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BY WHOM AND HOW SHOULD ACCOUNTING STANDARDS BE DETERMINED AND IMPLEMENTED?

by
Abraham J. Briloff
Emanuel Saxe Distinguished
Professor of Accounting
Bernard M. Baruch College

and

Robert N. Anthony
Ross Graham Walker
Professor of Management Control
Harvard University
February 27, 1978



[Introductory note: Professor Abraham J. Briloff is Baruch College's Emanuel Saxe Distinguished Professor of Accountancy. He received his B.B.A. ('37) and M.S.Ed. ('41) from Baruch and his Ph.D. ('65) from New York University. His identification with the Baruch faculty began in 1944.

Professor Briloff received his CPA certificate in 1942 and has engaged in the practice of Accountancy continuously since then. He has been a consultant to various Federal and city agencies (presently the U.S. Department of Energy). His writings include "The Effectiveness of Accounting Communication," "Unaccountable Accounting," and "More Debits Than Credits." In addition, he was the coordinator for the principal contributor to the American Institute of CPA's Professional Development course, "Estate Planning and the CPA." He has contributed numerous articles to professional journals. His articles in *The Financial Analysts Journal* have earned him successive Graham and Dodd awards; his writings in *Barron's* have induced important accounting reforms and earned for him the epithets of "accounting gadfly" and "the conscience of the profession." Most recently a Federal District Court Judge noted, "Briloff is the Cassandra of the Accountants."

Professor Briloff has lectured frequently at home and abroad before academic and governmental bodies. He is a Trustee of The City College Student Aid Fund and Honorary Trustee of The Baruch College Fund.]

[Introductory note: Professor Robert N. Anthony's career combines teaching and writing with practice experience in business and government. His home base since 1940 has been the Harvard Business School from which he received M.B.A. and D.B.A. degrees. Currently he is the Ross Graham Walker Professor of Management Control.

He has taught at other schools and management programs on four continents. He is the author of 12 books. His "Management Accounting: Text and Cases," now in its fifth edition, has been translated into several languages.



In 1965-68, he was Assistant Secretary of Defense, Controller. For his work in developing a new management control system in the Department of Defense, he received the Distinguished Leadership Award of the Federal Government Accountants Association and the Department of Defense Distinguished Public Service medal. He is an advisor to the Financial Accounting Standards Board, the Cost Accounting Standards Board, the General Accounting Office, and the Federal Trade Commission. He has testified before a number of Congressional Committees on accounting matters.

Dr. Anthony is a director of Warnaco, Inc., and chairman of its Audit Committee. He is consulting editor to Richard D. Irwin, Inc. He is a Trustee of Colby College and a Past President of the American Accounting Association.

Professor Anthony is joined by Professor Abraham J. Briloff in tonight's lecture.]

Introduction

For some years Financial Accounting Standards have been established by committees or boards organized in the private sector. Since 1972, the standards setting body has been the Financial Accounting Standards Board. Early in the staff of the late Senator Lee Metcalf's Subcommittee released a study that was highly critical of this method of setting standards. It recommended that the standards setting process be removed from the private sector and become the responsibility of a government agency.

Professors Abraham J. Briloff and Robert N. Anthony discuss this issue. Professor Briloff's writings were quoted extensively in the Staff Study. Professor Anthony submitted a statement to the Subcommittee in support of the Financial Accounting Standards Board and critical of Professor Briloff's review.

Extensive hearings on this question were held in 1977, and the Metcalf Subcommittee has issued its report. The topic continues to be current, however. Representative John T. Moss has announced plans for a new set of hearings on it.

DR. ABRAHAM J. BRILOFF

This is for me *an* especially momentous occasion - as me Emanuel Saxe Distinguished Professor delivering an Emanuel Saxe Distinguished Lecture. As many in the audience know the very name of the great Dean has been hallowed in my family for almost a half century -- he stands as our standard of Excellence, by whom we measure our ideals and values. There was a sound of exultation through the house when my mother might announce that Doctor Saxe was on the telephone calling me (and later calling for my sister).

And fully justified is this affection for this *great* person who was for me and countless others for a half century a great teacher. For me, as I have expressed on many an occasion, the great Dean opened wide the vistas of Accountancy; when I came to his classes almost 45 years ago Accountancy was, for me, journeyman bookkeeping. He it was who demonstrated the universality of that discipline - its interface with law, economics, philosophy, communications, in fact no area of man's knowledge is beyond its scope.

I have said all this in part as a sentimental journey for which I do not apologize. But there is yet a further reason, importantly related to the genesis of my participation tonight with Professor Robert N. Anthony in this Sixteenth Saxe Lecture.

Thus, last Spring Professor Anthony submitted a 22-page statement to the Subcommittee on Reports, Accounting and Management of the U.S. Senate's Committee on Governmental Affairs which was then probing "The Accounting Establishment." Of that submission, it turned out that but seven pages pertained to the subject matter of the inquiry; the remaining fifteen represented Professor Anthony's polemical thrust at Professor Briloff. Despite the appeal of the late Senator Lee Metcalf on behalf of the subcommittee that Professor Anthony withdraw those last fifteen pages as being irrelevant, the Distinguished Harvard Business School Professor persisted -- as though he had a contract on me.

Now it does not matter that much that Professor Anthony disagrees with my notions regarding the appropriate accounting practices for research and development costs, oil and gas exploration and production, depreciation, or any of the other areas plaguing the philosophers of our profession. Nor did it especially concern me that, in his submission to the Senate last May Professor Anthony sought to denigrate me as what he called a "Type II Crusader." This is the kind, he said, who "uses...cases as vehicles for calling attention to himself. He is no(t) much concerned with reporting the facts accurately. He shouts. He devises cute phrases. He uses irrelevancies, distortions, non sequiturs, exaggerations and any other device that will help attract an audience. His suggestions for change are superficial and simplistic; indeed, he doesn't really care whether change occurs or not. He takes a tone of moral superiority; a lonely battle against the entrenched forces of evil. His aim is to achieve personal notoriety."

Despite the fact that the professor's obloquy was even more strident than that voiced by the officers of the Reliance Group in their \$37.5 million lawsuit against *Barron's* and myself last year, I did not take umbrage, excepting to write to the Distinguished Harvard Professor that "I am prepared to let history judge." (Nor will I endeavor here to affect that judgement.)

Nor did I, nor do I, especially care that Professor Anthony did not like my proposals for improving corporate accountability in general, through the creation of a Corporate Accountability Commission. I did, however, and do presently, resent his smearing that considered proposal with epithets like "pre war Facist Italy," "the Soviet Union," "Orwell's 1984."

Remember in my opening remarks about a boy from Williamsburg (Brooklyn, not Virginia) whose vista was opened by his great teacher at the then-free City University, and who was privileged to aspire to the American Dream only through the blessings of our Democratic Institutions. Remembering the important sacrifices in material and psychic terms that I was prepared to make, and have made, for the preservation of our Constitutional Liberties; remembering the dedication to the ideals of Mr. Justice William O. Douglas who graced my first published book with a Forward, I resented and resent Professor Anthony's smear. And so it was that in my direct response to him, as well as in my response to the late Senator Metcalf (and published in his committee's hearing record), I expressed my readiness and willingness to engage that professor in an open dialogue regarding the establishment and implementation of accounting standards.

As to whether my proposals ate as good as those that might be contemplated by Professor Anthony is something to be "judged in the market place of ideas."

It is for all these reasons that I stated at the outset, and not as a rhetorical conceit, that this is for me a most momentous occasion.

And so I turn to the exposure of my views regarding the establishment and implementation of accounting standards.

Almost six years ago when addressing a plenary session of the American Accounting Association Convention in Salt Lake City I opted for the tide theme, "It's a Matter of Principle: Accountants' Not Accounting." I am, in essence, committed to that theme this evening.

As most of us here tonight are aware a burning issue with which the Moss and Metcalf Committees wrestled long and arduously related to the question as to whether generally accepted accounting principles ("GAAP") should be determined by the public sector (e.g., the SEC) or left within the private sector (presumably the FASB). For me this is a perfect example of the "excluded middle," i.e., the academic sector. Assuming that there was a need to identify a specific locus for this GAAP-determination process, does not the academic environment present the ideal setting? I nevertheless consider that whole debate to be most sterile.

I am presently of the view that the determination of accounting principles cannot be confined to either the private or public sector. Accounting principles are, in fact, a polyglot; they represent the conglomeration sociology, history, economics, communications, philosophy, law, mathematics, taxation, and accounting converging on itself. In fact it can be seen to represent every conceivable discipline -- certainly every one among the behavioral sciences.

I can see why the Accounting Principles Board ("APB") set out on its quest for certitude, in search of a single rule for each type of accounting transaction. The APB was, after all, reared in the shadows of the Continental Vending trauma. When we reflect on the; history of the APB and more recently of the FASB, we find their determinations to be much in the manner of Procrustes. For example, the *rules* (not standards) promulgated for Research and Development Costs, Foreign Currency Translation, Accounting for Equity Securities, Leases, Restructured Debt, Oil and Gas -- all can be seen to be consistent with this quest for certitude -- a quest destined to be a chimera.

I would, therefore, unshackle the accountants from the bonds of uniformity and leave it to the market place of ideas to judge the quality of the principles in practice.

If we accept the concept of flexibility and alternatives in GAAP we confirm the challenge: Who shall be responsible for choosing the alternatives from the Good Book of GAAP to be applied in a particular context? Are the choices to be made by the independent auditor or shall the responsibility continue with corporate management as at present?

These questions were considered by the Moss and Metcalf committees, they have also been the subject of important deliberation by the American Institute of Certified Public Accountants' Commission on Auditors' Responsibilities (the "Cohen Commission"). I would shift the center for the responsibility for an entity's financial statements from where it is now, namely, in the entity's management, to the independent auditor. I would want him, on the basis of his credentials, his professional responsibility and integrity, to assert that, from the alternatives in GAAP he has determined the options and the particular alternatives that he deemed to be most appropriate and fairest under the circumstances. Note the superlatives "most appropriate" and "fairest."

At present, the words used by the auditor when he "certifies" the financial statements make it appear that this is precisely what he is presently doing; but those of us who are sophisticated know that the words in the auditor's certificate about the statements presenting the financial condition and operations fairly are specious. I am presently urging that this appearance become reality. While our profession usually prefers to gloss over this condition, namely, the auditor's abdication of primary responsibility for the statements, when it suits the profession's purposes the condition is permitted to surface. This usually occurs in the process of litigation, when an accountant is found with his procedures down. It was also emphasized by the then AICPA Chairman Michael Chetkovich when he moved to the defense of the profession in a letter to Senator Sam Nunn, a member of the Metcalf Committee. He-there rationalized the current state of opprobrium directed against the "Accounting Establishment", thus:

It is not surprising that public accountants have been targets of such attention since

they are important to the process of financial disclosure. Much of the criticism has its origins in the misconception that financial statements are prepared by auditors. The preparation of financial statements is the responsibility of management. The auditor's responsibility is to examine them for conformity with generally accepted accounting principles...

I would put the profession's performance where our fees are. In short, to give to the public that for which we are exacting billions of dollars in fees each year.

Nor should the selection of the particular alternatives or options from the book of GAAP be made in an environment of intimacy between the auditor and the client's management. Instead, I would have these determinations made consistent with the "Sunshine Standards" presumed to be applicable in governmental deliberations -they should be "open covenants openly arrived at"; these covenants would then become a matter of public record. Nor would management then be permitted to squeeze a contrived transaction into a particular accounting alternative in order to achieve a preconceived accounting consequence. This "new wine into old bottles" phenomenon should be recognized by the auditor whenever it occurs, and he should thereupon apply a more appropriate, a fairer, alternative -- all to avoid misrepresentations and misapprehensions.

This leads to the recommendations made by the Metcalf Committee based on the testimony of many witnesses during the course of its hearings, namely, that each publicly-owned corporation create an independent audit committee of its board of directors.

I will leave, for the present, the questions, first, just how "outside" are the ostensibly outside directors, and then second to determine just how "independent" are the members of the ostensibly independent audit committee.

In a few instances reviewed by me thus far I find that the terms "outside" and "independent" are essentially terms of art, full of sound and fury but signifying precious little.

I do want to make clear that if really, fully and effectively implemented, a truly independent audit committee could well represent the keystone in the arch of corporate visibility and accountability. This could result from such a committee stemming from the apogee of the "corporate inside" reaching out to the independent auditor, who should stand as the surrogate for the "corporate outside." But then, to the extent this "outside" also includes shareholders as well as all others, the audit committee, derivative from the board of directors, elected by the shareholders, might also be deemed to occupy a role in behalf of the "corporate outside." Hence the keystone metaphor.

If my "let many flowers grow" proposal were to become operative, I would then assign an even higher responsibility to the FASB. Thus, if it is no longer to set standards for *accounting*, I would look to it to oversee the standards of the *accountant*. By this critical shift I mean for the board to proceed diligently to review the accounting alternatives which are being applied in practice, in the particular corporate context, and to ask, "Did the particular auditor then and there apply the best of the alternatives available in the book of GAAP? If not, why not?"

It is this oversight responsibility which should serve to prevent the Greshamizing of accounting principles in practice; to avoid the race for the bottom which might result from auditors competing to accommodate possibly improper proclivities on the part of their clients' management.

I would look to such a resurrected or reoriented FASB to maintain a close and effective liaison with the accounting profession's disciplinary process - all for the purpose of exorcising evil and those who persist in its perpetration.

With particular relevance for the implementation aspect of the evening's dialogue, the American Institute of CPAs last Fall moved anxiously, possibly even in violation of its own bylaws to forestall

Congressional action to enforce some regulatory constraints on the profession.

Thus, Council of the AICPA voted to bifurcate the Institute's membership into a Big League and a Bush League -- the former for firms identified with public corporation audits, the latter for the privates.

For me this would be legitimizing and concretizing the existing power structure of the profession. It would be concentrating the power in those very firms comprising The Accounting Establishment which have, in fact, induced the crisis in confidence and the gap in credibility, which I will be considering presently. This development is sadly remindful of Adlai Stevenson's comment, "This is the first time I have ever heard of a party going into battle under the slogan, "Throw the rascals in.' "

If the past be prologue I predict that this Noble Experiment is destined to fail and to be seen in retrospect as a major PR ploy to forestall governmental intervention.

You are undoubtedly aware that the "forces of destiny" induced me to keep a box score of the actions taken by our most prestigious American Institute of Certified Public Accountants to discipline those of its members who have gone astray. Such actions, as published in the annals of the AICPA (presently in the *CPA Letter*) for the eight-year period, 1970 through 1977, are summarized as follows:

For conviction of bribery	23
For failure to file (or for false filing) of personal returns	22
Because of revocation or suspension of member's certificate by this state-licensing body (where specific reasons not indicated)	21
For conviction of grand larceny, embezzlement, extortion, theft, perjury and corresponding high crimes	14
For conviction of mail fraud	8
For failing to disclose (or for false disclosure) to the SEC or IRS	6
For substandard auditing and reporting	5
For conviction of involvement in the Equity Funding fraud	5
For lack of independence	5
For moral turpitude and other undisclosed crimes	4
For solicitation and advertising	4
For violation of securities laws	3
For fraud on CPA exams or application thereof	2
For refusal to cooperate in grand jury or state investigations	2
For failure to pay for securities	1
For obstructing justice	1
For failure to acquire sufficient information	1
For threatening to inform on client	1
For filing false reports with HUD	1
For inadequate disclosure in footnotes	1

Study these constabulary actions with all your might and you will not find the perpetrators of the *causes celebres*, those who have induced the crisis in confidence or the credibility gap in our profession -- excepting for the inexorable disciplining of those who were convicted of the felonies in Equity Funding and National Student Marketing.

I had occasion recently to write to the head of the Ethics Apparatus at the AICPA inquiring as to the status of the proceedings against the Penn Central auditors -proceedings which I was constrained to initiate precisely seven years ago. His response (which I quote in full): "We continue to maintain an open investigation file on the Penn Central matter since there is still active litigation involving the auditors."

This incident is related with almost sardonic delight; it does illustrate most effectively the basis for my indignation. Thus, a January, 1978, issue of the *CPA Newsletter* devoted more than half a page to a disciplinary action taken by a Trial Board against a member because of acts deemed discreditable to our profession. In view of the space devoted to that action I could not help but presume that the Institute had determined to reconsider the Maurice Stans affair in the light of disclosures before the New York Board of Regents.

Alas! It turned out that our colleague's discreditable acts consisted of his failure to take a CPA improvement course as he had promised to do, and, further, God save the mark, he failed to return a form W-2 to a client.

This, mind you, is the kind of stuff which preoccupies the attention of the mature, sophisticated certified public accountants and lawyers, *et al.*, in our Ethics Division, with a full panoply of committees, trial boards, and the like.

Can you see why I accuse the Division, *et al.*, of acting like the blind guides of Scripture those who "strain at a gnat while swallowing camels"?

The new SEC identified division of the AICPA maintains that it will succeed because it has implanted as its "keystone" a system of peer review.

We have had manifestations of what our colleagues can do if they really want to review the work of their colleagues. Thus, Touche Ross got a good look at Haskins' & Sells' activities at Equity Funding; reciprocally the latter saw what the former was doing at U.S. Financial. Price Waterhouse looked in at what Arthur Andersen did wrong at Mattel; but then Arthur Andersen carried on some postoperative analysis of Arthur Young's activities at Lockheed. Leidesdorf saw what PW failed to do at Gulf. (I don't presently know who did probe or is probing Leidesdorf's involvement in Tidal Marine International Corp.)

Now then, having found these aberrations, did our colleagues do that which, in my view, the AICPA Code of Professional Ethics requires of them, namely, to initiate a disciplinary action against the malefactors? If they did I don't know of it -- in any event, the published bans do not reveal any action by the awesome disciplinarians in the AICPA Ethics Division.

Nor has the SEC earned my unqualified approbation. True, it has brought to the fore some of the perversity perpetrated by the giants in our midst -- Touche Ross, Haskins & Sells, Price Waterhouse and Peat Marwick Mitchell. It has also reached several in the second tier of the profession's hierarchy. But even in thus reaching out the SEC has moved only in the way in which porcupines are reputed to make love -- very gingerly.

In this regard, let me recite for you what I believe to be only the most recent glaring manifestation of the SEC's lack of forthrightness.

In July, 1975 the Commission promulgated its monumental Accounting Series Release Number 173 exposing the actions of Peat Marwick Mitchell in no fewer than five major fiascoes: Penn Central, National Student Marketing, Republic National Life, Tally Industries and Stirling Homex.

For these transgressions PMM was prohibited, for a brief period, from taking on some new public clients and was constrained to expose some of its mode of conduct to a special review committee (one acceptable to the firm and the SEC). In addition the firm had to consent to decrees of the court enjoining it from violating the Securities Laws again in the future.

So it was that in mid-1975 the firm was subjected to an elaborate tongue lashing, made to do some brief penance and to foreswear future violations. Significantly the firm obtained a clean bill of health from one of its peers, Arthur Young & Company in late 1975, and a limited clear bill from the special review panel.

But lo!! Just last fall the SEC filed a complaint against Sharon Steel Corporation, its holding company (NVF) and several individuals, especially Victor Posner, alleging a catalogue of corporate and individual misconduct (e.g., using assets of public corporations as though they were those of a strictly private fiefdom). Aside from these enormous perquisites which apparently escaped the auditor's attention, SEC complaint spelled out the following distortions in the audited financial statements of Sharon Steel:

In 1975, Sharon reported \$25,520,000 pretax earnings, \$13,878,000 of which earnings were overstated because of a number of improper accounting devices used by Sharon...

Among these improper accounting devices, we are told, were:

In 1975 approximately \$7,050,000 of Sharon's pre-tax earnings were properly attributable to Sharon's 1974 earnings...

In 1975 Sharon improperly revalued virtually its entire iron ore inventory, by creating a certain type of iron ore pellet (called ITPV)... This device created \$4,929,000 in 1975 pre-tax earnings... and added approximately 40% to Sharon's actual 1975 pre-tax earnings of under \$12,000,000...

There were further allegations of "Misrecording of Iron Scrap Inventories," "Recording 1976 sales as -1975 sales," and several other categories of the fouling of GAAP and GAAS in Sharon's audited financial statements for 1975.

That reference in the SEC complaint to the Inventory hoax is especially intriguing -- it may be worth our consideration for a few minutes.

Sharon, like most steel companies, has been maintaining its iron ore inventories on a LIFO basis. Consequently, these stocks are carried on their balance sheets at debased, historical costs.

Assume now that Sharon had three piles of such ores labeled, respectively, as "L," "S." and "D" -- each with a LIFO carrying value of \$1 million.

Alchemist Posner takes the three piles (all having a consistent metallurgy) and combines them, and Abracadabra! He says he has a new product. This being a new product he puts an \$8 million price tag on it, and into the 1975 closing inventory it goes with that number, producing a \$5 million hypo for that year's income.

Why, it's so deceptively and cleverly simple -- one wonders why it isn't done each day.

And now, it should be noted, that among those who saw and were bedazzled by the Posner Alchemy

(according to an opinion by Federal District Judge C. F. Poole of California) were "members of (Sharon's) outside accountant staff." The court branded the 1975 financial statements as "at best the cultivated product of questionable fluctuations and self serving maneuvering of accounting procedures." This, he said, was perpetrated "with some concurrence of respected outside accountants."

And here it must be told, Sharon's "respected outside accountants" for 1975 happened to be, you guessed it, Peat Marwick Mitchell & Co. Now, mind you, that 1975 audit was performed after PMM had been inculcated in ASR 173, pleaded *mea culpa* and promised to mend its ways (and, it might be added, after AY earned its more than a half million for its PMM peer review and its "A-OK" published seal of approval).

If it had been PMM which "blew the whistle" on its client after it discovered the ways in which it "had been had" I might manifest some compassion. Instead, it would appear from a *Business Week* article this mare's nest was uncovered by Haskins & Sells -- and not because the firm was engaged in a *pro bono* expedition. Instead, H & S's client, Foremost-McKesson & Robbins was being threatened by a take-over by Sharon. Since Foremost chose not to fall into the Posner empire it had its auditors do a review of the Sharon accountings -- and lo!! while much of the detailed evidence is still under a court order of confidentiality, enough has surfaced to demonstrate the ineptness and/or scienster on the part of PMM. (It was in a proceeding brought by Foremost to enjoin Sharon from proceeding with the take-over that Judge Pool made the foregoing pronouncements.)

For these and other reasons I share the judgment of the former Chief Accountant of the SEC, Professor John C. Burton, who testified at the beginning of this month before the Moss Committee, thus:

Unfortunately, I do not believe that the new divisional structure is adequate to provide either effective surveillance over accounting practice or the institutional stability required by the profession. While it is a significant step forward compared to the previous efforts by the AICPA at professional discipline and many of its characteristics may be utilized in the development of an effective system of professional self regulation, in the final analysis I believe that the AICPA system as a whole must be characterized as insufficient.

Why does he despair for the contemplated AICPA - PR (i.e. peer review) apparatus? His "point 3":

In addition to the legal problems associated with a private surveillance mechanism, there are serious problems of public perception which will exist. The AICPA program, under which major accounting firms will review each other, is likely to be seen as a process of mutual back-scratching. While a prestigious group of persons will be gathered to serve as a Public Oversight Board, it is highly doubtful that a part time group can either in fact or perception provide "an effective substitute for statutory regulation" as the AICPA contends.

It now appears that the Arrogance of Power (or is it the Power of Arrogance?). Who is it that turns up as the Chairman of the Executive Committee of the SEC-1st division of the AICPA? You guessed it -- the \$800,000 a year managing partner of PMM. And this, mind you, when one of his partners is slated to be the next Chairman of the AICPA as a whole.

When he was challenged at the hearings of Congressman Moss's Oversight and Investigations Committee on this potential concentration of power in a single firm, the managing partner responded that if that is what the fates should decree he was prepared to accept his destiny. O tempore! O mores!

I turn, finally to the proposal I advanced in my *More Debits Than Credits* which induced Professor Anthony's invective against me, his assertions that the proposal was remindful of Communism, Facism and Orwell's 1984. Thus, I proposed a Corporate Accountability Commission. In that connection I stated:

Coming within the ambit of such a commission would be the coordination and possibly even the

overseeing of functions presently housed in the Securities and Exchange Commission, Federal Trade Commission, General Accounting Office, agencies responsible for a particular industry or nexus of industries (Interstate Commerce Commission, Federal Communications Commission, Federal Power Commission, Civil Aeronautics Board, Cost Accounting Standards Board, and even the Comptroller of the Currency and the Federal Deposit Insurance Corporation). The Internal Revenue Service might be included to the extent that its functions impact upon or relate directly to the principal responsibilities of such a Corporate Accountability Commission.

Would that I could see what there is in that proposal to cause Professor Anthony's nightmares of Red Shirts and Black Shirts.

Significantly, as I made clear in that very context, my proposal was inspired by an article by my friend Professor William Cary, who now turns up as one of the 51,000 a day overseers of the SEC-1st division of the AICPA.

Frankly I see my proposal as entirely consistent with the Constitutional process of checks and balances. I do not see the proposed Corporate Accountability Commission as being more Communistic or Facistic or Orwellian than, say, the Federal Reserve Board of Governors.

It may well be that, from the vantage of the present, I might have proposed, instead, a Joint Congressional Committee constituted, say, by Congressman Moss's committee and that of the late Senator Lee Metcalf, the Subcommittee on Reports, Accounting and Management.

And the intervening two years since *More Debits Than Credits* was published have, if anything, added emphasis to the need for such a commission or a committee.

Thus, if a G. William Miller or a Bert Lance is not fit to exert power in the government sector, should he be permitted to do so in the public corporation sector -- at least before he has demonstrated his credentials openly, fully and forthrightly, and subjected them to the process of cross examination?

Should the managing partner of an accounting firm plagued by major fiascos during the recent past be permitted to move into a position of enormous power in the corporate sector without being made to respond, openly and on the record, as to where he should have been?

In successive disclosures we have learned about the International Telephone & Telegraph Corporation, how its counsel and prestigious financial advisors cuckolded the Internal Revenue Service, the Securities and Exchange Commission and how its perfidious conduct reached to the very highest levels of the Justice Department of our Nation -- even forgetting for the present its intrigue in the affairs of other Nations. I would expect such a Corporate Accountability Commission to question whether those executives, etc., should be permitted to retain their positions of power in the executive suite.

I would expect such a commission to challenge the right of a convicted felon to sit at the head of a giant corporation in our military and industrial establishment. After all, if there are constraints on heads of labor unions, pension funds and security firms, should a giant corporation be sacrosanct?

The commission envisaged by me might also be charged with the responsibility

for confirming persons aspiring for the: Financial Accounting: Standards Board and/or the newly conceived Public Review Board for the SEC-1st Division of the AICPA.

Why these strident notes? Essentially because the modern corporation is an enormous power complex -- impacting critically on the economic, social, political, moral, legal, cultural in fact, every conceivable aspect -- of our existence. As a consequence the conduct of these corporations is too critical to be left to the flowering of their bottom lines.

Remember Lord Acton's dictum: Power corrupts and absolute power corrupts absolutely. Add to that the wisdom derivative from the Oval Room: Power exercised insidiously corrupts insidiously.

I do not pretend to have all the answers, certainly not the ultimate answer. Because the issues are so compellingly urgent, I wrote to Professor Anthony and the late Senator Metcalf last Spring that I would welcome a free and open dialogue with that professor -- in Washington, Boston or here. It is, indeed, a very special privilege that the dialogue occurs as an Emanuel Saxe Distinguished Lecture.

DR. ROBERT N. ANTHONY

Last October when Abe spoke at my school, I was not able to be present at his meeting. I'm very glad that finally we can share the same platform.

I want to make one thing very clear at the beginning. I certainly am not attacking Briloff as a person; I am attacking Briloff's ideas. The distinction which he made at the beginning of his remarks is an important one. Abe and I have met before and carried on a conversation without coming to blows, and I trust it will always be that way.

When I said that his proposal was a fascist proposal I wasn't name calling; I meant that literally. In Fascist Italy, in the days of Mussolini, there was a large governmental agency that had supreme authority over business companies. It laid down detailed rules as to how businesses should operate, and it had power to enforce those rules. I consider that agency one important feature of the system that we call Facism.

Abe says that in the next portion of this debate he will tell you about his corporate accountability commission. Let me tell you about it now. I will quote from the proposal that he made both to the Moss Committee and to the Metcalf Staff. You can judge for yourself whether this fits the description of fascism as you understand it. "I propose the establishment by Congress of the Corporate Accountability Commission. Such a Commission's mandate would include the responsibility for studying, determining, and promulgating standards pertaining to corporate morality, anti-trust and monopoly aspects, accounting, accountability, and corporate tax policy, on a national and multi-national scale. Coming within its scope would be the coordination, and possibly even the overseeing of functions presently performed by the SEC, the Federal Trade Commission, the General Accounting Office, [and a long list of government agencies that regulate various parts of our economy]. The Internal Revenue Service might be included to the extent that its functions impact on or relate directly to the principal responsibilities. I would look to the Corporate Accountability Commission to establish procedures for disciplining and even ostracizing persons identified with any of the professions charged with a public responsibility. In addition, I would look to such a commission to professionalize corporate responsibility and to act about those who may have violated the established standards of conduct appropriate for their positions. It may even be that the role of such a commission would embrace a judicial function. Such an extension might take the right of a trade court."

In short, what Abe proposes is a body which is going to set rules for all businesses, enforce these rules, and operate a judicial system. He includes, within the purview of this system, not only accountants, which was the initial subject of the hearings, but also management and directors. If they don't live up to the rules that the commission lays down, they get punished. I submit that it is not an exaggeration to call this a fascist proposal.

Our topic is supposed to be, "Who sets accounting standards?" I think therefore we should rule out all discussion about sins that may exist in the practice of accounting; whether Sharon Steel did or did not, in a particular instance, use appropriate accounting; whether Peat, Marwick, Mitchell did or did not exercise proper diligence in finding out what Sharon Steel did, and so on. These are important questions, but they are not the questions that we are supposed to be discussing tonight. We are

discussing the question "Who sets the standards that govern the accounting numbers that appear on these financial statements?" No matter who sets the standards or how they are set, we all know there are going to be people who do not adhere to the standards. There are embezzlers in banking, there are quacks in medicine, there are people who give a bad name to any profession. Their existence does not mean that we should change the laws of embezzlement or that we shouldn't do the best we can to improve the practice of medicine. Standard setting is a different matter than standard enforcement.

My position is that accounting standards should be set by a private sector body, specifically the Financial Accounting Standards Board. I thought that Abe's position was that his corporate accountability commission, a government agency, would set the standards, and the quote that I read indicated to me that that's what he had in mind

Although Abe may clarify what he has in mind when his turn comes again, I guess from what he said in his opening remarks, this is not his present position. Rather, his remarks were principally addressed to the question, "Do we need accounting standards at all?" The general premise since the 1960s has been: yes, there should be some body that develops a general framework of accounting. Without such a body, it is unlikely that we will get financial statements from individual companies that will be comprehensible to those who use them. The argument about whether there should be such a body was quite hot in the 1960s. There were those that felt, as I gather Abe feels, that there should not be a standards setting body, that we should leave it up to the judgment of the management of individual companies to record in the financial statements the situation as they saw it, using whatever practices they thought appropriate.

It was decided, somewhere in the 1960s, that this laissez-faire approach wouldn't work. It simply resulted in too much diversity of practice, too much misunderstanding on the part of the public. There needed to be a common set of ground rules. There have been attempts by the private sector to develop this common set of ground rules. The first two attempts made some progress, but not enough to satisfy most of us. In 1973, the then existing body, the Accounting Principles Board, went out of business, and the Financial Accounting Standards Board came in. Along about that same time, the American Institute of Certified Public

Accountants adopted its Rule 203 which said that a public accountant should abide by the principles that the authoritative bodies laid down, and that if a company they audited did not do so, the public accountants were required to call attention to the departure and qualify their opinions accordingly.

This was a very controversial action. At the time, a great many people felt that this placed the accounting profession in a straight jacket. They preferred to let the accountant look at the situation, call the shots as he saw them, and thus prepare the annual report. I think Abe is saying that we should go back to this approach to auditing. He said "let many flowers grow," let the auditors in a given situation record the facts as they see them. I may be wrong in this, but if this is what he means, it seems to me the results are likely to be quite different than what he has in mind. I have an analysis of all the standards that have been adopted by the Financial Accounting Standards Board, and I'll take the simplest one to try to illustrate the point that I'm going to make. It happens to be one on which I think Abe has a fairly firm view, Financial Accounting Statement #2, Accounting for Research and Development Costs.

Now the Financial Accounting Standards Board said that by and large you must expense research and development costs in the year in which they were incurred, rather than capitalizing these costs and charging them off over the life of the products that result from the research and development process. This tabulation shows how various people felt about this proposal as evidenced by the comments they made to the FASB when it was being considered. Three academicians agreed with-the FASB, eleven did not. Six major accounting firms agreed, three did not. Thirty-four businesses agreed, seventeen did not. Now, I'm not trying to say who is right and who is wrong in this controversy about research and development costs. I am trying to say that if we adopt the philosophy of "let many flowers bloom," then we are going to see the diversity that's indicated in these comments reflected in annual statements, even

though This diversity does not reflect any difference in the underlying situations in the companies that these annual statements report on. They will reflect, strictly, differences of opinions of the people responsible for preparing these statements. So we would expect that some companies would capitalize research and development costs, and other companies would not. Or some auditing firms would have as a firm policy, capitalize research and development costs; other firms would say, don't capitalize research and development costs.

Now I submit that There is no immutable truth about research and development costs. As in all tough accounting questions, there is support on both sides. The FASB hears arguments, and having done so, it tries to come up with a principle that seems to be the most appropriate, all things considered. For research and development costs, the issue was straightforward and clear. On the one hand, there is no doubt that research and development costs conceptually do benefit future periods. That is the only reason you'd spend the money, to produce products that are going to produce revenue in future periods. But on the other hand, the amount of benefit to the future period is uncertain. And so the Financial Accounting Standards Board, weighing those essentially two arguments, decided, "we think the uncertainty of making judgment outweighs the benefit of trying to spread the cost over future periods. We are going to lay down a standard saying, don't do it, charge it to expense."

I think that this process is the best way of reducing the amount of diversity in financial statements. I think there's an implication if auditors were only to go in and call the shots as they saw them, that all of a sudden truth would emerge, and we would have financial statements that unequivocally told the truth about these companies. There's no such thing as absolute truth or being right about a great many of these points, and it is essentially for that reason that we need a set of standards that somebody should put down and agree to.

I will not give in any depth my reasons for concluding that the Financial Accounting Standards Board is the best body to do this job. Originally, I intended to do so because I thought, based on the quotations that I read to you, that Abe's position was that the government should set accounting standards. Let me just say briefly that the Financial Accounting Standards Board is well equipped for the job and that it has already demonstrated an ability to do the job better than any government agency that has tried it. It has done far more work, and on far tougher problems, than its nearest analog, the Cost Accounting Standards Board. It has a very competent staff, and I assure you that it is extremely difficult to find people who are interested in sitting down and thinking through the problems involved in developing accounting concepts and standards.

The FASB has set up a procedure that is well designed to elicit everybody's views on the topics it has on its agenda. It sends out, first, a discussion memorandum that lists the pros and cons on the issues. People are encouraged to respond to that memorandum, either in writing, in testimony at open hearings, or both. Many do so. They may criticize the discussion memorandum, they may agree with some of its points, or they may disregard it and give their own ideas on the topic. All of this grist goes into the mill. The Board considers it and then issues an exposure draft, which gives the board's tentative conclusions on this particular issue. Tens of thousands of copies of this draft are sent around for people to comment on. These comments come back, and the Board considers them. Its staff has an intricate, good mechanism for summarizing these comments and arranging them in such a way that they are useful to the Board. Board members use these points for arguments among themselves and finally reach a conclusion. I don't think that the government is likely to set up a procedure that can match this one for eliciting and analyzing pro and con arguments on a particular issue.

Abe has one other part to his proposal as I understand it. The main part is, "Let many flowers grow,)' let the accounting firms use whatever standards they prefer in reporting the results in a given company. The second part of his new proposal would be that the work of the auditors would be checked by the audit committee of the company's board of directors. He made some comments that indicated that he didn't think audit committees as currently constituted were actually to be trusted. I assume he didn't mean a personal reference to me with that conclusion.

I am the chairman of an audit committee of a listed, fairly large company. I assure you we're independent. I assure you that we meet with our public accounting firm privately, without the presence of anyone in management, and instruct them to let us know if there's anybody holding things back from them, or if they are not getting complete cooperation, or if there's anything they think needs to be communicated to the audit committee. They should tell us, and if they don't tell us and we find out that there is some deficiency, they're through. We make this point pretty firmly, and I think it's effective.

We have the same private meeting with the chief of internal auditing in this company, and we tell him, without his being in the presence of any of the management, to let us know if he doesn't have full freedom to get what he wants, and to report to the audit committee anything that we should know.

I think we are independent, but I think we are completely ill equipped to go through the accounts and decide, say, how the company should account for research and development costs. This is an example of perhaps a hundred different accounting issues that have to be decided in the course of a year. Although I happen to have done a fair amount of work in accounting, I have neither the time nor the inclination to go into this detail. I don't think you can expect that the average chairman of the ten thousand audit committees would have the necessary amount of background on these various accounting issues.

The final part of Abe's proposal, as I understand it, is that he would have the Financial Accounting Standards Board, instead of setting the standards, review the financial statements of the companies, raise penetrating questions about them, ascertain if these statements really do present the situation fairly, and take corrective action if the public accounting firm does not do this. Even if the Standards Board restricted itself only to the ten thousand SEC companies, and disregarded the three million other entities that prepare financial statements, it seems completely obvious that thus is a completely unrealistic proposal. It takes a partner, perhaps several partners, in a public accounting firm several weeks to arrive at the conclusions about the adequacy and fairness of the financial statements of one company. I can't imagine a Financial Accounting Standards Board large enough to devote that number of man-weeks to each of these companies.

So I think that the notion of "let every flower grow" is not a viable notion, that we must have standards, that we crossed that bridge about ten years ago and decided that we must have standards, and that the real argument, if there is one, comes on the question of who should set these standards, the government or the private sector, as represented by the Financial Accounting Standards Board. I think the evidence is strong, that the Financial Accounting Standards Board is the best equipped body and that in its brief life it has already shown an excellent promise of carrying this process on in the future. I look forward to the next opportunity to discuss this question.

REBUTTAL

Briloff:

Thanks, Bob. I particularly appreciate what Professor Anthony did. He saved me about seven minutes out of the ten that I have allotted to me; it was he who read to you that which I had set forth in my *More Debits Than Credits* regarding my concept of the corporate accountability commission.

Let me first try to disabuse you of some nonsensical aspects suggested by Professor Anthony. First, when the auditor, as envisioned by me, would be moving in to promulgate the financial statements to be as fair as he sees the fair, he would not just be going in there with a *carte blanche*, with a blank canvas, without having the total body of knowledge that has evolved over time. I expect him to proceed with a proper respect for our profession's traditions. When the judge ascends to the bench in order to mete out justice he does not come up there with a blank tablet ready to do that which he feels is appropriate and consistent with what he sees as being appropriate -- whether he be a Torquimada or some compassionate sentimentalist. So it is that when the auditor goes in there he is not going to be creating the body of knowledge or the Book of Accounting Standards all over the lot.

Second, what about the epithets, "Soviet Union" and "prewar Italy" and "Orwell 1984" included in the public record by Professor Anthony and the published record of the U.S. Senate? It is true the Type I -- Type II paragraph that was read was expurgated by Professor Anthony after being coaxed, urged, petitioned and pleaded to by the late Senator Metcalf to abort the entire segment regarding Briloff. Nevertheless, Professor Anthony manifested that when a Harvard Professor becomes an irresistible force, even the Senate of the United States is not an immovable object. Therefore, despite the pleading letter to remove the Briloff allegations, Professor Anthony persisted, and, yes, the reference to Type II and Type I was deleted. (Anyone that wants the full unexpurgated record of the dialogue between Professor Anthony and the Congress, I have a copy here.) But, again, tossing the epithet pre-war Fascist Italy to any recommendation and proposal that I might make in 1976 or 77 or 78 is an absurd, denigration, and a perversion. Is there a Constitution in the Soviet Union? Was there a Constitution in pre-war Fascist Italy protecting due process? Would my corporate accountability commission be mandated by some demagogue? Was it not going to be created by Congress, with all of the constitutional liberties that are there? And so it is that you (Professor Anthony) go and repeat those phrases. And that you then seek, at this particular juncture, to rationalize them is the ultimate of indignity. As I said, I resented them before, and resent now only that particular aspect of your polemic to the Senate.

We return to the Research and Development Accounting issue where Professor Anthony tells you the Financial Accounting Standards Board determined to hand down Solomonic Wisdom, whether to permit the capitalization of R & D off into the future, or to write it off presently and immediately. They decided to move towards the conservative conclusion -- and who can damn conservatism, particularly where, with Research and Development there is uncertainty? As Professor Anthony knows, the fault with respect to R & D lay in that old cliché that we used to recite when we taught this subject! Those who might, and possibly should, defer R & D will not. Their profits are so enormous they prefer not to add to them. Those who should not, because the whole thing is going to pot, will be deferring the cost to buttress their earnings. So it was because of the misapplication of a standard, or alternative standards, that brought us to that critical pass.

Now Professor Anthony preferred to spend his half hour or so talking about the setting of standards, saying that the implementation thereof isn't the topic. Professor Anthony apparently didn't read the program "How and by whom should accounting standards be determined and implemented?" I want to go back to five years ago, almost six, when I was privileged to deliver a plenary session address at the American Accounting Association convention in Salt Lake City. The title theme there was, "It's a Matter of Principle," I then added, "Accountants Not Accounting." Professor Anthony might go back and read that presentation; he will see that I expressed the same lament then that I make now. It's not an anxiety about whether the debits are to the left or the credits to the right or so on -- it is instead, with the very soul and conscience of our profession. And when we read the first column of today's (February 27, 1978) *Times* financial section, with respect to the enormous numbers and the enormous amounts of bribes, illegal and improper payments, you can see that my emphasis on the conscience of the profession is not misplaced.

You set up a straw man of what goes on in your (Professor Anthony's) particular audit committee when, in fact, I was talking about a standard for independent audit committees. This is, again, an unfair response. I ask you to join with me in common cause -- instead of rationalizing your audit committee, let us move toward the setting of standards for the effective implementation of the Metcalf Committee recommendations on this score at least.

With respect to the Financial Accounting Standards Board and the setting of standards, let's go back to R & D. Can't you (Professor Anthony) conceive of instances where an R & D expenditure might very well be considered to be a capital-budgeting decision -- with the same kind of uncertainty that's implicit in a capital-budgeting decision generally? Where you do have to get experts to see whether there is the contemplated cash flow off into the future, and conceivably discounted to the present? All I'm asking is

that you apply the same parameters, the same assumptions, to R & D that you might apply to an insurance situation. Possibly even more appropriately applied to the motion picture industry, where you might have whole pool of pictures that are created and put into exhibition, and where you don't know where they will or won't pay off. They may "bomb out" or they may be enormous successes. One doesn't know whether it's a "Star War" or destined to generate as much box office excitement as an accounting dialogue. Do you not see that R & D is a capital budgeting decision, requiring the same kind of conscientious insights? Now you tell me where the Financial Accounting Standards Board has set a standard -- a standard by which to judge good or bad, rather than a rule, -very much like a ball game.

Let me give you a standard as FASB conceives a standard. It has to do with Restructured Debt. That's a beauty; I have referred to this one as a manifestation of a deathwish by the Financial Accounting Standard Board. Just get this: A bank made, some years back, let's say a 100 million dollar loan to third-world nation. The nation gets into serious financial difficulties. The bank, therefore, "restructures" the debt. The 100 million dollar loan called for a 10 percent interest rate, and it was supposed to have been paid off in ten years. Well the bank, in view of the financial straits of the borrower, agrees that they are going to forgive half of the loan (wipe 50 million dollars off the loan); they are going to reduce the interest from 10 per cent to 5. In addition the loan is to be paid off in 20 years rather than the original 10. Note the three changes; 100 million down to 50; interest from 10 percent down to 5: the repayment from 10 years to 20. If you put the arithmetic together, Professor Anthony, you'll find that this bank has not had to take any write-down with respect to that loan. Why? Because when you add the \$50 million that is still left, plus the 5 percent of annual interest multiplied by the 20 years still to go -- you put the two of them together, including the 20 year run-off into the future, and it adds up to a 100 million dollars. The bank will give this absurd arithmetic to the auditor, the auditor will match it against the Financial Accounting Standards Board Statement No. 15, and declare, "Yes, it's going to equal 100 million dollars. God's in heaven, all's right with the world." If you believe Professor Anthony the Financial Accounting Standards Board has promulgated wisdom.

And I notice that you, Professor Anthony, with your wisdom intact, have wisely ignored Financial Accounting Standards Board Statement #8, with respect to Foreign Currency Translation. And just see some of the rhubarbs that are coming through in that regard. An interesting example, IT&T announced that they had lost a bundle, I forget whether it's a 100 million dollars, in the fourth quarter of 1977 - because of foreign currency conversion and translation and the like; but then, they said, "Don't worry," - and correctly so. They said, "Don't worry, we're going to make all of it up in the next quarter" Why? Because at the end of the fourth quarter the company may have borrowed, and in the next quarter sold that which was bought with the borrowed funds. Show a loss here and a profit there -- it all adds up to zero. Alice in Wonderland would have equivalent rules.

Now to go back to the Corporate Accountability Commission, and to get down to the bottom line, I said early in my remarks, our corporate complexes are concentrations of power. It is important that this power be exercised for the good.

And when I read in successive disclosures about the way in which, let us say, AT&T Corporation, not your corporation Professor Anthony, but ITT, was able to cuckold, hoodwink, and distort and confuse and betray the Securities and, Exchange Commission on the one hand, and the Internal Revenue Service on the other,-and then as we read most recently the disclosures from the Watergate Special Prosecutor of the way in which that one corporation was able to prostitute not only one Attorney General but successive Attorney Generals of the United States, Assistant Attorney Generals, and where these persons in the hierarchy of that corporation, and their financial advisors, still continue as though they are as clean as new blown snow of several weeks ago. Is this not something that gives you concern? Are you not concerned when a convicted felon remains as head of let us say, the Northrup Corporation? Do you not share with me the view that if a Mr. Lance or a Mr. Miller say, were not entitled to sit in a position in the public sector, he should be denied the opportunity of being in a position of the highest management and power of a major corporation?

Anthony:

I'll be very brief. First, I'm not going to talk anymore about Fascism. You can think about the quotations I read earlier and make up your own mind whether it is or is not a Fascist proposal. I think it is. Second, Abe says the auditors are not going to create standards. That leads to the question: then who is? We are then back to the question that I thought we were supposed to focus on. I take it from the examples that Abe just gave about research and development, restructured debt, and foreign currency measurement, that on each of these topics he had ideas of his own and that if he were the auditor he would act according to those ideas. I'm sure he does recognize that well informed and well intentioned people may have *different* ideas about each of these topics. If you have people with different ideas facing these same problems, they're going to come up with different answers.

I tried quickly to run through the FASB statistics and count the number of alternatives that were favored by respondents on accounting for foreign currency. Out of all the respondents, only 14 people supported the FASB position. On the table I am looking at, there are seven other columns, listing alternatives that people supported in far greater numbers. I won't take the time to read them. Obviously, these were sincerely felt beliefs, and they come from people who, if they audited the books, would reflect those beliefs. The resulting financial statements would be in their opinion the fairest way to present the results of foreign currency exchange transactions. I submit that this is an intolerable situation. It leads to a bewildering variety of financial statements derived from sincerely held, but divergent, beliefs. Therefore we come back to where I think we started. We have got to have standards. The FASB is the best organization to set them. We have time, I hope now for some questions.

QUESTIONS AND ANSWERS

Question:

With respect to accounting standards and those people who are in the accounting profession, can't we identify two different constraints which deter unethical practices: (1) the severity of the punishment, and (2) the certainty that the sinner will be censored by the profession and by public opinion?

Anthony:

That's a difficult question. We are in the fact members of a profession, and in a profession there really isn't such a thing as certainty. Certainty means that there is a set of precise rules. If the rule says drive 55 miles an hour, and you drive 60 miles an hour, you have broken that rule. There's no question about it. Accounting isn't like that. In accounting there is a set of general standards or guidelines. But judgment is required in how you apply those guidelines. I think that's why certainty is just not appropriate for this situation.

Question:

Professor Anthony, a great many of the practitioners that I know do not think that the FASB has demonstrated that it has done an excellent job. Most of the people I know believe that the FASB has been unduly concerned with the viewpoint of public corporations, of large accounting firms, and the audit of public corporations. In the setting of standards my question really relates to whether there should also be an appeal process. Is there any kind of method by which there might be an appeal against the general attitude of the FASB? I might point out in this respect, that the SEC distinguishes between small and large companies, between public corporations and non-public corporations. The FASB does not. It is difficult for me to imagine that Congress would not give a more sympathetic ear to the problems of non-public corporations and of smaller corporations than the FASB has shown.

Anthony:

As to the small GAAP, big GAAP problem, as you perhaps know the FASB currently is considering this matter. I think they made a mistake, frankly, in the specificity of their standards. If they had written their statements at the broad level of what are truly standards, they would have been broad enough so that they should apply to everybody. But they didn't do this. In a few instances, they got down to a

lower, more specific level than what I would call standards. And having done so, they have placed requirements on small companies, I think that are onerous for those companies. I think that some people in the FASB feel the same way, and that is why they have what's called the big GAAP, small GAAP study currently. (GAAP means generally accepted accounting principles.) My guess is that the calculation of earnings per share is not going to be required for privately held companies. It's an involved calculation which doesn't amount to anything for those companies, and I think that's the sort of thing you had in mind.

As for the appeal process, I think that's another procedure that is down the road. The FASB is very mindful of the impact of its work. It has two studies on this topic going on right now, one of them on the foreign currency matter. They will try to determine what the impact has been, whether it has been on the whole beneficial. The FASB is willing to reconsider the topic based on the results of those studies. That's sort of an appeal process. I would expect that as time goes on, there will be an increase in reexaminations of the conclusions that the FASB has arrived at.

Briloff:

May I just add one or two further remarks to that? I know the question is not directed towards me. I would say that with respect to small enterprise, in view of the fact that the universe to which those statements will be going, creditor, generally of relatively substantial amounts who are presumed to have sufficient sophistication to be able to understand to judge those data, Internal Revenue possibly, bankers as well, I believe all the more intensely that this idea of "letting many flowers grow" is peculiarly responsive. Thus, the auditor there, first of all knows his reputation is on the line as to what he's doing. He practically can assure the certainty that if he "fouls his nest" the Institute's Establishment would be on his neck peremptorily; he can be assured of professional discipline. Why? Because there are creditors looking on very, very directly and forthrightly -- these creditors are not dispersed among the multitudes. Therefore for example, if it has to do with Research and Development, or Leases, or Foreign Currency, and the auditor, in good conscience, proceeding in accordance with "open covenant openly arrived at", capable of demonstrating clearly why and how he came to those conclusions with independence and integrity, I would say he is fulfilling very objective of our professional responsibility. This going in the manner of Procrustes, based on what seven people in Stamford determined to do is, to my mind, leading to absurdity in too many instances.

Question:

This question is directed to Professor Briloff. If I can just summarize what I feel are the two views here I think Professor Anthony is saying that we have to set standards. And if we can use the analogy that was brought up before of the speed limit, I think that Professor Anthony is saying one, that speed limits should be set at 50 or 60 and let the FASB set the precise limit. Professor Briloff, on the other hand, claims that no, let each auditor set a safe and reasonable speed limit. Now, there are two problems with this. - We could probably all agree that someone driving 20 miles per hour on a super highway is not going too fast. We could also agree that someone going 150 miles per hour is going too fast. But if he was doing 70 you'd then like to judge him ex post and say, Professor Briloff feels that 40 would have been reasonable given the conditions. And so you are judging him without telling him what the standard is. I think this is very problematic. The Sharon Steel example that you quoted is very interesting. You objected to the fact that they had inventories which were being valued at an unrealistically low value and they were upvaluing it by 5 million dollars to what is a more realistic value. Here they were presenting what they could claim is a very fair and true picture and yet you say, well, this is unfair because it violates the rules. So, in your own example you recognize the importance of those rules in determining whether something is fair.

Briloff:

Well, first of all, let's try to strip away some of the rather specious observations. To begin with, let's say if you were to have someone pontificating from on high, and say the speed limit is 55, and you had that 55 on a country road, one possibly leading to a creek -- I think you could see that that kind of a rule applied for small and large, single lane dirt roads and super highways is clearly an absurdity. But yet

ironically this is what the FASB is doing. Second, we're not talking here of a rule, we're talking of a *standard*. And whether it's a standard of history, philosophy, law, religion, you can't put it down in a single phrase and say this is an absolute, inexorable truth. These standards evolve out of time, out of the totality of our Being. I use the term "Weltanschauung" for the persons who are supposed to be involved and committed to it. These standards of law and history, morality, ethics are evolved from the total process of our existence. It cannot be defined categorically and anyone who presumes to this certitude is again trying to lead us down the primrose path.

But I believe the most unfortunate implication of your remarks, of your question, and I say this not critically, instead I want to pick it up on a very positive tone, is that we are not talking here of drivers who for 10 dollars, or whatever the fee is, can get a driver's license, or as the saying goes, possibly get it out of a box of Cracker Jacks. We're talking of persons committed to a *profession*. This means that we're committed to a higher body of knowledge and a commitment to service -- and where we have to move ever upwards towards that ultimate objective. Once we can reduce all of these things to some kind of a computer program we don't need a professional person. Then all you need is just some drivers who have gotten their licenses no matter where and how.

And yes, I'm now going to repeat that Sharon Steel hoax. I'll put it this way. If the auditors had said, "you know we want to step it up from 3 million to 8 million because we want to put on the books what it's worth," and they put it down, and they're saying, this is what we've done today, I can understand it. I can understand it; I can play games with LIFO too. But, you also know we have the so-called realization concept in accounting. So when someone sees a 5 million dollar profit in that bottom line coming out of that 5 million differential between an 8 and a 3, what do they presume? That stuff was sold for 8 million dollars.

So it is that you are not going to pin me down by taking just one particular set of numbers and relating it to my principal themes. Nor even am I going to accept the fact that given this condition is-not the independent auditor the good guy? Given that condition, isn't R & D the way in which the FASB determined it great? Or given this condition, isn't leasing good? And I can even see how foreign currency translation might be good in some instances. Maybe most instances as FASB determined it. But I want the professional person, with his total *Weltanschauung* on the line to make that determination.

Question:

Following up on that question, if each situation is going to be ad hoc or each standard, then who will be the auditors who will determine whether the truth has been revealed to the public or the investing public. In other words, who's going to make that determination or will it just sort of evolve from the profession.

Briloff:

Please understand that you've got to bear importantly in mind the phrase which I may have thrown out rather glibly, "open covenants, openly arrived at," requiring the disclosures regarding the set of standards and assumptions that were used. If there's a contrived transaction like the 3 versus the 8 million, and assuming for the moment that the auditor considers it to be appropriate for him to disclose why and how he did it. I am urging that we move, with this important sense of idealism. You know I'm called a Cassandra; I'm called a lot of other things, am I not? I'm caned a critic, I am a loving critic of the profession -- but I do have this important sense of idealism that, given the burdens and responsibilities, and given a responsibility to avoid rationalization, there are more than enough good people and conscientious persons in our profession who are capable of moving us forward.

Question (Continued):

In effect, would you be saying that another FASB for the common law and then there would be an FASB....

Briloff:

Excepting for the fact that the FASB would then be something of an oversight and a review group, as I see it, rather than one that would be promulgating rules by edict. The FASB would be presumed to have an awareness of the alternatives as they have evolved have a sensitivity as to which are most appropriately to be applied. It is the multiplicity of layers.

Now may I interpose one further observation, which I did put into my prepared text. It may very well be that were I thinking of my objectives now, in terms of effective corporate accountability, recognizing that within our environment we have the Moss Committee on Oversight and Investigation, the Metcalf Committee on Reports, Accounting and Management, the Metzenbaum Committee on Citizens and Shareholders' Rights and Remedies I might think in terms of possibly implementing my objectives through a joint congressional committee. The objective, though, is to my mind, the transcendent one, corporate accountability -- with respect to these enormous pools of power which are concentrated in our corporations. Inasmuch as our society has evolved to the point where these concentrations of power are inexorable, and they're going to become greater, we must be ever mindful of Lord Acton's observation that power corrupts and absolute power will corrupt absolutely, and as we've learned within the past few years, power exercised insidiously will corrupt insidiously.

I want to put faith and confidence in my colleagues in the accounting profession.

I have that confidence just as I have faith and confidence in the ideal of the judiciary, just as I have faith and confidence in the dignity and the professional responsibility of the historian. If we entrust these awesome burdens to those in the accounting profession, are we of lesser stature?

