full-time auditing standard-setting body will require a larger, highly qualified staff. Other possibilities should be considered, such as a fellowship program.	As a result of actions taken in response to this recommendation, the ASB staff is led by a highly qualified AICPA vice president, and the staff usually includes a professional fellow.	Cohen Commission (1978)	Accounting profession

(continued)

Issue: Setting Auditing Standards

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
14. The standards for the audit function should have broader scope than the present standards. They should be applicable whenever a CPA undertakes an audit engagement. The restructuring should include a statement of the independent auditor's role.	Rule 201 of the Code of Professional Conduct establishes general standards of professional competence, due professional care, planning and supervision, and sufficient relevant data that are applicable to all services provided by all AICPA members. The ASB initiated a new series of attest standards to govern services that do not involve financial statements. Also, the ASB has dealt with and will continue to deal with matters that go beyond the boundaries of the financial statements, such as compliance auditing and special reports.	Cohen Commission (1978)	Accounting profession
15. Other groups who have a strong interest in auditing standards should be encouraged to become more involved in the standards-setting process. Industry audit guides appear to constitute a special case in which particular attention should be paid to obtaining the participation by management in the affected industry. While the Cohen Commission has concluded that there is a need for formal outside participation in the process of setting auditing standards, it has no specific recommendation on the form this participation should take. An advisory committee or direct participation by a few knowledgeable individuals on the board or its subcommittees are two distinct possibilities.	The AICPA established an Auditing Standards Advisory Committee and some years later disbanded it at the committee's own request. Afterwards, the ASB placed public members on its planning committee but subsequently concluded that insufficient benefits accrued from their participation. Now, the ASB relies on frequent and extensive communication with outside groups, such as the FEI, SEC, American Bar Associations, etc., and on its extensive due process procedures to obtain input from preparers and users. In addition, committees dealing with specific industries include significant representation of members working in those industries; see the handbook titled AICPA Committees for data on the composition of AICPA boards and committees.	Cohen Commission (1978)	Accounting profession
16. The standards-setting body should increase communication about its work within the profession.	The CPA Letter announces all ASB pronouncements, and the ASB frequently publishes notices or alerts on practice matters. See, for example, "The Auditor's Responsibility to Detect Fraud" in the January 1994 CPA Letter. Also, a new information newsletter, In Our Opinion, was inaugurated and is distributed to a number of interested groups and individuals.	Cohen Commission (1978)	Accounting profession
17. The ASB should have a periodic review of its operations to identify needed changes and improvements.	A formal, periodic review procedure has not been established. However, the Treadway Commission reviewed the structure and functions of the ASB as part of its work.	Cohen Commission (1978)	Accounting profession

(continued)

Issue: Setting Auditing Standards

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
18. AudSEC should be reconstituted within the AICPA as the AICPA ASB, responsible for the promulgation of auditing standards and procedures that define the nature and extent of the auditor's responsibility; provide guidance to the auditor in carrying out his duties; make special provisions, where appropriate, to meet the needs of small enterprises; and consider costs and benefits.	See action taken for recommendation 12.	Oliphant Committee (May 1978)	Accounting profession
19. The new auditing standards board shall provide auditors with all possible guidance in the implementation of its pronouncements.	The AICPA plans to issue supplemental guidance, such as Technical Practice Aids and educational materials, to aid auditors in implementing new auditing standards. In response to a suggestion by the SEC's Chief Accountant, the ASB in 1989 inaugurated a procedure for issuing audit risk alerts annually to provide additions with an overview of current economic, professional, and regulatory developments that may affect audits they perform.	Oliphant Committee (May 1978)	Accounting profession
20. The new auditing standards board should have 15 members, to be appointed for renewable 1-year terms, by the chairman of the AICPA with the consent of the AICPA Board of Directors. The chairman's and member's terms should not exceed 6 years.	See action taken for recommendation 12.	Oliphant Committee (May 1978)	Accounting profession
21. Any person who has had extensive experience in auditing, whether a member of the AICPA or not, should be eligible to serve on the new auditing standards board.	No action was taken with respect to this recommendation. All ASB members are members of the AICPA.	Oliphant Committee (May 1978)	Accounting profession
22. Nine affirmative votes (out of a board of 15 members) should be required to approve an auditing standard.	No action was taken with respect to this recommendation. Ten affirmative votes (out of a board of 15 members) are required to approve an auditing standard.	Oliphant Committee (May 1978)	Accounting profession
23. Meetings of the new auditing standards board relating to the establishment of standards through statements on auditing standards, and other auditing and reporting matters directly affecting the public interest, will be open to the public.	Meetings of the ASB are open to the public.	Oliphant Committee (May 1978)	Accounting profession

(continued)

Issue: Setting Auditing Standards

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
24. The board chairman or a board member (of the new auditing standards board) may request compensation, in return for a commitment of at least 50 percent of his time to the work of the board, and should routinely be reimbursed for expenses.	See action taken for recommendation 12.	Oliphant Committee (May 1978)	Accounting profession
25. The new auditing standards board staff should be considerably expanded and strengthened to enable it to undertake more research, to provide more support for the task forces, and to take over more of the drafting.	See action taken for recommendation 13.	Oliphant Committee (May 1978)	Accounting profession
26. The new auditing standards board should have a highly qualified, well-paid executive director, who will report to and work closely with the chairman and members of the new auditing standards board.	See action taken for recommendation 13.	Oliphant Committee (May 1978)	Accounting profession
27. The new auditing standards board should have a research director to direct its research activities.	In response to this recommendation, the AICPA created a research director position. However, this position was recently vacated.	Oliphant Committee (May 1978)	Accounting profession
28. The new auditing standards board should have an advisory council composed of between 12 and 18 members to be appointed by the chairman of the AICPA for a 1-year term that is renewable up to 3 years. No member of the council shall be a member of the auditing standards board. Members of the council will not be compensated. The council should meet at least once a quarter, in public.	See action taken for recommendation 15.	Oliphant Committee (May 1978)	Accounting profession
29. Enhance the ASB's capacity to develop auditing standards.	Changes in ASB composition and operations have been made as necessary, as evidenced by the issuance of 23 SASs between 1987 and July 1995, including the nine "expectation gap" SASs. However, a full-time chairman and board was not deemed necessary.	Big 7 (1986)	Accounting profession
30. The AICPA should reorganize the ASB to afford a full participatory role in the standard-setting process to knowledgeable persons who are affected by and interested in auditing standards but who either are not CPAs or are CPAs no longer in public practice.	See action taken for recommendation 15.	Treadway Commission (1987)	Accounting profession

Table II.5: Expanded Reporting and Auditor Services

Issue: Expanded Reporting and Auditor Services			
Recommendation	**Action taken**	**Recommendation made by/date**	**Recommendation directed to**
1. A basic objective of financial statements should be to provide information useful for making economic decisions.	See CON 1 para. 34. The requirements for information included in financial statements are continually being improved.	Trueblood Committee (1973)	FASB
2. An objective of financial statements should be to serve primarily those users who have limited authority, ability, or resources to obtain information and who rely on financial statements as their principal source of information about an enterprise's economic activities.	See CON 1 para. 28 and 30.	Trueblood Committee (1973)	FASB
3. An objective of financial statements should be to provide information useful to investors and creditors for predicting, comparing, and evaluating potential cash flows to them in terms of amount, timing, and related uncertainty.	See CON 1 para. 37.	Trueblood Committee (1973)	FASB
4. An objective of financial statements should be to provide users with information for predicting, comparing, and evaluating enterprise earning power.	See CON 1 para. 42-48.	Trueblood Committee (1973)	FASB
5. An objective of financial statements should be to supply information useful in judging management's ability to utilize enterprise resources effectively in achieving the primary enterprise goal.	See CON 1 para. 50-53.	Trueblood Committee (1973)	FASB
6. An objective of financial statements should be to provide factual and interpretative information about transactions and other events that is useful for predicting, comparing, and evaluating enterprise earning power. Basic underlying assumptions with respect to matters subject to interpretation, evaluation, prediction, or estimation should be disclosed.	See CON 1 para. 54.	Trueblood Committee (1973)	FASB

(continued)

Issue: Expanded Reporting and Auditor Services			
Recommendation	**Action taken**	**Recommendation made by/date**	**Recommendation directed to**
7. An objective should be to provide a statement of financial position useful for predicting, comparing, and evaluating enterprise earning power. This statement should provide information concerning enterprise transactions and other events that are part of incomplete earnings cycles. Current values should also be reported when they differ significantly from historical cost. Assets and liabilities should be grouped or segregated by the relative uncertainty of the amount and timing of prospective realization or liquidation.	The FASB concepts statements deal with the objectives of financial reporting, the qualitative characteristics of accounting information, and the elements of financial reporting. These statements deal with matters that are the subject of this recommendation. However, financial reporting is evolving and the Jenkins Committee has made recommendations on the nature and extent of information that should be made available to others by management. The committee has learned that users oppose replacing the current historical cost-based accounting model with a fair value accounting model. However, they view fair value information as useful for particular types of assets and liabilities and in certain types of industries. In that connection, FASB has required disclosure of the current value of financial instruments (SFAS 107) and has required that certain debt equity securities be reported at fair value (SFAS 115). SFAS 33, issued in 1979, required disclosure of supplementary information about the effects of inflation and changes in specific prices, but that requirement was changed to encouragement by SFAS 89.	Trueblood Committee (1973) and	FASB
8. An objective should be to provide a statement of periodic earnings useful for predicting, comparing, and evaluating enterprise earning power. The net result of completed earnings cycles and enterprise activities resulting in recognizable progress toward completion of incomplete cycles should be reported. Changes in the values reflected in successive statements of financial position should also be reported, but separately, since they differ in terms of their certainty of realization.	See action taken for recommendation 7. The Jenkins Committee has learned that users want information about the portion of a company's reported earnings that is stable or recurring and that provides a basis for estimating sustainable earnings. Also, users believe that current disaggregated disclosures do not provide adequate information to help them predict an entity's future earnings and cash flows.	Trueblood Committee (1973)	FASB
9. An objective should be to provide a statement of financial activities useful for predicting, comparing, and evaluating enterprise earning power. This statement should report mainly on factual aspects of enterprise transactions having or expected to have significant cash consequences. This statement should report data that require minimal judgment and interpretation by the preparer.	See action taken for recommendation 7. The Jenkins Committee has learned that users want information about the portion of a company's reported earnings that is stable or recurring and that provides a basis for estimating sustainable earnings.	Trueblood Committee (1973)	FASB

(continued)

Issue: Expanded Reporting and Auditor Services

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
10. An objective of financial statements should be to provide information useful for the predictive process. Financial forecasts should be provided when they will enhance the reliability of users' predictions.	The Jenkins Committee has learned that investors and creditors need forward-looking information on which to base their own projections, but they do not expect management to provide projections or forecasts. Users also want more information about operating opportunities and risks that are relatively near-term and relatively certain and quantifiable.	Trueblood Committee (1973)	FASB
11. An objective of financial statements should be to report on those activities of the enterprise affecting society that can be determined and described or measured and that are important to the role of the enterprise in its social environment.	Measuring and reporting on social interactions in financial statements is in its infancy. The present focus is on efforts to deal with environmental costs. AcSEC issued in 1995 an exposure draft of a proposed SOP on environmental remediation liabilities.	Trueblood Committee (1973)	FASB
12-16. The SEC should act promptly to promulgate rules necessary to assure that		Moss Subcommittee (1976)	
12. ... publicly owned corporations adopt and enforce codes of business conduct that conform to the laws of all countries in which a corporation operates and that are disclosed publicly to shareholders through filings with the SEC.	COSO received 1,014 responses to a 1988 survey of over 8,500 public companies that indicated that a significant number of companies have written codes of conduct: — 87 percent of companies with over 10,000 employees, — 60 percent with 1,000 to 10,000 employees, — 32 percent with 100 to 1,000 employees, and — 15 percent with under 100 employees.		SEC
13. ...procedures which allow corporations to develop off-the-book accounts are eliminated.	The SEC encouraged adoption of the Foreign Corrupt Practices Act of 1977 and adopted rules under those laws to address this concern. The SEC further stated that public companies "should review their accounting procedures, systems of internal accounting controls and business practices" in order to take any actions necessary to comply with this act.		SEC
14. ...uniform financial controls are applied throughout every department and operating division of the consolidated corporation and complementary accounts among subsidiaries and between subsidiaries and the parents are reconciled regularly.	See action taken for recommendation 13.		SEC

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Issue: Expanded Reporting and Auditor Services			
Recommendation	**Action taken**	**Recommendation made by/date**	**Recommendation directed to**
15. ...communication is strengthened among in-house accountants and auditors and the appropriate levels of management.	See action taken for recommendation 13. Also see discussions of communications requirements in SAS 53, on errors and irregularities; SAS 54, on illegal acts by clients; and SAS 61, on communication with audit committees. Note that "Information and Communication" is one of the five components of internal control under the COSO report. The Private Securities Litigation Reform Act of 1995 (§301) requires certain communications from the auditor to the company's management and board of directors, and, under certain circumstances, to the SEC.		SEC
16. ...independent auditors attest to the quality of internal controls and the quality of enforcement of those controls in the annual report.	On two separate occasions (1979 and 1988) the SEC proposed for public comment management and/or auditor reports on the adequacy of registrants' internal controls. Comments on these proposals suggested that the costs of such reports may exceed any benefit to investors and noted other concerns. The proposals were not adopted.		SEC
17. In instances where uniformity in accounting principles is not practicable, the SEC should require the independent auditor to attest that the accounting principles selected by management represent financial data most fairly. The SEC should also prescribe supplemental data to permit a translation from one set of assumptions to another, thereby permitting comparability among companies in a particular industry.	In the absence of an authoritative pronouncement, there is no basis for determining which principle or method produces the "most fair" result. In any event, FASB statements, interpretations, and technical bulletins; EITF consensuses; and AcSEC statements of position and practice alerts have significantly narrowed the number of alternatives available to management. The SEC requires that auditors of companies making a discretionary change in accounting file a letter indicating that such change is to a preferable method of accounting. Moreover, users have informed the Jenkins Committee that information about a company that is consistent over time is valued more highly than information that is comparable between two or more companies—they believe differences in accounting principles and methods of application should be permitted as long as there is disclosure.	Moss Subcommittee (1976)	SEC

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Issue: Expanded Reporting and Auditor Services			
Recommendation	**Action taken**	**Recommendation made by/date**	**Recommendation directed to**
18. Corporate accountability should be improved through strengthening internal controls and enhancing the professionalism of management's accountants and internal auditors employed by corporate managements.	The September 1992 COSO report, Internal Control—Integrated Framework, and the publicity and educational efforts that accompanied its issuance have drawn the attention of corporate management and boards of directors, once again, to the significance of this recommendation. Other initiatives include the establishment of a Management Accounting Committee and a Members in Industry Committee by the AICPA, the extension of the entire AICPA Code of Professional Conduct to members not in public practice, and the establishment by the Institute of Management Accountants of the certified management accountant program.	Metcalf Subcommittee (1977)	Accounting profession
19. Until uniformity in the development and application of accounting principles is achieved, the public should be informed of the effect on financial statements from using a particular accounting standard to report a transaction, rather than using any of the acceptable alternatives.	FASB statements, interpretations, and technical bulletins; EITF consensuses; and AcSEC statements of position and practice alerts, along with the GAAP hierarchy and related requirements established in SAS 69, have significantly narrowed the number of alternatives available to management. AICPA industry audit and accounting guides are being used as a vehicle to achieve more uniform application of accounting principles. For example, the banking and the savings institutions guides, which differ in some respects, are being combined into one guide. Interestingly, users have informed the Jenkins Committee that information about a company that is consistent over time is valued more highly than information that is comparable between two or more companies—they believe differences in accounting principles and methods of application should be permitted as long as there is disclosure.	Metcalf Subcommittee (1977)	FASB

(continued)

Issue: Expanded Reporting and Auditor Services			
Recommendation	**Action taken**	**Recommendation made by/date**	**Recommendation directed to**
20. An independent auditor should give an opinion that the standards used are the most appropriate under the circumstances.	In the absence of an authoritative pronouncement, there is no basis for determining which principle or method produces the “most appropriate” result. The SEC requirement for a preferability letter is described under recommendation 17. However, the revised auditor’s standard report does indicate that the auditor assessed the accounting principles used by management (AU §508.08). See also action taken for recommendation 19.	Metcalf Subcommittee (1977)	Accounting profession
21. The independent auditor’s report to the public should comment on the adequacy of internal auditing controls and employee conduct standards, as well as compliance with them.	The AICPA Board of Directors and the POB in their June 1993 and March 1993 reports, respectively, continue to endorse mandatory reports by managements of public companies and by their auditors on the system of internal control for financial reporting.	Metcalf Subcommittee (1977)	Accounting profession
22. Independent audits should be continual throughout the year.	From a practical point of view, most audits are conducted over a period of time. Also, SAS 71 provides performance standards and reporting guidance on interim financial information.	Metcalf Subcommittee (1977)	Accounting profession
23. A standard of skill and care is needed to call upon the auditor to extend the study and evaluation of internal controls to all controls that have a significant bearing on the prevention and detection of fraud.	The objectives of this recommendation have been achieved to a large degree by the clear statement of the auditor’s responsibility in SAS 53, which also discusses (para. 11-12) internal control problems in the context of the assessment of audit risk. In addition, SAS 78 (which supersedes SAS 55) requires that the auditor obtain an understanding of the internal control structure, including the accounting system and control procedures, and para. 11 specifically identifies certain types of procedures designed to prevent fraud. Finally, implementation of the recommendation in the June 1993 policy statement of the AICPA Board of Directors for management and auditor reports on the system of internal control would result in full implementation of this recommendation.	Cohen Commission (1978)	Accounting profession

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Issue: Expanded Reporting and Auditor Services

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
24. Corporations should be required to adopt codes of conduct indicating in detail conduct that will not be tolerated. The code should be made readily available to shareholders and others. Corporations must also adopt policies and procedures to provide for effective monitoring of compliance and should distribute the code to employees at the appropriate levels.	COSO received 1,014 responses to a 1988 survey of over 8,500 public companies that indicated that a significant number of companies have written codes of conduct: — 87 percent of companies with over 10,000 employees, — 60 percent with 1,000 to 10,000 employees, — 32 percent with 100 to 1,000 employees, and — 15 percent with under 100 employees.	Cohen Commission (1978)	SEC and public companies
25. The standards for the audit function should have broader scope than the present standards. They should be applicable whenever a CPA undertakes an audit engagement. The restructuring should include a statement of the independent auditor's role.	Rule 201 of the Code of Professional Conduct establishes general standards of professional competence, due professional care, planning and supervision, and sufficient relevant data that are applicable to all services provided by all AICPA members. The ASB initiated a new series of attest standards to govern services that do not involve financial statements. Also, the ASB has dealt with and will continue to deal with matters that go beyond the boundaries of the financial statements, such as compliance auditing and special reports.	Cohen Commission (1978)	Accounting profession

(continued)

Issue: Expanded Reporting and Auditor Services			
Recommendation	**Action taken**	**Recommendation made by/date**	**Recommendation directed to**
26. The auditor should review the corporation's code of conduct and the procedures adopted to monitor compliance with it. The auditor should determine whether there are material weaknesses in the monitoring procedures, and indicate his conclusions on these matters in his report.	SAS 78, which revised SAS 55 to conform to the COSO report, Internal Control—Integrated Framework, requires the auditor to obtain an understanding of all of the elements of the internal control structure. The COSO report, issued in 1992 and amended in 1994, has drawn the attention of preparers, auditors, and regulators to the significance of internal controls. COSO points out that codes of conduct are widely used and may be part of the control environment, but properly warns that "existence of a written code of conduct, and even documentation that employees received and understand it, does not ensure that it has been followed. Compliance with ethical standards...is best ensured by top management's actions and examples...." Full implementation of this recommendation is therefore contingent on a requirement for written codes of conduct, which, for that reason, may not be necessary for all companies, and on implementation of the recommendations in the June 1993 policy statement of the AICPA Board of Directors for management and auditor reports on the system of internal control over financial reporting.	Cohen Commission (1978)	Accounting profession
27. If there is a corporate code of conduct, the report by management in the annual report should include a statement that such a code exists and that procedures have been implemented to monitor compliance. The auditor's report should state that he has reviewed the code of conduct. It should also describe his review of the company's monitoring procedures and his conclusions on those aspects that can be audited. It should disclose any violation of the code found during the course of the audit if management and the board of directors failed to make an adequate response when it was brought to their attention.	Although the subject of two separate SEC rule proposals, there is no present requirement for a report by management or for an auditor's report thereon. See action taken for recommendation 26 for additional commentary.	Cohen Commission (1978)	SEC and accounting profession

(continued)

Issue: Expanded Reporting and Auditor Services			
Recommendation	**Action taken**	**Recommendation made by/date**	**Recommendation directed to**
28. The audit function should expand to include information of an accounting and financial nature that management has a responsibility to report if the auditor's competence is relevant to verifying the information and that information is produced by the accounting system.	This is an ongoing activity of the ASB. Over the years, guidance has been provided on matters such as interim information, segment information, forecasts, internal control, "special reports," compliance with laws and regulations, and attest services in general. Guidance will continue to be provided as necessary. Also, the Elliott Committee is to consider the scope and evolution of the assurance function over the foreseeable future.	Cohen Commission (1978)	Accounting profession
29. The audit should be considered a "function" to be performed during a period of time, rather than an audit of a particular set of financial statements. The annual financial statements should be only one, although the most important, of the elements audited. Eventually, the audit function should expand to include all important elements of the financial reporting process.	From a practical point of view, most audits are conducted over a period of time. Also, SAS 71 provides guidance on reporting on interim financial information. However, no formal action has been taken to implement this specific recommendation. The work of the Elliott Committee may, however, address this recommendation again.	Cohen Commission (1978)	Accounting profession
30. The auditor should review and test the entire accounting control system. The objective of this study and evaluation would be to enable the auditor to reach a conclusion on whether controls over each significant part of the accounting system provide reasonable, though not absolute, assurance that the system is free of material weaknesses.	SAS 78 (which supersedes SAS 55) requires the auditor to obtain a sufficient understanding of the elements of the entity's control structure to plan the audit by performing procedures to understand the design of the policies and procedures relevant to audit planning and whether they have been placed in operation. The auditor is not required to test the entire system because of a belief that the policies and procedures are not relevant to a financial statement assertion, are unlikely to be effective, or because evaluating their effectiveness would be inefficient. The AICPA believes this is an appropriate position until such time as managements and auditors are required, as the AICPA and the POB recommend, to report on internal control over financial reporting.	Cohen Commission (1978)	Accounting profession

(continued)

Issue: Expanded Reporting and Auditor Services

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
31. The condition of the controls over the accounting system and management's response to the suggestions of the auditor for correction of weaknesses should be disclosed in the report by management. The auditor should report on whether he agrees with management's description of the company's internal controls and should describe material uncorrected weaknesses not disclosed in that report.	SAS 60 requires the auditor to communicate, generally to the audit committee, "reportable conditions" noted in the audit of the financial statements. However, although rules were proposed on two separate occasions, there is no SEC requirement for a public report by management or by the auditor on internal controls and weaknesses therein. (See recommendations 85-90 relating to depository institutions.) Comments received on the proposals contended that the costs associated with such reports might outweigh their benefit to investors and expressed other concerns. The June 1993 policy statement of the AICPA Board of Directors endorses such a requirement.	Cohen Commission (1978)	SEC and accounting profession
32. Information on internal accounting control should be provided whenever audited financial statements are issued for use outside the company.	See action taken for recommendation 31.	Cohen Commission (1978)	Accounting profession
33. The auditor should be required to review and report on the company's interim information on a timely basis.	SAS 71 provides guidance to auditors who are requested to review and report on interim financial information, but the SEC has not made this a requirement.	Cohen Commission (1978)	Accounting profession
34. To provide assurance when interim information is released, the auditor must have an audit base; that is, he should have a continuing relationship with the company. Normally, he should have audited the financial statements of at least the preceding period, and his audit should have included a comprehensive study and evaluation of the accounting system and the controls over it.	SAS 71 para. 10 mandates a "sufficient knowledge of a client's internal control structure," which is normally obtained in prior audits. However, the SAS allows, as it must, for the possibility of a new auditor and requires that auditor to obtain the same level of knowledge through other procedures. (A recent SEC enforcement case—ZZZZ Best—drew attention to the problems that can occur when the auditor does not have an audit base.)	Cohen Commission (1978)	Accounting profession

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Issue: Expanded Reporting and Auditor Services			
Recommendation	**Action taken**	**Recommendation made by/date**	**Recommendation directed to**
35. The auditor should read all of the other information accompanying audited financial statements and compare it to the information in the financial statements and his audit workpapers to assure himself that it is not inconsistent with anything he knows as a result of his audit. His report should include a description of the work performed and his conclusions.	SAS 8 was not modified for this recommendation. The SAS requires the auditor to read the other information and if it is materially inconsistent with the financial statements and not corrected, to include an explanatory paragraph in the audit report, withhold the use of the report, or withdraw from the engagement. The auditor is advised to consult with legal counsel with respect to material misstatements that are not inconsistent with the financial statements. Also, SAS 61 requires the auditor to explain his or her responsibility for the other information to the audit committee.	Cohen Commission (1978)	Accounting profession
36. If the process of preparing forecasts is standardized to the same extent as that for other accounting information, then reviews could be made of the process. The degree of standardization that would be required has so far not been approached.	Attestation standards have been issued for financial forecasts and projections, but no requirement for their inclusion with audited historical financial statements has been adopted. In that connection, the Jenkins Committee has found that users do not expect management to provide forecasts or projections.	Cohen Commission (1978)	Accounting profession
37. To the extent information bearing on the efficiency, economy, or effectiveness of corporate programs, including social programs, is produced by the accounting system and is required to be disclosed in public releases of financial information, the audit function should evolve to include it.	Such information is not required to be reported by public companies.	Cohen Commission (1978)	Accounting profession
38-42. The acceptance and discharge of added responsibilities should be communicated by the auditor to users of his work. The additional messages, for example, should cover		Cohen Commission (1978)	
38. ...other information in documents accompanying the audited financial statements.	See action taken for recommendation 35 for the auditor's responsibilities. The auditor's report was not modified to report on the execution of those responsibilities. To do so in today's environment would unduly expose the auditor to additional liability. However, SAS 61 requires the auditor to explain his or her responsibility for other information accompanying the financial statements to the audit committee.		Accounting profession

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Issue: Expanded Reporting and Auditor Services			
Recommendation	**Action taken**	**Recommendation made by/date**	**Recommendation directed to**
39. ...association with interim information.	Interim information accompanying audited financial statements of public companies is marked as “unaudited” but is required to be reviewed under SAS 71. However, the auditor’s report is not modified unless the information is omitted or the auditor has not made such a review. These requirements are believed to be acceptable to the SEC.		Accounting profession
40. ...internal accounting controls.	Neither management nor the auditor of an entity, with the exception of certain federally insured depository institutions, is required to issue a public report on an entity’s internal controls. (SAS 60 does mandate a report, generally to the audit committee, on “reportable conditions” noted during an audit of financial statements.) The AICPA has recommended that such a requirement be enacted by the SEC.		Accounting profession
41. ...corporate codes of conduct.	There is no requirement for the auditor to review the company’s code of conduct. See action taken for recommendation 26 for additional commentary.		Accounting profession
42. ...meetings with the audit committee.	The auditor is required under SAS 61 to communicate certain matters to the audit committee, but those communications are not mentioned in the auditor’s report.		Accounting profession
43-47. Boards of directors (or official bodies, if necessary) should require the company’s chief financial officer or other representative of management to present a report by management that		Cohen Commission (1978)	
43. ...acknowledges the responsibility of management for the representations in the financial information.	Although many companies voluntarily issue reports by management that address some, if not all, of the items suggested for disclosure, there is no SEC requirement for such a report.		Public companies
44. ...provides managements assurances that the information is presented in conformity with GAAP appropriate in the circumstances and that all material uncertainties have been appropriately accounted for or disclosed.	See action taken for recommendation 43.		Public companies
45. ...indicates that the company’s legal counsel has been consulted regarding the accounting for or disclosure of legal matters and that those matters have been appropriately disclosed.	See action taken for recommendation 43.		Public companies

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Issue: Expanded Reporting and Auditor Services			
Recommendation	**Action taken**	**Recommendation made by/date**	**Recommendation directed to**
46. ...presents management's assessment of the company's accounting system and controls over it.	See action taken for recommendation 43.		Public companies
47. ...describes the work of the company's audit committee and its internal auditors.	See action taken for recommendation 43.		Public companies
48. The auditor should be required by the ASB to report on all unaudited financial information with which he is associated. Users should be informed about the work done and the assurances intended rather than merely about the audit that is not done.	The recognition of compilation and review services in Statements on Standards for Accounting and Review Services addresses this recommendation with respect to private companies. The audited information in financial statements of public companies is typically interim financial information, covered by SAS 71.	Cohen Commission (1978)	Accounting profession
49. Professional standards should require that if information acquired in performing other services indicates a material deficiency in unaudited financial information issued by an audit client, the independent auditor should persuade the client to correct the information or, failing that, assure that the necessary disclosure is made.	SAS 71 addresses this matter in the context of interim financial information and during the performance of other specified procedures.	Cohen Commission (1978)	Accounting profession
50. There should be a limited extension of the "safe harbor" concept when auditors are asked to assume new responsibilities or significantly extend old ones.	The SEC has been willing to provide a "safe harbor" with respect to forecasts and projections. The Private Securities Litigation Reform Act of 1995 (§301) provides an extension of the "safe harbor" concept when the auditor notifies regulatory authorities about suspected fraud.	Cohen Commission (1978)	Accounting profession
51. Existing accounting standards should be expanded to include a requirement that the auditor review the company's system of management controls, including conducting an audit process to more adequately address the company's financial condition as well as its financial position.	This recommendation has not been adopted in this form. However, SAS 78 (which supersedes SAS 55) and SAS 59 focus the auditor's attention on the control environment and require the auditor to consider whether there is substantial doubt about the entity's ability to continue as a going concern. See also SAS 64 and 77, which supersede SAS 59.	Price Waterhouse (1985)	Accounting profession
52. Enhance the relevance of financial statements through improved disclosures of risks and uncertainties.	SOP 94-6, issued in December 1994, calls for increased disclosures of risks and uncertainties.	Big 7 (1986)	Accounting profession
53. Audit the enhanced financial statement disclosures of risks and uncertainties.	Audits of financial statements that will encompass such disclosures include the additional disclosures relative to risks and uncertainties.	Big 7 (1986)	Accounting profession

(continued)

Issue: Expanded Reporting and Auditor Services

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
54. The accounting profession should be providing better disclosure and early warnings regarding the condition of companies that are in precarious positions.	SAS 59 required the auditor who concludes that there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time to reflect that conclusion in his or her report, and provides guidance on relevant disclosures. However, SAS 77, issued in 1995 to amend SAS 59, precludes the auditor from using conditional language in the auditor's conclusion about the entity's ability to continue as a going concern in a going-concern paragraph.	GAO (1986)	Accounting profession
55. The accounting profession should be improving its efforts in determining whether companies are complying with laws and regulations.	SAS 54 discusses the consideration an auditor should give to the possibility of illegal acts. Although the SAS states that an audit normally does not include procedures specifically designed to detect illegal acts, para. 9 provides examples of specific information that may raise a question concerning possible illegal acts. The SAS includes guidance on audit procedures in response to possible illegal act, as well as the auditor's response to detected acts. FDI Act §36(e) requires auditors to report on large banks' and thrifts' compliance with laws and regulations. Also, SAS 68 deals with compliance auditing applicable to governmental entities and other recipients of governmental financial assistance.	GAO (1986)	Accounting profession
56. The accounting profession should be making sure internal controls and accounting systems are in place that will help prevent fraud and mismanagement in the companies being audited.	The proposed revision of SAS 53, which was exposed for comment in May 1996, provides more specific guidance for the auditor's use in assessing the risk of fraud.	GAO (1986)	Accounting profession
57-60. A business enterprise should make disclosures beyond those now generally made in financial reports about the risks and uncertainties facing it as of the date of the financial reports. The disclosures should include		AICPA Task Force on Risks and Uncertainties (1987)	
57. ...a description of the kinds of products or services the enterprise sells, its principal markets, and the locations of those markets.	SOP 94-6 requires disclosure of these matters.		FASB
58. ...an explanation that the preparation of historical financial information requires the use of management's estimates.	See action taken for recommendation 57.		FASB

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Issue: Expanded Reporting and Auditor Services			
Recommendation	**Action taken**	**Recommendation made by/date**	**Recommendation directed to**
59. ...a discussion of significant, change-sensitive estimates used by management to measure assets and liabilities at the reporting date. Disclosure would be required for any significant estimate used in the determination of the carrying amount of an asset or a liability at the current reporting date that based on facts and circumstances existing at that date, is particularly susceptible to changes that could result in material effects on near-term results of operations.	See action taken for recommendation 57.		FASB
60. ...information about current vulnerability to risk due to concentrations (for example, in the enterprise's assets, customers, or suppliers), other than those generally known to be associated with the industry or trade in which the entity operates, would be required in the following circumstances: (a) concentrations existing at the report date make the enterprise vulnerable to the risk of severe impact on near-term cash flows or results of operations and (b) it is at least reasonably possible that the events that could cause the severe impact will occur.	See action taken for recommendation 57.		FASB
61. For the top management of a public company to discharge its obligation to oversee the financial reporting process, it must identify, understand, and assess the factors that may cause the company's financial statements to be fraudulently misstated.	This responsibility is emphasized in the COSO report, Internal Control—Integrated Framework, in the sections on the control environment and on risk assessment.	Treadway Commission (1987)	Public companies
62. Public companies should maintain internal controls that provide reasonable assurance that fraudulent financial reporting will be prevented or subject to early detection.	This is required by the Foreign Corrupt Practices Act of 1977 and emphasized by the issuance of the COSO report and the surrounding publicity and educational efforts.	Treadway Commission (1987)	Public companies

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Issue: Expanded Reporting and Auditor Services

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
63. Public companies should develop and enforce written codes of corporate conduct. Codes of conduct should foster a strong ethical climate and open channels of communication to help protect against fraudulent financial reporting. As a part of its ongoing oversight of the effectiveness of internal controls, a company's audit committee should review annually the program that management establishes to monitor compliance with the code.	COSO received 1,014 responses to a 1988 survey of over 8,500 public companies that indicated that a significant number of companies have written codes of conduct: — 87 percent of companies with over 10,000 employees, — 60 percent with 1,000 to 10,000 employees, — 32 percent with 100 to 1,000 employees, and — 15 percent with under 100 employees.	Treadway Commission (1987)	Public companies
64. Public companies should maintain accounting functions that are designed to meet their financial reporting obligations.	This is required by the Foreign Corrupt Practices Act of 1977 and emphasized in the COSO report in the section on control activities.	Treadway Commission (1987)	Public companies
65. Public companies should maintain an effective internal audit function staffed with an adequate number of qualified personnel appropriate to the size and the nature of the company.	This is emphasized in the COSO report in the section on monitoring and further discussed in Chapter 8 on roles and responsibilities. In the survey referred to under action take for recommendation 63, 54 percent of the respondents indicated that their companies have a separate internal audit function. Significantly, this was true in 98 percent of the companies with over 10,000 employees and in 80 percent of the companies with 1,000 to 10,000 employees.	Treadway Commission (1987)	Public companies
66. Public companies should ensure that their internal audit functions are objective.	This is emphasized in the COSO report in the section on monitoring. While in the survey referred to under action taken for recommendation 63 only 26 percent of the respondents indicated that the person responsible for the internal audit function reports to the chief executive officer, as recommended by the Treadway Commission, an impressive 86 percent of the respondents said that the person had private access to the audit committee.	Treadway Commission (1987)	Public companies
67. Internal auditors should consider the implications of their nonfinancial audit findings for the company's financial statements.	This appears clear from the Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors, as they relate to due professional care. Moreover, the COSO report as a whole emphasizes the notion of bringing all available knowledge to bear on a control issue and on an evaluation of the reliability of the financial statements.	Treadway Commission (1987)	Public companies

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Issue: Expanded Reporting and Auditor Services			
Recommendation	**Action taken**	**Recommendation made by/date**	**Recommendation directed to**
68. Management and the audit committee should ensure that the internal auditors' involvement in the audit of the entire financial reporting process is appropriate and properly coordinated with the independent public accountant.	SAS 65 para. 23 discusses coordination of the audit work with the work of the internal auditors, and the practice is suggested in the Good Practice Guidelines for the Audit Committee published by the Treadway Commission.	Treadway Commission (1987)	Public companies
69. COSO should cooperate in developing additional integrated guidance on internal control.	The COSO report, Internal Control—Integrated Framework, was issued in September 1992 and an addendum, which resulted in GAO endorsement of the COSO report, was issued in May 1994.	Treadway Commission (1987)	Accounting profession
70. All public companies should be required by SEC rule to include in their annual reports to stockholders management reports signed by the chief executive officer and the chief accounting officer and/or the chief financial officer. The management report should acknowledge management's responsibilities for the financial statements and internal control, discuss how these responsibilities were fulfilled, and provide management's assessment of the effectiveness of the company's internal controls.	SAS 60 requires the auditor to communicate, generally to the audit committee, "reportable conditions" noted in the audit of the financial statements. In 1979 and 1988, the SEC proposed requirements for a public report by management or by the auditor on internal controls and weaknesses therein. (See action taken for recommendations 78-85 relating to depository institutions.) Comments received contended that the costs associated with such reports might outweigh their benefit to investors, and others expressed other concerns. The proposals were not adopted. The AICPA believes such a requirement should be instituted.	Treadway Commission (1987)	SEC
71. All public companies should be required by SEC rule to include in their annual reports to stockholders a letter signed by the chairman of the audit committee describing the committee's responsibilities and activities during the year.	The SEC's proxy rules require disclosure of whether the company has an audit committee and, if so, the identity of its members and the function it performs. Additional disclosure of audit committee activities is required when there is a change in the company's auditors. Therefore, no formal action has been taken on this recommendation.	Treadway Commission (1987)	SEC
72. The SEC should require independent public accountants to review quarterly financial data of all public companies before release to the public.	The SEC issued a release on the subject of timely auditor involvement with quarterly reports. Comments expressed concerns regarding the costs of the reviews and the possible delay in the release of data pending the accountants' review; a regulation was not issued.	Treadway Commission (1987)	SEC

(continued)

Issue: Expanded Reporting and Auditor Services

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
73. The ASB should revise the auditor's standard report to describe the extent to which the independent public accountant has reviewed and evaluated the system of internal accounting control. The ASB also should provide explicit guidance to address the situation where, as a result of his knowledge of the company's internal accounting controls, the independent public accountant disagrees with management's assessment as stated in the proposed management's report.	The AICPA has been reluctant to assume these additional responsibilities and the related risk of additional liability without a legislative or regulatory mandate. Nevertheless, the ASB has a current project to consider adding language to the auditor's report that would describe the auditor's responsibility for internal control in an audit of the financial statements. An auditing interpretation (AU §9550.03) provides guidance to the auditor who disagrees with management's published assessment of the company's internal controls.	Treadway Commission (1987)	ASB
74. Management of banks and bank holding companies with securities affiliates should report on the adequacy of the entities' internal controls and on compliance with laws and regulations. Moreover, as part of the annual financial audit, independent auditors should be required to review and report on management's assertions regarding internal controls and compliance.	The FDI Act (amended by FDICIA) requires internal control and compliance reporting for large banks and thrifts.	GAO (1988)	SEC and accounting profession
75. Boards of directors of public companies should encourage management—which should seek the advice of its in-house lawyers and outside counsel—to develop and maintain a compliance program. The program should include the establishment of internal controls to prevent and detect noncompliance with laws and regulations that, if violated, could materially affect a company's operations and financial statements.	The COSO report identifies compliance with applicable laws and regulations as one of the three categories of internal controls and provides tools to evaluate the effectiveness of related controls.	GAO (1989)	Public companies
76. The SEC should expedite its review of MD&A disclosures and issue guidance, such as the planned interpretive release, to improve information on risks and disclosures in annual reports.	The SEC has complied with this recommendation. See Financial Reporting Release 36 concerning MD&A disclosures.	GAO (1989)	SEC
77. The SEC should adopt its proposal to require management of public companies to publicly report on its responsibility for the financial statements and internal controls. The SEC should require the auditor to review and publicly report on the management report.	Although proposed as a rule amendment, the SEC has not imposed this requirement, which the AICPA believes should be implemented. See action taken for recommendation 70.	GAO (1989)	SEC

(continued)

Issue: Expanded Reporting and Auditor Services

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
78. The Congress should enact legislation requiring each insured bank to: (a) prepare an annual management report that (1) describes management's responsibility for preparing financial statements and for establishing and maintaining an effective internal control structure and (2) contains management's assessment of the internal control structure, (b) prepare an annual management report that (1) describes management's responsibilities for complying with laws and regulations related to the safety and soundness of thrift operations and for establishing methods to monitor compliance and (2) contains management's assessment of the bank's compliance with laws and regulations related to operations, and (c) have the bank's independent auditor report on the management assertions described above and submit such reports with the independent auditor's audit report to the bank's regulator. The report also recommends that the insurer identify applicable laws and regulations that have material consequences on the safety and soundness of bank operations to be reviewed and reported on in management reports.	The FDI Act (amended by FDICIA) contains provisions for internal control and compliance reporting for large banks and thrifts.	GAO (1989)	Congress

(continued)

Issue: Expanded Reporting and Auditor Services

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
79. The Congress should enact legislation requiring each insured thrift to (a) prepare an annual management report that (1) describes management's responsibility for preparing financial statements and for establishing and maintaining an effective internal control structure and (2) contains management's assessment of the internal control structure, (b) prepare an annual management report that (1) describes management's responsibilities for complying with laws and regulations related to the safety and soundness of thrift operations and for establishing methods to monitor compliance and (2) contains management's assessment of the thrift's compliance with laws and regulations related to operations, and (c) have the thrift's independent auditor report on the management assertions described above and submit such reports with the independent auditor's audit report to the thrift's regulator. The report also recommends that the insurer identify applicable laws and regulations that have material consequences on the safety and soundness of thrift operations to be reviewed and reported on in management reports.	The FDI Act (amended by FDICIA) contains provisions for internal control and compliance reporting for large banks and thrifts.	GAO (1989)	Congress
80. The Congress should amend banking laws as well as securities laws to strengthen both management's and the auditor's responsibilities for evaluating and reporting on internal controls (including those directly and not directly related to the financial statements) and compliance with laws and regulations.	These matters were addressed in FDI Act §36(e) and (c) for large banks and thrifts. The Private Securities Litigation Reform Act of 1995 §301 requires auditors to perform procedures to identify related-party transactions and detect illegal acts (but does not require auditors to evaluate or report on internal controls).	GAO (1990)	Congress
81-83. The Congress should enact legislation requiring that as a condition for federal depository insurance, depository institutions		GAO (1991)	
81. ...prepare annual financial statements in accordance with GAAP and have them audited by an independent public accountant.	See FDI Act §36(b)(1) and 36(a)(2)(A)(ii), respectively, and implementing regulations.		Congress

(continued)

Issue: Expanded Reporting and Auditor Services

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
82. ...maintain a system of internal accounting controls, which meets requirements like those contained in §13(b)(2)(B) of the Securities Exchange Act of 1934, as added by the Foreign Corrupt Practices Act.	See FDI Act §36.		Congress
83. ...maintain controls to ensure compliance with laws and regulations and with special regulatory directives, such as memorandums of understanding or cease and desist orders.	See FDI Act §36.		Congress
84. The Congress should enact legislation that authorizes the appropriate regulator to require that the independent public accountant for large institutions review specific operations of the institution, as deemed necessary, to ensure regulatory objectives are met.	No action taken.	GAO (1991)	Congress
85-87. The Congress should enact legislation requiring independent auditors of federally insured financial institutions to		GAO (1991)	
85. ...report on management's assertions described in its report on internal controls by studying and evaluating the institution's internal controls in accordance with GAAS or other procedures prescribed by the regulators and include the auditor's report in management's annual report.	FDI Act §36(c) and 36(a)(2)(A)(ii), respectively, address such requirements relative to the internal control structure over financial reporting.		Congress
86. ...report to the institution and the regulators the internal control weaknesses that are important but are not defined as material to the financial statements or already included in management's annual report.	See FDI Act §36(h)(2) and implementing regulations.		Congress
87. ...report to the institution and the regulators on the institution's compliance with (a) laws and regulations that are identified by the regulators as relating to safety and soundness where compliance can be objectively determined and (b) special regulatory directives, as defined by the regulators, to maintain prudent operations or to restore the financial health of the institution.	See FDI Act §36(e). Legislation has been introduced to repeal this requirement.	C	ongress
88-90. The Congress should enact legislation that requires large institutions to have the independent public accountant that audits their financial statements		GAO (1991)	

(continued)

Issue: Expanded Reporting and Auditor Services			
Recommendation	**Action taken**	**Recommendation made by/date**	**Recommendation directed to**
88. ...review and report on the institution's quarterly financial reports employing specific procedures agreed upon with regulators.	See FDI Act §36(g)(2).		Congress
89. ...examine a 1-year financial forecast prepared for the independent public accountant.	No action taken.		Congress
90. ...meet at least annually with the institution's regulators and audit committee to review the institution's annual financial forecast and assessment of internal controls.	No action taken with respect to annual financial forecasts. FDI Act §36(g) does require the audit committee to review the basis for the independent auditor's reports, which includes an assessment of internal controls.		Congress
91. Management should have to prepare an annual report to be published along with the audited financial statements, which (a) describes actions taken to establish and maintain an effective system of internal controls that meets a minimum set of specific measurable legislative objectives for internal control structures, (b) contains management's assessment of the effectiveness of its internal control structure and identifies material weakness that have not been corrected, and (c) is signed by the chief executive officer and the chief accounting or financial officer of the organization.	FDI Act §36(b)(2) established such requirements for the internal control structure over financial reporting for large banks and thrifts.	GAO (1991)	Congress
92. Auditors should be required to evaluate and report on the assertions described in management's report on internal controls. The auditor's assessment should be included in management's annual report.	FDI Act §36(c) and 36(a)(2)(A)(ii), respectively, address such requirements relative to the internal control structure over financial reporting for large banks and thrifts.	GAO (1991)	Congress
93. The ASB should establish standards that require clear communication of the limits of the assurances being provided to third parties when auditors report on the adequacy of client internal control systems.	SSAE 2 on reporting on an entity's internal control structure over financial reporting was issued in May 1993.	POB (1993)	ASB
94. The AICPA's AcSEC should promptly adopt a Statement of Position providing guidance on, and requiring disclosure of information about, the nature of risks and uncertainties associated with the reporting entity's operations and financial condition.	This was done in December 1994 with the issuance of SOP 94-6.	POB (1993)	Accounting profession

(continued)

Issue: Expanded Reporting and Auditor Services			
Recommendation	**Action taken**	**Recommendation made by/date**	**Recommendation directed to**
95. The SEC should require registrants to include in a document containing the annual financial statements (a) a report by management on the effectiveness of the entity's internal control system relating to financial reporting and (b) a report by the registrant's independent accountant on the entity's internal control system relating to financial reporting.	This recommendation was discussed in a meeting between AICPA representatives and the Chairman of the SEC on December 15, 1993. However, no action was taken. (For discussion of SEC rule proposals, see action taken for recommendation 70.)	POB (1993)	SEC
96. FASB should add to its agenda a project to study comprehensively the possibility of requiring the reporting of values and changes in values rather than historical transaction prices, either as a basis to propose changes to financial accounting standards or to explain publicly why such a change in accounting standards is impractical or otherwise inappropriate. In carrying out this effort, FASB should consider the conclusions of the AICPA, the FEI, and the AIMR studies with respect to the future of financial reporting.	FASB does not believe it is appropriate at this time to add this project to its agenda. Given the fact that the Jenkins Committee has learned that users oppose replacing the current historical cost-based accounting model with a fair value accounting model, the AICPA concurs with this decision.	POB (1993)	FASB
97. FASB should add to its agenda a project to design a brief statement explaining the limitations of financial statements. The explanation should be made a part of every set of financial statements described as being "in accordance with generally accepted accounting principles."	SOP 94-6 partially addresses this recommendation by requiring disclosure about the use of estimates in financial statements. It is not likely that the benefits of an additional FASB requirement would outweigh the costs involved in issuing such a document.	POB (1993)	FASB
98. The AICPA joins the POB in calling for a statement by management, to be included in the annual report, on the effectiveness of the company's internal controls over financial reporting, accompanied by an auditor's report on management's assertions.	The SEC proposed but never implemented such a requirement. See action taken for recommendation 70.	AICPA Board of Directors (1993)	SEC
99. Set financial information in its business context. Management should explicitly describe its strategies, plans, and expectations and report its results in a manner that is consistent with the organization and management of the firm.	In February 1996, FASB issued an Invitation to Comment on the recommendations of AIMR. Comments were due to FASB July 31, 1996.	AIMR (1993)	FASB
100. Continue to deliberate on the role of current values in financial reports.	See action taken for recommendation 99.	AIMR (1993)	FASB
101. Recognize all executory contracts.	See action taken for recommendation 99.	AIMR (1993)	FASB

(continued)

Issue: Expanded Reporting and Auditor Services

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
102. Develop standards for reporting comprehensive income to facilitate analysis of income statement items that have a bearing on forecasting and valuation of the firm.	See action taken for recommendation 99.	AIMR (1993)	FASB
103. Provide frequent and detailed reports (continue quarterly reporting and provide more disaggregated financial data in interim reports).	See action taken for recommendation 99.	AIMR (1993)	FASB
104. The appropriate regulatory authorities should establish specific requirements for independent, knowledgeable audit committees and internal control reporting for all major OTC derivatives dealers. Internal control reporting by boards of directors, managers, and external auditors should include assessments of derivatives risk-management systems.	Financial regulators do not think it is appropriate to mandate specific management policies to dealers in derivatives. Financial regulators believe that current assessments of internal controls are adequate and cover derivatives activities. FDI Act §36 includes requirements for internal control reporting for large banks and thrifts.	GAO (1994)	Regulators
105. FASB should consider adopting a market value accounting model for all financial instruments, including derivatives products.	This complex matter is on FASB's active agenda.	GAO (1994)	FASB
106. The SEC should ensure that SEC registrants that are major end users of complex derivative products establish and implement corporate requirements for public reporting on internal controls. Internal controls reporting by boards of directors, managers, and external auditors should include assessments of derivatives risk-management systems.	The SEC believes that at this time it is more beneficial to investors to focus on improving the accounting for and disclosure of derivatives than to adopt mandatory reporting on internal controls.	GAO (1994)	SEC
107. It is urgent that the SEC take the lead in helping the profession to reduce exposure to unwarranted litigation. There are dangers, not just to the profession but to the investing public, if the current liability situation continues to drift without SEC leadership.	The Private Securities Litigation Reform Act of 1995 is expected to reduce the profession's exposure to unwarranted litigation.	Kirk Panel (1994)	SEC
108. Report separately the effects of core and noncore activities and events, and measure at fair value noncore assets and liabilities.	FASB has issued an Invitation to Comment addressing the Jenkins Committee and AIMR recommendations. Comments were due in July 1996. The SEC will hold a symposium on these recommendations during 1996.	Jenkins Committee (1994)	FASB and SEC

(continued)

Issue: Expanded Reporting and Auditor Services

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
109. Standard setters should develop a comprehensive model of business reporting indicating the types and timing of information that users need to value and assess the risk of their investments.	FASB has issued an Invitation to Comment addressing the Jenkins Committee and AIMR recommendations. Comments were due in July 1996. The SEC will hold a symposium on these recommendations during 1996.	Jenkins Committee (1994)	FASB, AICPA, and SEC
110. Improve the understanding of costs and benefits of business reporting, recognizing that definitive quantification of costs and benefits is not possible.	See action taken for recommendation 109.	Jenkins Committee (1994)	FASB and AICPA
111. Improve disclosure of business segment information.	FASB, in cooperation with Canadian standard-setting authorities, has exposed for public comment revised standards for disclosing business segment information. See action taken for recommendation 109.	Jenkins Committee (1994)	FASB and SEC
112. Address the disclosures and accounting for innovative financial instruments.	The SEC recently published for public comment amendments to its rules to require enhanced disclosures of the accounting policies and market risks associated with certain instruments. See action taken for recommendation 109.	Jenkins Committee (1994)	FASB and SEC
113. Improve disclosures about the identity, opportunities, and risks of off-balance sheet financing arrangements and reconsider the accounting for those arrangements.	See action taken for recommendations 109 and 112.	Jenkins Committee (1994)	FASB and SEC
114. Improve the disclosures about the uncertainty of measurements of certain assets and liabilities.	See action taken for recommendations 109 and 112. Also, the accounting profession issued SOP 94-6 on risks and uncertainties in December 1994.	Jenkins Committee (1994)	FASB, SEC, or public companies
115. Improve quarterly reporting by reporting on the fourth quarter separately and including business segment data.	See action taken for recommendation 109.	Jenkins Committee (1994)	SEC or public companies
116. Allow for flexible auditor association with business reporting, whereby the elements of information on which auditors report and the level of auditor involvement with those elements are decided by agreement between a company and the users of its business reporting.	See action taken for recommendation 109.	Jenkins Committee (1994)	Accounting profession
117. The auditing profession should prepare to be involved with all the information in the comprehensive model so that companies and users can call on them to provide assurance on any of the model's elements.	Anticipating the effect of future changes in the reporting model is one of the major responsibilities of the AICPA's Special Committee on Assurance Services as well as an ongoing responsibility of the ASB.	Jenkins Committee (1994)	Accounting profession

(continued)

Issue: Expanded Reporting and Auditor Services

Recommendation	Action taken	Recommendation made by/date	Recommendation directed to
118. The newly formed AICPA Special Committee on Assurance Services should research and formulate conclusions on analytical commentary in auditors' reports within the context of the Committee's model, focusing on users' needs for information.	The AICPA's Special Committee on Assurance Services is still in the early stages of its work.	Jenkins Committee (1994)	Accounting profession
119. The profession should continue its projects on other matters related to auditor association with business reporting.	As indicated in the details of the Jenkins Committee report, the ASB has active projects on reporting on internal control and on the auditor's responsibility for the detection of fraud. Also, the SECPS has issued a response to the report of the POB panel on auditor independence.	Jenkins Committee (1994)	Accounting profession
120. National and international standard setters and regulators should increase their focus on the information needs of users, and users should be encouraged to work with standard setters to increase the level of their involvement in the standard-setting process.	The new AICPA Financial Reporting Coordinating Committee will follow up on this recommendation of the Jenkins Committee.	Jenkins Committee (1994)	FASB, AICPA, SEC, and international standard setters and regulators
121. U.S. standard setters and regulators should continue to work with their non-U.S. counterparts and international standard setters to develop international accounting standards, providing that the resulting standards meet users' needs for information.	FASB, the SEC, and the AICPA are all actively involved in efforts to achieve international accounting standards that meet users' needs for information. For example, FASB meets regularly with standard setters from the United Kingdom, Australia, Canada, and the International Accounting Standards Committee and has jointly published studies with them about future events, hedge accounting, leases, and loss provisions. The International Accounting Standards Committee has set a goal of producing, by 1998, accounting standards sufficient in quality to be adopted by the International Organization of Securities Commissions, of which the SEC is a member, as suitable for financial statements supporting securities issuance in any country.	Jenkins Committee (1994)	FASB, AICPA, and SEC
122. Lawmakers, regulators, and standard setters should develop more effective deterrents to unwarranted litigation that discourage companies from disclosing forward-looking information.	The Congress recently passed the Private Securities Litigation Reform Act of 1995, which provides a safe harbor for certain forward-looking statements (in §102 of this act).	Jenkins Committee (1994)	Congress, SEC, FASB, and AICPA

(continued)

Issue: Expanded Reporting and Auditor Services			
Recommendation	**Action taken**	**Recommendation made by/date**	**Recommendation directed to**
123. Companies should be encouraged to experiment voluntarily with ways to improve the usefulness of reporting consistent with the Committee's model. Standard setters and regulators should consider allowing companies that experiment to substitute information specified by the model for information currently required.	See action taken for recommendation 109.	Jenkins Committee (1994)	SEC
124. Standard setters should adopt a longer-term focus by developing a vision of the future business environment and users' needs for information in that environment. Standards should be consistent directionally with that long-term vision.	See action taken for recommendation 109.	Jenkins Committee (1994)	FASB and AICPA
125. Regulators should consider whether there should be any changes to the current requirement that public companies make all disclosures publicly available.	No action taken. However, the SEC has issued a proposal that would allow for abbreviated financial statements, thus acknowledging that users' needs may differ.	Jenkins Committee (1994)	SEC

Statements, Opinions, and Releases Referenced in Appendix II

Table III.1: Selected FASB Statements of Financial Accounting Standards

	FASB Statement Number and Title	Date issued
5	Accounting for Contingencies	March 1975
8	Superseded by FAS 52	October 1975
33	Superseded by FAS 89	September 1979
52	Foreign Currency Translation	December 1981
89	Financial Reporting and Changing Prices	December 1986
95	Statement of Cash Flows	November 1987
96	Superseded by FAS 109	December 1987
107	Disclosures About Fair Value of Financial Instruments	December 1991
109	Accounting for Income Taxes	February 1992
114	Accounting by Creditors for Impairment of a Loan: An Amendment of FASB Statements No. 5 and 15	May 1993
115	Accounting for Certain Investments in Debt and Equity Securities	May 1993
119	Disclosure About Derivative Financial Instruments and Fair Value of Financial Instruments	October 1994
121	Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of	March 1995
122	Accounting for Mortgage Servicing Rights: An Amendment of FASB Statement No. 65	May 1995
123	Accounting for Stock-Based Compensation	October 1995
124	Accounting for Certain Investments Held by Not-for-Profit Organizations	November 1995
125	Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities	June 1996

Table III.2: Selected FASB Concept Statements

	FASB Concept Statement Number and Title	Date issued
1	Objectives of Financial Reporting by Business Enterprises	November 1978
2	Qualitative Characteristics of Accounting Information	May 1980
5	Recognition and Measurement in Financial Statements of Business Enterprises	December 1984

Table III.3: Selected FASB Status Reports

	FASB Status Report Number and Title	Date issued
224	FASB Issues Research Report on Hedge Accounting	October 1991

Table III.4: Selected AICPA Statements on Auditing Standards

	AICPA SAS Number and Title	Date issued
1	Codification of Auditing Standards and Procedures	November 1972
5	Superseded by SAS 69	July 1975
7	Communications Between Predecessor and Successor Auditors	October 1975
8	Other Information in Documents Containing Audited Financial Statements	December 1975
11	Superseded by SAS 73	December 1975
12	Inquiry of a Client’s Lawyer Concerning Litigation, Claims, and Assessments	January 1976
16	Superseded by SAS 53	January 1977
19	Client Representations	June 1977
22	Planning and Supervision	March 1978
45	Omnibus Statement on Auditing Standards - 1983	August 1983
50	Reports on the Application of Accounting Principles	July 1986
53	The Auditor’s Responsibility to Detect and Report Errors and Irregularities	April 1988
54	Illegal Acts by Clients	April 1988
55	Consideration of the Internal Control Structure in a Financial Statement Audit	April 1988
56	Analytical Procedures	April 1988
58	Reports on Audited Financial Statements	April 1988
59	The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern	April 1988
60	Communication of Internal Control Structure Related Matters Noted in an Audit	April 1988
61	Communications With Audit Committees	April 1988
64	Omnibus Statement on Auditing Standards - 1990	December 1990
65	The Auditor’s Consideration of the Internal Audit Function in an Audit of Financial Statements	April 1991
67	The Confirmation Process	November 1991
68	Superseded by SAS 74	December 1991
69	The Meaning of “Present Fairly in Conformity With Generally Accepted Accounting Principles” in the Independent Auditor’s Report	January 1992
70	Reports on the Processing of Transactions by Service Organizations	April 1992
71	Interim Financial Information	May 1992
73	Using the Work of a Specialist	July 1994
77	Amendments to Statements on Auditing Standards No. 22, “Planning and Supervision,” No. 59, “The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern,” and No. 62, “Special Reports”	November 1995

(continued)

	AICPA SAS Number and Title	Date issued
78	Consideration of Internal Control in a Financial Statement Audit: An Amendment to SAS No. 55	December 1995
79	Amendment to Statements on Auditing Standards No. 58, Reports on Audited Financial Statements	December 1995

Table III.5: Selected AICPA APB Opinions

	APB Opinion Number and Title	Date issued
19	Reporting Changes in Financial Position (superseded by FAS 95)	March 1971
20	Accounting Changes (amended)	July 1971
31	Disclosure of Lease Commitments by Lessees (superseded by FAS 13)	June 1973

Table III.6: Selected AICPA Statements of Position

	AICPA SOP Number and Title	Date issued
92-3	Accounting for Foreclosed Assets	April 1992
94-6	Disclosure of Certain Significant Risks and Uncertainties	December 1994

Table III.7: Selected AICPA Statements on Standards for Attestation Engagements

	AICPA SSAE Number and Title	Date issued
2	Reporting on an Entity's Internal Control Structure Over Financial Reporting	May 1993

Table III.8: SEC Accounting Series Releases

	SEC Accounting Series Release Number and Title	Date issued
194	Reporting Disagreements With Former Accountants—Adoption of Amendments of Requirements	April 29, 1976 (omitted)
250	Disclosure of Relationships With Independent Public Accountants	June 29, 1978 (omitted)
264	Scope of Services by Independent Accountants	June 14, 1979 (rescinded)
296	Relationships Between Registrants and Independent Accountants	August 20, 1981 (codified into FRR No. 1 Sections 601 and 604)
297	Rescission of Certain Accounting Series Releases and Adoption of Amendments to Certain Rules of Regulation of S-X Relating to Disclosure of Maturities of Long-Term Obligations	August 20, 1981

Table III.9: SEC Financial Reporting Releases

	SEC Financial Reporting Release Number and Title	Date issued
36.	Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures	May 18, 1989

Experts Consulted in Our Review of the Accounting Profession

Securities and Exchange Commission

Office of the Chief Accountant:

Michael Sutton, Chief Accountant
Walter Schuetze, Former Chief Accountant
John Riley, Deputy Chief Accountant
John Albert, Associate Chief Accountant
Michael Kigin, Associate Chief Accountant
Robert Burns, Chief Counsel

Financial Accounting Foundation

Dennis Dammerman, President
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Financial Reporting Coordinating Committee:

Jerry Weygandt, Chair, Professor, University of Wisconsin

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Alton "Chip" Jones, Advocacy Administrator

American Association of Individual Investors

John Markese, President
John Bajkowski, Financial Analyst

Standard & Poor's

Equity Investor Services Group:

David M. Blitzer, Vice President and Chief Economist
Robert Natale, Research Director
Stephen Biggar, Equity Analyst
Jane Colis, Equity Analyst
Joshua Harari, Equity Analyst
Steve Klein, Equity Analyst

Debt Rating Group:

Mark E. Bachmann, Managing Director
Solomon B. Samson, Managing Director - Corporate Finance Department
Scott Serif, Associate Director
Scott Sprinzen, Managing Director, Corporate Ratings

Business Roundtable

Robert Butler, Chair - Accounting Policy Committee
Fredrick Batline, Vice President, Citibank
Gerand Ketz, Vice President, Citibank
Diane Staab, International Paper, Washington Council

Financial Executives Institute

Susan Koski-Grafer, Vice President
Ken Johnson, Chair - Committee on Corporate Reporting
Mitchell Danaher, Member
David Sidwell, Member

Securities Industry Association

Marc Lackritz, President
Stuart J. Kaswell, Senior Vice President

Moody's Investors Service

John J. Kriz, Managing Director

Institute of Management Accountants

Bill Ihlanfeldt, President

American Accounting Association

Stephen Zeff, Former President

American Bar Association

Abraham Stanger, Coordinator for Law and Accounting Committee

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Wallace Olson, Former President of the AICPA
Katherine Ortega, Former Treasurer of the United States

GAO Consultant

Douglas Carmichael, Professor, Baruch College, CUNY

Comments From the American Institute of Certified Public Accountants

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

AICPA

Ronald S. Cohen, CPA
Chair of the Board

August 26, 1996

The Honorable Charles A. Bowsher
Comptroller General of the United States
U.S. General Accounting Office
441 G Street, NW
Washington, DC 20548

Dear Mr. Bowsher:

The AICPA appreciates the opportunity to review and comment on the U.S. General Accounting Office's (GAO) draft report "The Accounting Profession; Major Issues: Progress and Concerns." The GAO report discusses recommendations made and actions taken from 1972 through 1995 to improve accounting and auditing standards and the performance of independent audits of publicly owned companies. As requested in your August 6, 1996, letter, the AICPA's comments incorporate comments from (1) the Managing Partners of the Big 6 accounting firms, (2) the Auditing Standards Board, (3) the AICPA Special Committee on Assurance Services, and (4) the former AICPA Special Committee on Financial Reporting. The GAO report reflects a comprehensive and thorough analysis of the many recommendations and implementation actions taken by the CPA profession over the past two decades. In general, we agree with the GAO's observations posed in its report.

The GAO report highlights five major issues discussed in the various studies of the accounting profession from 1972 through 1995:

(1) auditor independence,
(2) auditor responsibilities to detect fraud and report on internal controls,
(3) audit quality,
(4) the accounting and auditing standards setting processes, and
(5) the role of the auditor in the further enhancement of financial reporting.

Many of these issues were discussed in the AICPA Board of Directors' report, "Meeting the Financial Reporting Needs of the Future: A Public Commitment from the Public Accounting Profession," issued in June 1993. In that report, the AICPA Board affirmed the importance of maintaining the U.S. financial reporting system as the best in the world, and detailed specific steps and actions to improve the value of financial information and the public's confidence in that information. As noted in the GAO report, the AICPA has a long history of responding positively to the ongoing challenges facing the profession in a fast-changing world, and we will remain fully committed to similarly meeting new challenges in a manner consistent with the profession's special role in serving the public interest.

Below are our specific comments on the GAO's observations related to the major issues identified in the GAO report.

See comment 1.

Auditor independence - We agree with the GAO that, as recommended in the report of the Public Oversight Board (POB) Advisory Panel on Auditor Independence, the relationship between a company's directors and its independent auditor should be strengthened to help directors meet their governance responsibilities and improve the quality of financial reporting. As a result, the AICPA SEC Practice Section

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The Honorable Charles A. Bowsher
August 26, 1996
Page 2

(SECPS) has pledged to work with the POB in developing an appropriate plan of action for the accounting profession in this respect.

As part of that process, the SECPS Executive Committee has directed its Peer Review Committee to identify "best practices" in implementing the recommendations of the Advisory Panel. A new database of such practices relating to corporate governance should be available in early 1997. In addition, the Peer Review Committee is developing a second database of practices relating to polices and procedures used by auditing firms to conduct internal accounting consultations. These practices should be useful to firms for strengthening controls over internal accounting consultations and to peer reviewers in evaluating those controls.

Further, the AICPA believes that SEC registrants and other publicly accountable organizations should be required to have audit committees composed entirely of independent directors whenever practicable. Audit committee members should be charged with specific responsibilities, including overseeing the financial reporting process and recommending appointment of the entity's independent auditors.

See comment 2.

Auditor responsibilities to detect fraud and report on internal controls - In keeping with its public responsibility and further improving the detection of material fraud in financial statements, the AICPA Auditing Standards Board (ASB), as noted in the GAO report, has proposed new auditing standards to ensure that auditors exercise a proper degree of professional skepticism in planning and performing the audit to detect misstatements in financial statements resulting from fraud. The proposed new standard, "Consideration of Fraud in a Financial Audit," would require auditors to assess the risk of material misstatement due to fraud, develop appropriate responses to such risks, document the risk assessment, and communicate any findings to an appropriate level of management or, in some circumstances, others. It also provides expanded guidance to assist auditors in meeting their existing responsibility for fraud detection. The standard is intended to change auditor behavior and improve auditor performance. The ASB has invited public comments on the proposed standard.

The AICPA also supports auditor reporting on internal controls over financial reporting. We believe that management and auditors' reports on internal control can make a positive, cost effective contribution to the assurance system and would improve investor confidence in the integrity and reliability of the financial reporting process. Mandating management reporting on internal controls would encourage an appropriate "tone from the top," and help assure that appropriate controls are maintained. Moreover, auditor reporting on management's reports would add significant benefit to the financial reporting process and, therefore, to investor protection. As noted in the GAO report, the Federal Deposit Insurance Corporation Improvement Act (FDICIA) already requires auditors to evaluate and report on the effectiveness of certain banks' internal controls. The AICPA supported the FDICIA reporting model and has expressed concerns to Congress about recent attempts to repeal the requirement for independent assurance on bank managements' reports on internal controls.

See comment 3.

Audit quality - As noted in the GAO report, the AICPA has undertaken several actions to be responsive to various recommendations to improve audit quality. We are pleased that the GAO finds these efforts impressive and we will continue to seek ways to strengthen audit quality. With respect to specific audit documentation and reporting deficiencies noted by the GAO, the SECPS, through its Peer Review Committee, is currently considering what additional steps firms or the Section should take to improve this

See comment 4.

See comment 5.

The Honorable Charles A. Bowsher
August 26, 1996
Page 3

situation, along with other proposals designed to improve performance in these areas.

Accounting and auditing standards setting process - We agree that the private sector standards setting process in the United States is the best system in the world for the development of accounting and auditing standards. Because the continued independence of Financial Accounting Standards Board (FASB) members is critical to this process, the AICPA supported the recent restructuring of the Financial Accounting Foundation to achieve more public representation and actually gave up one of our three seats on its Board of Trustees to accomplish that goal.

In addition, the AICPA strongly supports the FASB undertaking a project to implement the comprehensive model of business reporting contained in the 1994 report of the AICPA Special Committee on Financial Reporting (Special Committee) entitled "Improving Business Reporting—A Customer Focus; Meeting the Information Needs of Investors and Creditors." The AICPA created the Special Committee in 1991 to serve as a catalyst to improve the value of business information and the public's confidence in that information. Consequently, it is not surprising that the AICPA has recently urged the FASB to accelerate its review of the Special Committee's recommendations and to proceed to the implementation stage of the comprehensive model as promptly as possible.

Role of the auditor in the further enhancement of financial reporting - The AICPA's Special Committee on Assurance Services (Special Committee), created in 1994, is in the final stages of a two-year project to consider the changing needs for relevant and reliable information by decision-makers and recommended ways CPAs can help meet those needs. Among other things, the Special Committee has studied recent trends in information technology, corporate structures, accountability, investment capital, the aging of Americans, and globalization of markets that suggest a growing evolution in the way CPAs will serve the public in the future. The Special Committee expects to complete its work and report to the AICPA Council in October 1996.

* * * * *

This is a time of exceptional challenge for all participants in the financial reporting system. The AICPA is committed to helping its members meet this challenge and continue to serve the public interest by promoting efforts to ensure that CPAs maintain integrity, objectivity, competence and independence, and possess the skills needed in an increasingly complex business and economic environment.

Sincerely,

Ronald S. Cohen

Ronald S. Cohen, CPA
Chair of the Board

RSC/llp

The following are GAO's comments on the AICPA's letter dated August 26, 1996.

GAO Comments

1. See the "Comments and Our Evaluation" section in chapter 2.

2. See the "Comments and Our Evaluation" section in chapter 3.

3. See the "Comments and Our Evaluation" section in chapter 4.

4. See the "Comments and Our Evaluation" section in chapter 5.

5. See the "Comments and Our Evaluation" section in chapter 6.

Comments From the Public Oversight Board

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

PUBLIC OVERSIGHT BOARD
One Station Place
Stamford, CT 06902
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Assistant Technical Director

August 26, 1996

VIA MESSENGER

Honorable Charles A. Bowsher
Comptroller General of the United States
U.S. General Accounting Office
441 G Street, NW
Room 7000A
Washington, DC 20548

Dear Chuck:

First, on behalf of the Public Oversight Board I would like to commend you and your colleagues for the splendid draft report, **The Accounting Profession - Major Issues: Progress and Concern.** This Report admirably summarizes the recommendations which have emanated since 1972 from numerous bodies (including the Public Oversight Board) and the manner in which the accounting profession has responded.

As you know, while the formal mandate of the POB is to oversee the peer review program of the SEC Practice Section of the AICPA, we have long felt that such oversight unaccompanied by monitoring and observation of the entire financial reporting process would be unduly limiting and might breed an unwarranted complacency if the peer review process were working well, but other forces were undermining the integrity of the financial reporting process. Thus we have sponsored two studies addressed to non-audit services performed by firms for audit clients. In 1993 we published a report, **In the Public Interest**, containing numerous proposals directed to the profession, the Securities and Exchange Commission, the Congress and self-regulators in the securities industry. And in 1995 we published the report of the panel which we appointed, **Strengthening the Professionalism of the Independent Auditor,** dealing with the issue of auditor independence. In addition, the POB in its annual reports regularly comments on the state of auditing in this country and urges measures to strengthen the audit process. The GAO report enumerates and in many instances affirmatively recognizes the validity of the recommendations contained in our reports.

See comment 1.

We have been pleased by the responsiveness of the accounting profession to our recommendations, a responsiveness recognized in the GAO Report. We have been disappointed by the failure of others to whom we addressed recommendations to respond,

See comment 2.

The Public Oversight Board is an independent, private sector body that monitors and reports on the self-regulatory programs and activities of the SEC Practice Section of the Division for CPA Firms of the American Institute of Certified Public Accountants.

notably the failure of the SEC to take action to mandate issuer and auditor reporting on internal controls. Like you, we feel this would add immeasurably to the ability to prevent and detect fraud and would in general enhance the quality of financial reporting.

See comment 3.

The Report recognizes the importance of the recommendations of the Kirk Panel on Independence. The Executive Committee of the SEC Practice Section endorsed these recommendations and we are informed that a number of firms, including some of the largest, have taken measures to implement them. To further the creation of the new relationship between boards and audit committees on the one hand and auditors on the other, the POB prepared a special pamphlet dealing with the corporate governance parts of the Kirk Panel report and distributed it to every director of companies listed on the New York Stock Exchange and of every other company with sales of more than $250 million. In addition many thousands of copies have been distributed through accounting firms and other channels.

Auditor independence continues to be a major focus of the POB and we are carefully monitoring efforts to enhance it, including the work of the SECPS Task Force on Independence which the Board urged the Section to organize. The importance of this issue, particularly the growth and scope of non-audit services, was further evidenced when both the Chief Accountant of the SEC and one of the Commissioners addressed this issue at the recent meeting of the American Accounting Association. The Board expects to spend a significant amount of time dealing this matter during the next year. We believe it must be at the top of the agenda of everyone concerned with maintaining the viability of the independent audit process.

See comment 4.

We are pleased that the SECPS peer review program which we oversee has significantly contributed to the improvement of auditing services. We continue to work with the leadership of the Section to improve both the peer review process and the work of the Quality Control Inquiry Committee which monitors litigation against auditors of SEC registrants to determine whether the allegations indicate a failure of quality controls.

The GAO Report will be of immense help to us in our endeavors.

Again, congratulations to you and your colleagues for an excellent Report.

Respectfully,

AA Sommer Jr.

A. A. Sommer, Jr.
Chairman

cc: Members of the Board
Jerry Sullivan
Linda Griggs

The following are GAO's comments on the POB's letter dated August 26, 1996.

GAO Comments

1. The POB's reports referred to are discussed in chapters 2 and 3, and in appendixes I and II.

2. See the "Comments and Our Evaluation" section in chapter 3.

3. See the "Comments and Our Evaluation" section in chapter 2.

4. See the "Comments and Our Evaluation" section in chapter 4.

Comments From the Financial Accounting Standards Board

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116, Norwalk, Connecticut 06856-5116 | 203-847-0700
Fax: 203-849-9714

August 27, 1996

Mr. Charles A. Bowsher
Comptroller General of the United States
Washington, DC 20548

Dear Mr. Bowsher:

We appreciate the opportunity to comment on a draft of the General Accounting Office report, *The Accounting Profession Major Issues: Progress and Concerns*. Because of the short time allowed for comment, among other factors, we did not verify all aspects of the report that concern accounting standards setting and the financial reporting model. We did not review and do not comment on the sections of the report that concern auditor independence, reporting on internal controls, audit quality, and changes in the traditional audit function, because they are matters for which others are responsible. While Board members had an opportunity to review your draft and a draft of this letter, this letter is not an official position of the Board because it has not been the subject of extensive due process and deliberation.

Overall Comments

Overall, I believe that the report is an impressive review of matters very important for corporate financial reporting to investors, which has a major influence on capital allocation in the United States.

The report is a very comprehensive study of the major recommendations to the accounting profession over the last 25 years, and of what has been changed in response. We are pleased at your overall finding that the accounting profession generally and our Board in particular have been responsive to those recommendations. We also are pleased at your finding that the current structure for establishing accounting standards has served our nation well.

Our specific comments are about international activities, fair value accounting, the Jenkins Committee and AIMR reports, objectivity of comments to us, and clarity.

See comment 1.

Mr. Charles A. Bowsher
August 27, 1996
Page 2

International Standard-Setting Activities

Your report makes little mention of international standard-setting activities, which are increasingly important to investors, the accounting profession, the general public, and thus to the FASB. Investment activity increasingly crosses national borders. National standard-setting bodies with practices modeled in part on the FASB have recently been established in several major countries. The International Accounting Standards Committee (IASC), formed at the same time as the FASB, has been increasingly active in recent years. The FASB has made awareness of and cooperation with international standard-setting activities a priority for the last decade, and in 1992 made it part of its mission to "promote the international comparability of accounting standards concurrent with improving the quality of financial reporting."

In carrying out that part of its mission, the Board is currently conducting its disaggregated disclosures project jointly with Canada and its earnings per share project jointly with the IASC. With Canada and Mexico, the Board has jointly published a comparative analysis of accounting standards and is engaged in a joint effort to harmonize accounting standards within NAFTA. The Board meets regularly with standard-setters from the United Kingdom, Australia, Canada, and the IASC and has jointly published studies with them about future events, hedge accounting, leases, and loss provisions. An FASB Board member participates in the meetings of the IASC and certain of its committees and task forces. Three FASB staff members have been temporarily seconded to standard-setters overseas. Accountants from Australia, Japan, and most recently China have been seconded to the FASB staff.

Those international activities are important and necessary, but they are also time consuming, both in Board and staff efforts and in elapsed time required to complete joint projects. Such projects inevitably will take longer than the two-year average mentioned in your draft report.

One other international development of import is that the IASC has set a goal of producing, by 1998, accounting standards sufficient in quality to be adopted by the International Organization of Securities Commissions (IOSCO), of which the SEC is a member, as suitable for financial statements supporting securities issuance in any country. The SEC now requires foreign issuers to submit financial statements that conform to or are reconciled with the US generally accepted accounting principles set by the FASB. Depending on the results of the IASC's work, acceptance by the SEC of financial statements that conform only to IASC standards for foreign issuers could result in a major change in the quantity and quality of financial statement information available to investors in the U.S. financial markets

Fair Value Accounting

Your report reiterates the GAO's previous conclusion that changing to mark-to-market accounting for all financial instruments, and perhaps for other assets and liabilities, would

Mr. Charles A. Bowsher
August 27, 1996
Page 3

See comment 2.

resolve most of the financial instruments issues the Board has been confronted with. I agree with many of your criticisms of the mixed-attribute financial reporting model that has been the basis of financial accounting for decades. However, while fair value accounting for all financial instruments would resolve many financial instruments issues, it would leave open many major issues and raise additional issues. For example: hedging of forecasted transactions or nonfinancial assets with derivatives would continue to present the same difficult accounting problems; finding verifiable values for rarely traded loans, insurance obligations, and certain other instruments would be a challenge; and the appropriate way of reporting in the income statement the effects of changes in market prices and credit quality and of interest is by no means clear.

See comment 2.

Your report suggests that changing to consistent use of market or fair value accounting will reduce controversy and speed up the standard-setting process. Our experience suggests otherwise. For example, our Statement No. 33, *Financial Reporting and Changing Prices*, was so controversial that the Board had to devote considerable efforts to a later Statement making its provisions optional. Controversy erupts whenever the Board considers the possibility of fair value accounting: in deliberations on overall measurement concepts and reporting earnings in the early 1980's; in deliberations on measurement of financial instruments in the late 1980's and early 1990's; and even in reaction to our requests for comments on documents raising that possibility (for example, the Trueblood committee proposals you cite, our 1974 and 1976 Discussion Memorandums on reporting general price-level changes and on measurement concepts, our 1991 Discussion Memorandum on recognition and measurement of financial instruments, and the recent AIMR and AICPA reports.)

See comment 2.

While some Board members, like some of the Board's constituents, fully share your interest in fair value accounting for all financial instruments, others have not been persuaded. The Board is studying that possibility again, with emphasis on the measurement and reporting issues it would raise or leave open. The evidence suggests that efforts towards that goal will continue to be controversial and time consuming.

See comment 2.

Some of the discussion of fair value accounting in your report extends to using that method for all assets and liabilities, not just financial instruments. That raises still more challenging issues, as noted in my attached letter in response to the Public Oversight Board's 1993 recommendation, which is mentioned in your report, to study this possibility comprehensively and resolve it once and for all. And there is still more controversy about whether that change would be beneficial. For example, both the AIMR and AICPA reports suggest fair value accounting for certain situations but express a fair degree of satisfaction with the current accounting model.

Mr. Charles A. Bowsher
August 27, 1996
Page 4

See comments 2 and 3.

Jenkins Committee Report and AIMR Position Paper

Your draft report concludes that "overall, the Jenkins Committee's comprehensive reporting model represents a significant step in improving information for users." Letters received in response to our invitation to comment on that report and the AIMR position paper suggest that not all users agree with that conclusion. For example, the attached letter from AIMR dated July 31, 1996 says that they "have misgivings about many of the recommendations" in the Jenkins Committee report and goes on to discuss those misgivings in detail.

Objectivity of Comments to FASB

See comment 2.

Your report complains that some views expressed at meetings of the Board's Financial Accounting Standards Advisory Council (FASAC) do not objectively address the merits of the accounting issue under discussion. As you note, FASAC's membership is intentionally diverse, so that the FASB can hear a wide range of views on issues. FASAC members are there to express their views freely. It is inevitable that some of those views will be judged by some observers as not being objective. Board members, of course, make their own judgments about the objectivity and conceptual merit of what they hear at FASAC and other forums and read in comment letters as part of their decision-making process.

Clarity

See comment 4.

Your report cites important recommendations to develop a comprehensive business reporting model, incorporate more fair values into financial statements, and incorporate forward-looking information. As your report notes, we are considering each of those issues. But your report implies that those efforts are almost variations of the same idea. We suggest that those recommendations, while not unrelated, are about very different subjects and may often point toward different changes in financial reporting.

See comment 5.

In the Appendix to your report, some of the indicated Actions Taken in response to recommendations in previous reports reflect the state of affairs today. However, other Actions Taken reflect only the responses made shortly after the recommendation was first made, without reflecting further actions taken. The Appendix might be more useful to readers if the report used a consistent time reference or, failing that, if those two kinds of reported Actions Taken were distinguished.

See comment 6.

Your draft report refers in places to what FASB "Board members stated" in response to your inquiries. Those are the individual views of those Board members, but your report should not imply that they are the general position of the Board. Official positions of the Board are determined only after extensive due process and deliberation. In other places, your draft report refers to what "some Board members" stated, which is less likely to be misunderstood by readers of your report.

See comment 7.

Mr. Charles A. Bowsher
August 27, 1996
Page 5

We have sent our remaining comments about factual matters, questions about what is intended, and editorial suggestions separately to Mr. Gramling of your staff. Thank you again for your efforts and for the opportunity to comment on a draft of the report.

Sincerely,

Dennis R. Beresford

Dennis R. Beresford

Attachments

cc: Mr. Robert W. Gramling

The following are GAO's comments on the FASB's letter dated August 27, 1996.

GAO Comments

1. Reviewing the status of international standard-setting activities was beyond the scope of our review of the accounting profession's responsiveness to the many recommendations made by major study groups from 1972 through 1995, and to identify any unresolved issues related to those recommendations. However, we share FASB's view of the importance of international accounting standards and, accordingly, the priority attention to this task as a component of FASB's mission to improve the quality of financial reporting.

2. See the "Comments and Our Evaluation" section in chapter 5.

3. FASB's letter to the POB and the letter from AIMR have been considered in our final report.

4. We agree that these recommendations may involve different changes in financial reporting. For example, the more comprehensive reporting model recommended by the Jenkins Committee addresses the current mixed attribute accounting model and makes a distinction between core and noncore assets and liabilities and recommends fair value measurement for the noncore assets and liabilities. Also, the Jenkins Committee recommended model includes high-level operating data and performance measures that may more appropriately be reported outside the financial statements such as in a management discussion and analysis report section. However, a common theme among the recommendations is that the current mixed attribute report model is not meeting the broad range of information users' needs.

5. FASB's comment references appendix II that lists the recommendations of the major studies considered in our report and the actions taken in response to those recommendations. The appendix is organized by major issue, such as independence, and then, within that issue, chronologically by study group. We selected that presentation to provide a time line of actions taken in addressing the major issue. The reader needs to consider all actions taken, as we have in our analysis, to determine the status of the major issue. As FASB has noted, actions taken in response to recommendations of a study group may also relate to recommendations made by a previous study group and the actions taken at that time.

6. The final report has been annotated to show that we use the term FASB Board members in the report to refer to the information provided to us in interviewing the individual board members and that such positions do not reflect the official positions of FASB.

7. These additional comments have been considered in the final report.

Comments From the Securities and Exchange Commission

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

OFFICE OF
THE CHIEF ACCOUNTANT

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

September 5, 1996

The Honorable Charles A. Bowsher
Comptroller General of the United States
Washington, D.C. 20548

Dear Mr. Bowsher:

Thank you for your August 6, 1996 letter to Chairman Levitt and the opportunity to provide comments on the draft report being prepared by the General Accounting Office (GAO) that summarizes the accounting profession's actions to address recommendations made to the profession since the 1970s. As you know, during preparation of the draft report staff from the Office of the Chief Accountant (OCA) at the Securities and Exchange Commission (SEC or Commission) provided background materials to GAO, met with GAO staff several times to discuss the issues presented in the report, and commented on various sections of the appendix to the report.

The draft report and detailed appendix reflect the hard work and deliberate analysis of the GAO staff. OCA appreciates the consideration that Mr. Chapin, Mr. Gramling, and others on the GAO staff have given to OCA's comments and views. We have the following comments on the draft report.

SEC Relationship with Professional Standard Setting Bodies

See comment 1.

At several points in the draft report, the statement is made that the SEC has "delegated" responsibility for setting accounting standards to the private sector and that the SEC has "accepted" standards prepared by the Financial Accounting Standards Board (FASB) as the primary standards for preparing financial statements. Other statements indicate that the Commission has not strongly asserted its role of protecting investors in its relationship with private sector standard setters, and applaud as a step in the right direction the SEC's "recent attention" to strengthening standard setting through its support for balanced representation on the Financial Accounting Foundation (FAF). Those statements imply that there has been a transfer of official, statutory responsibility from the SEC to the FASB, that the SEC has little continuing involvement in the process, and that SEC oversight has been sporadic rather than consistently vigilant. This, however, is not the case. The Commission and OCA actively are involved in the establishment of

Mr. Charles A. Bowsher Page 2

accounting standards through the diligent oversight of, and close working relationship with, the FASB and other professional standard setting bodies and through the adoption of rules and the publication of interpretive guidance in Regulation S-X [17 CFR § 210], the Codification of Financial Reporting Policies, and Staff Accounting Bulletins.

See comment 1.

As part of its oversight activities, the Commission meets periodically with the FASB in open meetings to discuss matters of mutual interest, and the SEC staff actively oversees the FASB's activities. The SEC staff discusses accounting issues with the FASB staff frequently, and the two staffs meet regularly to discuss topical issues and FASB agenda items. Each of the projects on the FASB's technical agenda is assigned to Commission staff members who follow project developments, review comment letters submitted to the FASB, attend FASB meetings and public hearings on the project, and confer with FASB staff, including orally conveying any concerns the staff may have with positions in draft standards. Once a standard is adopted, OCA staff are in frequent contact with the FASB staff regarding implementation and effectiveness issues. In addition, the Chief Accountant participates on the FASB's Emerging Issues Task Force (EITF) as a non-voting observer with the privilege of the floor, and attends meetings of the Financial Accounting Standards Advisory Council (FASAC) and the FASAC Agenda Advisory Committee. The Commission also actively oversees standard setting activities by various bodies of the American Institute of Certified Public Accountants, such as the Auditing Standards Board and the Accounting Standards Executive Committee.

See comment 1.

As evidenced by the discussion in the draft report, the Commission also takes an active role in assuring the integrity of the private sector standard setting process. The recent effort to increase the number of public members on the FAF reflects the Commission's commitment to the independence of private sector standing setting.

See comment 1.

The draft report notes that the GAO has observed a lack of objectivity in some positions expressed at the FASAC and conveyed to the FASB. OCA believes that FASAC's membership may not be balanced appropriately to provide objective guidance to the FASB. Accordingly, OCA would support a reconsideration of the FASAC membership criteria.

See comment 1.

The fact that the Commission has looked to the private sector for leadership in establishing and improving accounting principles, but closely overseen that process and supplemented private sector principles when necessary, has led to a successful public-private sector partnership and to what are widely recognized as the most comprehensive accounting standards in the world.

Soft Assets

See comment 1.

The draft report suggests that the value of soft assets, as opposed to their historical cost, should be recognized in entities' financial statements. Soft assets include items such as brand names, technology related products, intellectual capital, patents, trademarks, and copyrights. As the draft report points out, these items affect the ability of

Mr. Charles A. Bowsher **Page 3**

an entity to develop and market its products successfully and information about these items may be significant to the investment decision-making process.

See comment 1.

Recognizing the importance of this issue, in April 1996 the Commission conducted a two-day symposium on the "Financial Accounting and Reporting of Intangible Assets." Several panels of highly respected experts from business, academia, government, and the practicing accounting profession presented papers and positions on the current and potential alternatives for accounting for soft assets.

See comment 1.

Most participants at the symposium thought that intangible asserts were important and in many cases the drivers of value for certain companies. These participants thought that it would be useful to have more information about these assets provided in financial reports. Notwithstanding this, many commenters pointed out that it currently would be difficult to arrive at a consensus with respect to how such information should be presented, citing difficulties with respect to measuring and ensuring the reliability of information related to intangible assets.

See comment 1.

OCA believes that the issue of how to provide investors and other users of financial reports with useful information with respect to intangible assets is an important one. It is OCA's understanding that the symposium has sparked additional academic research and analysis that may explore new ways of reporting relevant and reliable information about intangible assets. Although OCA is not recommending that the Commission consider adopting rules in this area at this time, OCA encourages research efforts in this area as an important first step in addressing the accounting and reporting for soft assets.

Auditor Independence

See comment 2.

OCA agrees with the observation in the draft report that the increase in non-traditional services provided by auditing firms to their SEC audit clients could lead to increased concerns about auditor independence. That observation is consistent with our own experience. The staff believes that there are limits to the services that may be provided by a firm to its SEC audit clients without impairing auditor independence and, importantly, the perception of auditor independence by the investing public.

See comments 2 and 6.

OCA also agrees with the statements in the draft report that concerns in this area must be resolved if the profession is to be successful in providing expanded assurance services, particularly those related to nonfinancial information.

See comment 2.

The suggestion in the draft report to establish a more direct relationship between auditors and entities' boards of directors and audit committees in order to strengthen auditor independence is compelling and should be considered. As indicated in the draft report, the Commission historically has encouraged the use of audit committees. For example, in OCA's March 1994 *Staff Report on Auditor Independence* the staff stated that such committees, among other things, may provide a forum apart from management

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where the auditors may discuss their concerns, recommend or approve selection of the auditors, and facilitate communications among the board of directors, management, and internal and independent auditors.[1] Accordingly, the Commission requires disclosure in proxy statements of the members of the audit committee, its primary functions, and the number of committee meetings. When a change in auditors occurs, additional information must be disclosed concerning whether the audit committee recommended the change in auditors and whether the audit committee consulted with the departing auditor concerning disagreements with management and other specified matters. Finally, as noted in the draft report, in the late 1980s the Commission encouraged the Exchanges and the National Association of Securities Dealers (NASD) to strengthen their listing requirements regarding independent audit committees, and several Exchanges and the NASD did so.

Thus, the Commission has promoted the establishment of independent audit committees and the use of those committees to enhance auditor independence.

Corporate Governance

The draft report indicates that the SEC could define more clearly the roles of boards of directors and audit committees as they relate to the independent auditor. It is suggested that requirements for audit committees could include reviewing auditor reports on financial statements, internal controls, and compliance with laws and regulations.

See comment 2.

OCA believes that active and effective boards of directors and audit committees can play an important role in safeguarding the interests of public investors and in facilitating the financial reporting activities of management and the performance of the audit of the financial statements by the independent auditors. OCA would be willing to discuss with GAO and others these proposals and other ways to strengthen further the board's role.

See comment 3.

The draft report cites the corporate governance provisions for financial institutions adopted in the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) as a model that Congress could use to adopt such provisions for all public companies. It should be kept in mind, however, that FDICIA focuses on a highly regulated industry and that the Commission currently requires certain regulated entities under its jurisdiction, which may be compared to financial institutions under the jurisdiction of the bank regulators, to adhere to regulations that have a similar purpose. For example, the Commission requires that independent auditors of certain broker-dealers, investment companies, and transfer agents file reports with the Commission on those entities' internal controls related to safeguarding assets and financial reporting, among other items.

[1] Office of the Chief Accountant, US Securities and Exchange Commission, *Staff Report on Auditor Independence*, 20-21 (March 1994).

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Reporting on Internal Controls

See comment 4.

The draft report notes that the Commission has not been persuaded of the merits of public reports by management and auditors on internal controls. In fact, however, the Commission has recognized that there may be benefits associated with management or auditor reports on registrants' internal control systems related to financial reporting and, as indicated in the draft report, twice has published proposed rules in this area for public comment. Commentators responding to these releases raised concerns regarding, among other things, the cost of auditor reports on registrants' internal control systems, potential over-reliance by investors on those reports, whether disclosure of potential improvements in internal control systems would constitute an admission of a violation of the internal accounting control requirements of the Foreign Corrupt Practices Act [15 USC § 78m(b)(2)], the potential liability of the individuals signing such reports, and whether such reports would create potential additional liability under section 18 of the Securities Exchange Act of 1934 [15 USC § 78r]. On balance, despite the potential benefits of such reports, on both occasions the Commission did not adopt the proposed rules.

See comment 4.

Most recently, the Commission has focused its attention on providing investors with enhanced accounting for and disclosure of market risk. In this regard, the Commission has proposed amendments to its rules to require enhanced disclosure of accounting policies and disclosure of qualitative and quantitative information about market risks inherent in derivative financial instruments, other financial instruments, and derivative commodity instruments.[2] In addition, the Commission is monitoring closely the FASB's projects related to derivative instruments and hedging activities. In connection with these projects, the staff attends FASB meetings where proposed standards are discussed and will review comment letters on the proposals, confer with FASB staff, and perform the additional, detailed oversight procedures noted above. Without denying the importance of internal controls over activities involving financial instruments, and assurances that those controls are working, focusing on providing more information related to market risk may be a more appropriate priority for the Commission at this time.

Public Interest Representation on the Auditing Standards Board

See comment 1.

The draft report suggests that the Auditing Standards Board (ASB) of the American Institute of Certified Public Accountants have more members who are knowledgeable of auditing standards but are not public practitioners.

See comment 1.

OCA supports increased user and public participation in all private sector standard setting processes. We recognize the difficulties that the ASB has experienced in attracting qualified, non-practicing individuals to participate on ASB advisory task forces and in keeping such individuals sufficiently knowledgeable of topical auditing and attestation issues. Nonetheless, the ASB should consider the recommendation in the draft report and

[2] Release No. 33-7250, 34-36643, IC-21625, File No. S7-35-95 (December 28, 1995); 61 Federal Register 578 (January 8, 1996).

See comment 5.

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other means of increasing user and public participation in the development of auditing standards.

Impact of International Standard Setting

The potential impact of international standard setting activities, although beyond the scope of the draft report, also significantly may impact the future of accounting and financial reporting. Any consideration given to implementing the GAO observations and suggestions in the draft report should take international activities into account.

Conclusion

The compilation and review of the recommendations to the accounting profession discussed in the draft report and listed in the appendix to that report obviously was a monumental task for the GAO staff. As noted above, OCA appreciates the consideration given in the report and appendix to its comments and views and looks forward to continuing to work with Congress, GAO, the accounting profession, and others, as the issues discussed in the draft report continue to be considered.

Sincerely,

Michael H. Sutton

Michael H. Sutton
Chief Accountant

The following are GAO's comments on the SEC Chief Accountant's letter dated September 5, 1996.

GAO Comments

1. See the "Comments and Our Evaluation" section in chapter 5.

2. See the "Comments and Our Evaluation" section in chapter 2.

3. It should be noted that the examples of reports cited by the SEC's Chief Accountant as having a purpose similar to those required by FDICIA do not provide an opinion on the effectiveness of financial reporting controls as required by FDICIA. The auditors' reports state that no assurance is provided on the internal control structure and that the auditors' reports are based on the consideration of internal controls in determining auditing procedures for the purpose of expressing an opinion on the entities' financial statements. As discussed in chapter 3, this auditing procedure is in accordance with GAAS, but does not result in the auditor reporting on the effectiveness of internal controls. However, the auditor will communicate to the entity internal control weaknesses discovered during the audit.

4. See the "Comments and Our Evaluation" section in chapter 3.

5. Reviewing the status of international standard-setting activities was beyond the scope of our review of the accounting profession's responsiveness to the many recommendations made by major study groups from 1972 through 1995, and to identify any unresolved issues related to those recommendations. We share the SEC Chief Accountant's view of the importance of international accounting standards. However, we do not believe that the status of international accounting standards should become a barrier to improving U.S. accounting standards and related financial reporting. Rather, such improvements should serve to help achieve similar improved international accounting standards and related financial reporting.

6. See the "Comments and Our Evaluation" section in chapter 6.

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