



U.S. Securities and Exchange Commission

Speech by SEC Chairman: Remarks Before the 2005 AICPA National Conference on Current SEC and PCAOB Developments

by

Chairman Christopher Cox

U.S. Securities and Exchange Commission

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Good morning, and welcome to the AICPA's 33rd National Conference. I want to begin by thanking each of you for taking the time to be here, in order to carry forward the important work of this organization. The Securities and Exchange Commission is a strong supporter of your efforts, and that's why, not only I, but also Commissioner Paul Atkins; our acting chief accountant, Scott Taub; and several SEC staff members will be participating with you in this event.

The AICPA has a proud history, dating back to 1887 — making this one of the oldest professional organizations in the country. It's no coincidence that the American Association of Public Accountants, as it was then called, was born in the midst of rapid economic growth, just as America was becoming a global economic power. A growing economy needs the accounting profession.

That was just as true in the 19th century as it is in the 21st. And the consequences of that successful growth are evident in the changes that have occurred in America since the AICPA came into being. Back then, 75% of our population lived in rural areas. Only a quarter lived in cities. Today, the opposite is true. Our rural population is miniscule — only 2% of Americans live on working farms today.

The growth in professional accountancy, from a membership of only a few hundred to more than a third of a million members today, has mirrored America's rise as a great industrial power. You can be proud that as we meet today in 2005, CPAs enjoy a solid reputation among the public, and among business decision makers. That's a testament to your integrity and professional competence — or perhaps it's because all the television programs are about politicians or lawyers or journalists. (Last time I checked, there wasn't a single TV show called "CPA Miami.") There's no need to tell

you that lawyers and journalists, not to mention politicians, get consistently low marks in public opinion polls. Accountants, in contrast, are seen as steady hands.

Business executives — your clients — give you a favorability rating of 95%. At the SEC, where we're focused on investor protection, we're most impressed that investors give you a favorability rating of 97%. That's as close to perfect as you're likely to get in this life. None of this means that anyone in this room can afford to be complacent. You have a reputation, and a future, to protect. Together, we've all got to remain vigilant.

This holiday season is a good time to take stock, and to look forward to the future. It's a little bit early for New Year's resolutions, but let me offer just a few suggestions for some work that we can do together.

First, as many of you already know, the SEC is encouraging a major national effort to make accounting less complex. We're joined in this effort by the Public Company Accounting Oversight Board, and by the FASB, and we need your help as well. From audits to financial reports, we're looking for recommendations on how to make the rules and their application much more clear, straightforward, and transparent.

The success of this effort will obviously depend not just on the regulators, the government, and the academy, but also on the profession. From an investor protection standpoint, the need for greater clarity and transparency is obvious. The accounting scandals that our nation and the world have now mostly weathered were made possible in part by the sheer complexity of the rules. Criminal conduct could be concealed in a thicket of detail. Conformity to hundreds of technical rules became not a shield to protect investors, but a sword to be wielded against them.

Of course, we all know how we got here. It was by traveling a well worn road paved with the best of intentions. Our financial reporting system is the cumulative product of pressure from different constituencies. That's one of its strengths. And it's also an inescapable fact that the complexity of modern financial transactions often calls for a commensurately detailed set of regulatory requirements. But the sheer accretion of detail has, in time, led to one of the system's weaknesses—its extreme complexity. Convolution is now reducing its usefulness.

In business, academia, and the regulatory community, the question is being seriously asked whether preparers and auditors can produce the transparent financial information that our capital markets require.

So: What's being done? Very quickly, let me give you a synopsis of some of the steps being taken. First, FASB, with our support, is reassessing specific standards in major areas where rules fail to provide transparent information. Second, FASB is trying to codify all of the existing literature, in order to establish a single source for all GAAP material. And third, in order to do that, FASB is trying to contain the proliferation of new pronouncements from

multiple sources. The efforts don't stop there, but that should give you a flavor of where we want things to go. "Plain English" is just as important in accountancy as it is everywhere else where investors are concerned.

There's a second pressing matter that's just as important to investors and consumers across the country. It's the lack of competition in the market for audit services for large public companies. Given the depth and breadth of the accounting profession — represented by the membership of the AICPA itself — this state of affairs is truly remarkable.

Your membership, and your leadership, ranges from the world's largest firms to the neighborhood CPA. Two of your directors come from the Big Four accounting firms. And 21 others represent a remarkable variety of practices, ranging well beyond the public accounting field. The over 300,000 members of the AICPA are a vital part of America's economy. With so much diversity and talent in our nation's ranks of accountants, we might fairly ask ourselves: Must it be that only four firms serve virtually the entire market for audit services for large public companies?

Why is this market an "oligopoly," in the words of the Government Accountability Office? You all know the facts. The Big Four firms audit 80% of all the public companies in the United States. Their audit clients account for 99% of all public company annual sales in the United States. These numbers speak for themselves. And they imply significant barriers to entry in the market for audit services for large public companies.

The fact that so few firms are available to perform such a critical role in the capital formation process has been the subject of discussion for some time now. It isn't just that a large public company seeking auditing services has only four firms from which to choose. In some cases, because of geographic demands or industry specialization, a company may even have only one realistic choice. In other cases, because of auditor-independence rules, a company that uses one or more of the Big Four for non-audit services may find itself in a position where it simply can't consider changing auditors.

As a result of this, within the accounting profession, and within the SEC, we are forced to ask ourselves: "Is this intense concentration in the market for large public company auditing services good for America?" If you believe, as I do, that genuine competition is essential to the proper functioning of any market, then the answer is no.

At the SEC, we are concerned first and foremost about the protection of investors. As the true customers in the market for auditing services, it is they who will most benefit from obtaining the highest quality at the lowest cost. When auditing fees rise, when services aren't delivered on time, when quality and consistency are lacking, it is investors who pay the price. So it should go without saying that investors have a significant stake in the development of a much more broad and competitive market for auditing services.

As regulators, we have a stake in seeing to it that our rules promote, rather

than restrict, competition. And we are not without tools. The auditing service is, after all, defined to a substantial extent by government rules. If a quadropoly has emerged, it's fair to ask if that's because of the way the rules are written. We must also ask ourselves whether we can rewrite our rules to eliminate barriers to entry for new competitors in the large-company auditing market. This is a challenge that will require much study and careful thought.

In the very short run, however, there are modest steps that the SEC and the AICPA can take together to support competition and choice in the market for smaller public company auditing services. Certainly, a company that doesn't need the global reach or other unique services of the Big Four should feel it has the option of using other firms for audit services, non-audit services, or both. The Commission staff have found that there are many medium and small accounting firms that provide high quality audit services. It's easy for audit committee members to find information about these firms — in fact, significant portions of their inspection reports are available on the PCAOB web site.

I must say, it is impossible for me to mention these questions of competition and market structure without recognizing the outstanding work of the PCAOB in this area, under the leadership of its Chairman, Bill McDonough. Since he is so recently retired — or should I say, since he has once again temporarily retired — it's appropriate to recognize Chairman McDonough for his profound contributions not only in this area, but across the board. He has done a superb job in his three years at the helm, and set a clear course for the Board as it continues to grow into its responsibilities. I will soon have the opportunity to name his successor, and it is my hope that our nation will be able to attract a woman or a man who can live up to the very high standards that Bill has set for both the organization and its Chairman. He has been the most important founding father of this significant new organization that will be so influential in the future of auditing, and of your profession.

That future will also be shaped by an extraordinarily important initiative that the AICPA is helping to lead — and that is also a top priority of mine. I'd like to close these brief remarks by thanking each of you and the AICPA for your leadership in promoting the use of Extensible Business Reporting Language, or XBRL. I completely agree with you that XBRL will do for business reporting what bar coding did for product distribution. But I believe its possibilities extend much farther than that.

The interactive data that this initiative will create will lead to vast improvements in the quality, timeliness, and usefulness of information that investors get about the companies they're investing in. Interactive data will give SEC analysts better tools to detect fraud. It can make it easier, less expensive, and less time consuming for companies — and their accountants — to comply with SEC reporting requirements. It is not mere wishful thinking that with interactive data, it would be possible for a significant part of the 404 work to be automated.

Auditors could test the integrity of internal controls over financial reporting in

large measure by examining the application of the data tags themselves. And interactive data could also make it far easier, less expensive, and more effective, for issuers to develop risk-based approaches to assessing and testing internal controls. Some day, the ability of investors and analysts to render financial information in any format they choose could help us reach the promised land of international accounting convergence far sooner than we could otherwise have hoped.

But of course, all of this lies ahead, in a future that we are only just beginning to build. Only one thing is certain: to the extent we are successful in simplifying accounting rules; creating more choice and competition for auditing services; and making financial information interactive for the benefit of investors — we will need more, not less, help from accountants. These improvements will help you better serve the public, and your clients. And they'll let you focus your efforts on what really matters. You'll be free to devote more of your time and energy to the questions of accounting judgment and materiality that are the ultimate determinants of quality. The truth is, in the 21st century as much as the 19th, our nation desperately needs you.

Each of you, and the noble profession you represent, are pillars of strength for the most productive and strongest economy on earth. Thank you for what you do, and for continuing to place the interests of investors first.

<http://www.sec.gov/news/speech/spch120505cc.htm>