U. S. Securities and Exchange Commission
Washington, D.C. 20549 (202) 272-2650

News Release

Address to the

Financial Executives Institute

(edited)

New York City
October 31, 1988

GREAT EXPECTATIONS

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The views expressed herein are those of Commissioner Fleischman and do not represent those of the Commission, other Commissioners or the staff.

It is an honor to be asked to sound the keynote at this Financial Executives Institute conference dealing with the challenges facing financial executives in today's changing environment. To me, the keynote can be expressed in one word, summing up the challenges that financial executives face: expectations.

I do not use the word "expectations" here as in the phrase "expectations gap", suggesting a failure to achieve what has been anticipated. Rather, I invoke "expectations" with the connotation of the excitement of prospective achievement, stimulated by the virtual kaleidoscope of change in the present-day business environment. To illustrate the extent and implications of this chosen keynote, let me try to bring some particulars into focus.

First, and especially important to my way of thinking, is an expectation of professional judgment. As a financial executive each of you makes judgments continually and regularly. Those judgments range from the most technical of accounting determinations, such as the length of an asset's useful life, to the most far-reaching of business conclusions, such as the proper structure of a recapitalization or, conversely, the characteristics (perhaps even the identity) of the next product or service area into which your company should expand. The judgments that I am labelling "professional" are that small but crucial subgroup relating to selection, and implementation, of accounting policies in order that your company's financial statements will comply with GAAP.

Each of you expects of yourself, and your audit committee, your company's shareholders (not to mention your CEO), the SEC and the oversight committees of Congress also expect of you, that your selection and public description of accounting policies will be but a first step, and that the decisions you make in implementing those policies in the preparation of periodic financial statements will both be true to the policies so selected and comport with the requirements of GAAP.

That expectation imposes on you an obligation, similar to -- perhaps even more stringent than -- the obligation imposed on your company's independent auditors, to possess yourself of the vital facts that confirm or disaffirm revenue recognition, that suggest or dispel related-party status, that imply or contradict the impairment of assets or the incurrence of liability, all so that you may have the necessary tools with which to exercise the judgment that arises from your training and experience and that is required in the performance of your financial executive function. That expectation imposes on you a high standard of proper professionalism in assessing those facts, in using those tools, in exercising that judgment. In my view, it is your honest striving to achieve that high standard that best serves the interests of your company's owners and managers, the purposes of the various regulators, and the fairness of the public markets generally. And therefore, in my view, the same expectation should assure you that no assessment in hindsight will subject you or your company to prosecution for honest failure in that effort. Proper professional judgment means honesty in the application of experience to a set of choices. I do not understand it to be the policy of the Securities and Exchange Commission to prosecute a financial executive for an incorrect judgment professionally made.

Second, there is an expectation of professional resistance. As a financial executive each of you is subjected continually and regularly to the same pressures that are exerted on your operations colleagues. In your case, the pressure is to endorse financial statements reflecting desired operating or other financial results. The resistance that I am labelling "professional" is the special resistance to external pressures in circumstances where the risk (perhaps the temptation) of material financial misstatement is heightened.

Each of you expects of yourself, and your audit committee, your company's shareholders (and usually your CEO), the SEC and the congressional oversight committees also expect of you, that, when the pressures for aggressive reporting are greatest, so too your professional care and skepticism will be at their peak.

That expectation imposes on you an obligation, again similar to the obligation imposed on your company's independent auditors, to identify "red flag" characteristics (whether or not those specified in SAS 53 1/) such as dominance and control of operating and financial decisions by an individual or cohesive group; or such as material transactions known frequently to involve contentious and troublesome accounting issues; or such as industry-wide conditions broadly understood to imply serious competitive pressures; or such as executive compensation arrangements, or even executive continuance arrangements, heavily dependent on particular financial or accounting results; and it imposes on you an obligation to resist the pressures known to accompany those characteristics. That expectation imposes on you a particular obligation to assure that transactions are recorded as necessary to permit preparation of financial statements in conformity with GAAP and to maintain accountability for assets. 2/ And, in my view, the same expectation should assure you that protective or punitive regulatory action, if otherwise warranted, will recognize the effect of your resistance to

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1/ Auditing Standards Board, American Institute of Certified Public Accountants, Statement on Auditing Standards No. 53 at para. 10 (1988).

2/ See generally Auditing Standards Board, American Institute of Certified Public Accountants, Codification of Statements on Auditing Standards at AU sec. 110.02 (1983); 15 U.S.C. § 78m(b)(2) (1982).

warranted, will recognize the effect of your resistance to pressure, not only for your own benefit but to the benefit of your company as well.

Third, there is an expectation of professional analysis. As a financial executive each of you is continually and regularly involved in analyzing, both retrospectively and prospectively, the results of your company's operations, its sources of funds, and the risks and uncertainties inherent in its business. The analysis that I am labelling "professional" is the category of analysis devoted to meeting the SEC's MD&A requirements 3/ and to complying with the SEC's omnipresent Rule 12b-20 (forbidding the use of any "half-truth" in any periodic report filed with the SEC). 4/

Each of you expects of yourself, and your audit committee, your company's shareholders (and usually your CEO), the SEC and the oversight committees of Congress also expect of you, that you will so analyze and discuss your company's periodic financial statements as to protect the company from liability and add measurably to the value of the information publicly reported about your company.

That expectation imposes on you an obligation, similar to the obligation "association" imposes on your company's independent auditors, 5/ to be sufficiently familiar with the underlying facts and with the pervasive risks and uncertainties of your company's business that you are able to disaggregate the reported financial results and reach a professional conclusion as to whether the further development of any disaggregated element carries within it, from what you know at the time of analysis and reporting, the likelihood of a material effect on future financial results; that is, to render a future-oriented analysis of presently known risks and uncertainties. That expectation also imposes on you, retrospectively and prospectively, an obligation that has been compared (correctly, I think) to your obligation in preparing a quarterly report to accompany financial statements presented at your company's board of directors' meeting. And, in my view, the same expectation should assure you that legislative or regulatory inquiry or action arising out of unexpected surprises impacting your company will recognize the extent to which your analysis of uncertainties could have alerted other observers to the possibility of material change.

3/ See 17 CFR § 229.303 (1988).

4/ See id. § 240.12b-20.

5/ Auditing Standards Board, American Institute of Certified Public Accountants, Statement on Auditing Standards No. 8 at para. 04 (1975).

Fourth, there is an expectation of professional emphasis on the crucial importance of your company's "control environment". As a financial executive, each of you continually and regularly conveys to all those who work with you your awareness of, and your attitude toward, the importance of the control environment within your company. The emphasis that I am labelling "professional" is the emphasis on the substance of policies, procedures and implementary actions, rather than their form. 6/

Each of you expects of yourself, and your audit committee, your company's shareholders (not to mention your CEO), the SEC and the oversight committees of Congress also expect of you, that you will help establish an appropriate control environment in your company.

That expectation imposes on you an obligation, singular and distinct from any obligation of your company's independent auditors, that, by your philosophy and operating style, by the organizational structure that you establish, by your methods of assigning responsibility and authority, by your control and monitoring of subordinates' performance, indeed by all your policies and practices, you will reflect the crucial importance of control and its emphasis in your company. That expectation imposes on you, as a financial executive, a particular obligation to supervise that portion of your company's control structure that is directed to providing reasonable assurance of accurate financial reporting, to determine that it is operating as intended. And, in my view, the same expectation should assure you that your company's policies regarding such matters as unacceptable business practices, conflicts of interest, and conduct of directors, officers and employees -- the policies that are, after all, the ultimate protection for you, your colleagues and your company's shareholders -- are in fact functioning as intended.

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Perhaps this is all by way of adding content to the Treadway Commission Report's phrase "the tone at the top". 7/ That phrase may be hackneyed already, less than two years after its coinage, but I think it deserves to be trumpeted from the financial rooftops. That Commission called on financial executives -- particularly financial executives -- to set the tone by identifying and understanding the factors that can lead to fraudulent financial reporting and by assessing the risk of fraudulent reporting that those factors create within a company.

6/ See Auditing Standards Board, American Institute of Certified Public Accountants, Statement on Auditing Standards No. 55 at para. 20 (1988).

7/ See Report of the National Commission on Fraudulent Financial Reporting at 11, 32-36 (Oct. 1987).

To quote the Commission, "if the tone set by management is lax, fraudulent financial reporting is more likely to occur." 8/ Conversely, if the tone you set is professional, the likelihood of fraudulent reporting is minimized.

If I may return once more to the Treadway Report, you as financial executives can "help establish [a control] environment where open communication is expected, accepted, and protected. . . . An atmosphere of open communication allows an employee, when confronted with suspected fraud, to bring the problem to the attention of those [like you who will] solve it without fear of reprisal." 9/ Each of you expects no less of yourself, and your audit committee, your company's shareholders, your CEO, the SEC and the oversight committees of Congress also expect no less of you. And I do believe that the obligations inherent in that expectation are coupled with assurances that regulatory policies focussed on protecting the integrity of the financial reporting process, and thereby on safeguarding the fairness and efficiency of the public securities markets, have been, are and will be applied in such manner as to credit your professional efforts in that regard.

In brief, my keynote is expectations of professionalism. In the performance of my own responsibilities I take comfort -- and I believe I am not alone -- in your continuing efforts to exercise professionalism in judgment, professionalism in resisting pressure, professionalism in analysis, professionalism in emphasizing the importance of your company's control environment. And I take great comfort -- and again I believe I am not alone -- that, in the face of the kaleidoscope of change in today's business environment, the Financial Executives Institute remains dedicated -- in a sense as proxy for all your audit committees, for your shareholders, for your CEOs, for the SEC, and for the congressional oversight committees -- to the excitement in, and the fulfillment of, those expectations.

8/ Id. at 32.

9/ Id. at 35.