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Faculty Working Papers

ACCOUNTING, AUDITING AND THE FIRST AMENDMENT

Orace Johnson, Professor, Department of Accountancy

#681

College of Commerce and Business Administration
University of Illinois at Urbana-Champaign

1. The first part of the document discusses the importance of maintaining accurate records of all transactions. It emphasizes that proper record-keeping is essential for the success of any business and for the protection of the interests of all parties involved.

2. The second part of the document outlines the various methods and techniques used to collect and analyze data. It provides a detailed overview of the different types of data that can be collected and the various ways in which this data can be analyzed to gain valuable insights into business performance.

3. The third part of the document discusses the importance of maintaining accurate records of all transactions. It emphasizes that proper record-keeping is essential for the success of any business and for the protection of the interests of all parties involved.

4. The fourth part of the document outlines the various methods and techniques used to collect and analyze data. It provides a detailed overview of the different types of data that can be collected and the various ways in which this data can be analyzed to gain valuable insights into business performance.

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FACULTY WORKING PAPERS

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Summary

This is an edited version of a discussion recorded January 31, 1980, at North Texas State University as part of a seminar sponsored by the Department of Accounting and Information Systems.* Following an historical background introduction, the following argument is expanded through questions from the audience and answers by the author: Under the United States Constitution, Congress can regulate commerce, but shall make no law abridging the freedom of speech. This means that under a strict interpretation of the First Amendment, the statutory power of the Securities and Exchange Commission to regulate accounting, as part of speech, is unconstitutional. But power of the SEC to regulate auditing, as part of commerce, would not be unconstitutional.

*The author wishes to acknowledge his gratitude to Professors Joseph DeMaris and Thomas Klammer, Department of Accounting and Information Systems, NTSU, for making a copy of this recording available. In the editing process some questions and answers were combined, deleted, condensed and/or expanded. Consequently, this manuscript is not exact to the letter, but it is true to the spirit, of the conversation at NTSU. The questions come from the seminar participants, while the introduction and answers are the opinion of the author, who takes sole responsibility for editing and transcript.

An historical marker in Hillsborough, North Carolina, proclaims in bold letters near the site of the state's first capital...

REGULATORS HANGED

Below this declaration of fact--which to many persons would be an ethical judgment of what ought to be done today with government regulators--is this brief explanation.

After the Regulators were defeated at Alamance, May 16, 1771, six of their number were hanged, 1/4 mile east. June 19, 1771.

The Battle of Alamance was in a real sense the first battle of the Revolution by the colonies against England. Five years later came the Declaration of Independence. Many of the Carolinians who had fought for the Crown at Alamance changed sides to fight against King George until the War ended in 1783. During two centuries since those events, the meaning of "Regulator" has been inverted. Wanting then to be free from legislative, executive and judicial excesses, men called themselves "Regulators" because they wanted individually to regulate their own affairs. The side of freedom lost at Alamance. The name "Regulator" has now changed sides, but the major issue of government intervention is still the same.

Twenty years after Alamance, the United States unanimously adopted ten amendments to the new Constitution. The Bill of Rights was needed to reassure both Federalists and Anti-Federalists that the new government would be strictly limited in the exercise of its powers. The Constitution granted Congress authority to make all laws that are necessary and proper for the execution of its legislative powers. The

Anti-Federalists were especially fearful that such a broad "necessary and proper" clause would permit no legal limit to what a totalitarian government could do. The Bill of Rights was passed to help define what "proper" means.

For example, no matter how "necessary" Congress might think a certain statute is for regulating commerce, that statute would not be "proper" if it were to violate any of the rights reserved to the people.

The language of the First Amendment is remarkably unconditional: "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the Government for a redress of grievances." (emphasis added)

In 1942 the United States Supreme Court unanimously agreed that commercial speech has no protection under the First Amendment against government regulation. Even before that decision (Valentine v. Chrestensen) for decades Congress had exercised a presumed power to regulate commercial speech through various government agencies. No First Amendment question was raised when the Securities and Exchange Acts were passed in 1933 and 1934, nor later when authority to regulate accounting was extended by other acts.

Justice William O. Douglas helped write the early securities laws. He was Chairman of the Securities and Exchange Commission in 1939 when he was appointed to the Supreme Court. During 36 years service while writing more than 1,200 opinions he saw many of his early dissents become the Court's majority view. By 1959 he had changed his mind about the First

Amendment and commercial speech, saying that he and the Court had been wrong in the 1942 decision. Douglas became a forceful defender of absolute protection for all speech under the First Amendment.' He reasoned that the Constitution requires Congress to be neutral with regard to both the content and motivation of speech. During the 1950's and 1960's he, along with Justice Hugo L. Black, were often the dissenting minority in Court decisions. They never won a majority to their absolute view of the First Amendment. But gradually they secured some support. By 1976, as if in posthumous tribute to their Brethren, the Court said unequivocally that commercial advertising does not lack First Amendment protection.

During his years with the SEC, Douglas had seen no First Amendment problem in securities regulation. Perhaps this was because he had not understood the distinction between accounting and auditing. He used the two words interchangeably, as do most people regardless of whether they are naive or sophisticated. But if Douglas had made this distinction during the 1930s, and if he had developed his First Amendment position 30 years sooner, the process of setting standards today for the publication of Financial Accounting Data Statements (hereafter FADS) would be very, very different.

So I want to discuss with you the proposition that SEC regulation of FADS is an unconstitutional violation of the First Amendment. Bluntly, no matter how "necessary" Congress may think a statute is for regulating the securities market and auditing as commerce, that statute is not "proper" if it abridges the freedom of speech. I reason that

accounting is a language, and as such is protected by the First Amendment from government regulation. I agree with Justice Douglas in one of his last dissenting opinions (California Bankers Association v. Schultz, 1974):

I am not yet ready to agree that America is so possessed with evil that we must level all constitutional barriers to give our civil authorities tools to catch criminals.

I have probably given too long an introduction. So lets start talking together.

Question. What is the argument that accounting is speech?

Answer. Any language consists of symbols with meaning--words--, and rules for combining those symbols systematically to communicate facts, ideas, and opinions--grammar. In the language of accounting we have defined symbols: "asset," "equity," "revenue," "expense," "gain," "loss," with all of their taxonomic categories, the various accounts for recording transactions. In accounting we also have grammatical rules: "debits equal credits," "income equals revenue minus expense," "net worth equals assets minus liabilities." Until someone has studied the words and grammar of a language, he cannot understand either its scope or its limitation. The need for special study is obvious in learning English, Russian, theology, mathematics, music, fortran, and choreography. Even body language and symbolic gestures have been recognized by the Court as speech. Language is pre-requisite to speech. Accounting also should be recognized as formal speech in this Constitutional context.

Question. Are accounting numbers part of the accounting language?

Answer. Yes, part of the formal language of accounting is the numerical measure of monetary value. But that doesn't mean everyone must, under threat of prosecution, use the base 10 number system with Arabic numerals. We could use base 2 or base 12 and Roman numerals. I do not see that Congress either has or should have the power to say that FADS are limited to base 10 numbers, Arabic numerals and Yankee dollars. A contemporary United States corporation would be foolish to expect much favorable communication to result from using base 2 Roman numerals and Italian lira. The investors would be puzzled and suspicious.

There are market incentives for management to choose FADS that investors will understand. The speaker, the professional auditor, and the listener need to know which dialect of accounting is being used-- the past tense grammar of historical cost, the present tense grammar of current market prices, or the future tense grammar of expected cash flows. There is a great need to educate the public about the scope and limitations of accounting so that no more will be demanded than the language is able to communicate.

Question. What exactly do you mean by "commercial speech" as you have used the term?

Answer. I can't say exactly. It is ultimately impossible, with regard to both content and motivation, to draw a distinct line between speech that is purely commercial and speech that is purely political, purely religious, or purely cultural. We cannot in a practical way separate economic from religious interests of evangelists, economic from political interests of presidential candidates, or economic from cultural interests of entertainers. In everyday life a person may be more concerned about the price of medicine at his corner drug store than he is about the political problems of Washington, the cultural questions of New York and Los Angeles, the religious reasons of Rome, or even the FADS follies of Stamford. Concern for the price of drugs may be a complex of political, religious, cultural and economic factors. If the First Amendment is to protect freedom of speech in the public interest, then so-called "commercial speech" cannot be subjected to discriminatory regulation by Congress directly or indirectly.

Question. You say that accounting is part of commercial speech. What do you think about the opposite proposition that commercial speech is really a subset of accounting?

Answer. Occasionally I read newspaper advertisements of grocery stores saying, for example, that a can of pineapple will be on sale Saturday for 98 cents. (Whether I would buy a can for personal consumption or for donation to a religious charity is irrelevant to the First Amendment.) Perhaps it is true that, in the background, an accounting determination of historical costs and revenues helped management to conclude that it could make a profit at that price and expected sales volume. So maybe commercial speech is subordinate to the accounting language in a sense. But more than FADS are involved in many kinds of speech, and many kinds of "commercial" decisions. Advertising of products and services has been the subject of a long line of First Amendment cases over nearly 40 years. I want to lodge accounting with those precedent cases because the Supreme Court is less likely to view accounting under any other arbitrary category such as political, religious, or cultural speech.

Question. Are you saying that the SEC is unconstitutional when it regulates accounting as speech, but not unconstitutional when it regulates auditing as commerce?

Answer. Yes.

Question. Do you think that the government is prohibited by anything in the Constitution from regulating accounting measurement in the way government regulates other weights and measures?

Answer. When the government establishes standards for various measures, it does not compel under threat of criminal action public communication in terms of standard feet, meters, gallons, pounds, or

dollars. The crime is in claiming falsely that X amount is equal to the standard weight or volume or length. Setting physical standards is part of regulating commerce. That is not the same as setting FADS as part of regulating speech. Factual discrepancies may be a crime in commerce. The choice of grammar should not be a crime.

Question. If we take away the SEC authority to regulate accounting, what is your position about the Constitutionality of the Financial Accounting Standards Board in the private sector?

Answer. The Constitutional question of the First Amendment relates to government, to laws defining crimes. The First Amendment doesn't prohibit voluntary uniformity and the FASB is a private association. Consider religion as an analogy. Private associations can say there is One God, no God, or many mini-gods. Congress can pay no attention to such differences in dogma and ritual. The First Amendment requires Congress to remain neutral. That is exactly what I have in mind when I say the SEC cannot validly pay attention to the words or grammar of accounting. A corporation or auditing firm that chooses to disregard FASB pronouncements should have First Amendment immunity from government prosecution. I don't care how many "standards" private associations propose for voluntary acceptance. I am skeptical of mandatory uniformity.

Question. So are you saying that, under the Constitution, the SEC cannot tell auditors that they have to attest to published FADS according to a particular accounting standard?

Answer. That is correct. The First Amendment prohibits criminal sanctions against speech that is contrary to the preferences of any individual or association. If the FASB through persuasion were to secure

uniformity in accounting, that would be fine. The AICPA can say to auditors, "If you don't follow our rules of speech we will expel you. If you don't believe there are only 1271/2 gods like we do, then you must join another religion." That's fine, so long as no government agent presumes to say that certain words and certain grammars are criminal.

One disturbing consequence of government regulation is that a defendent charged by an agency may be presumed guilty until he proves his innocence. That turns up-side-down our traditional notions of justice in which a defendent is innocent until proved guilty. I'm particularly disturbed by government's asserted power to make any speech criminal.

Question. Could you explain a little deeper about how the distinction between accounting and auditing can help us understand why it is not necessary to regulate accounting?

Answer. I did not say that Congress could not argue that FADS regulation is necessary. I said that the Bill of Rights was adopted with reference to the word "proper." There is a big difference between "necessary" and "proper." Some regulator might think it is absolutely necessary to control all speech, or all beverage consumption--like the Ayatollah Khomeini in Iran. He wants more control than we think appropriate. He thinks thought control is necessary. I think thought control is not a proper function of our government--either political, religious, cultural, or commercial. An inevitable result of grammar control is thought control. Our Founding Fathers believed that thought control by government is absolutely not proper.

Question. Can you explain how a "proper" regulatory system can be set up where the distinction between accounting and auditing helps us? How can auditing be regulated as commerce in a "proper" way that is consistent with the First Amendment?

Answer. The SEC could be restricted by Congress to regulating only auditing standards, such as the items to be examined, the sample size, and questions of sufficient evidence. The auditor, no more than the government, has any valid Constitutional power to tell the manager of a business association that he must use past tense base 10 Arabic numeral Yankee dollar FADS. The auditor might be regulated with regard to the process by which he attests that management's chosen FADS do express what management claims they express. The SEC can be kept from bias in its regulation of speech. The SEC can be required to be neutral toward accounting language. But please note, in saying that Congress can regulate auditing under its power to regulate commerce, I am not recommending that it do so.

Question. Would the SEC in regulating only auditing, decide what is a "fair" presentation?

Answer. I am not recommending that the SEC regulate even auditing. While there may be efficiency arguments against auditing regulation, I see no Constitutional barrier to government regulating auditing as commerce. The SEC could be allowed to decide what is "fair" in respect only to the auditor's ground for attesting to statements made in whatever FADS dialect that management might choose under the by-laws of the corporation. Consider another analogy. On First Amendment grounds the

Department of Education cannot discriminate between limericks and sonnets for the literary expression of romantic sentiment, making one criminal and the other a generally accepted poetic principle. On effectiveness and efficiency grounds, we would not expect an auditor to attest either that the emotion in a limerick is authentic for the speaker, or that the emotion in a sonnet is not the suitor's real feeling. Just as the content and motivation of neither limerick nor sonnet is necessarily false and misleading, so the content and motivation of neither historical cost or current value FADS are necessarily false and misleading. Nor are they necessarily true and useful. They may be only irrelevant.

Question. Auditors need some types of accounting standard to attest against. Without a standard, auditors have no way of judging right from wrong. Without some kind of conventions to tell what should be included or excluded from the cash account, auditors cannot tell whether the balance is proper. Wouldn't the removal of mandatory standards just cause confusion?

Answer. My understanding of the original and important role of the auditor is to say to the investor, on the basis of sufficient evidence, "Management has done what its FADS claim it has done." Such attestation can occur with regard to any dialect chosen by management. Auditors do it with fifo and lifo inventory, straight-line and accelerated depreciation, purchase and pooling mergers, cash on hand and other liquid assets. Auditors could also do it with historical cost, current prices, or discounted expectations. Auditors could attest that management FADS in one year have not changed materially from a preceding

year. The auditor should only test the hypothesis that management did do what it claims to have done. Auditors should not assert the power, spuriously derived from the SEC, to abridge the freedom of accounting speech.

Question. It seems to me that auditors would not like being regulated without some kind of a unified accounting standard. If management wants to use exit values in one part of a statement, entry values in another part, historical costs and discounted expectations elsewhere... how could auditors ever attest to what was happening in all that confusion?

Answer. You may be correct that auditors do not want their commercial practices subjected to SEC regulation. I have discussed the First Amendment and the distinction between accounting and auditing with a few auditing firm partners. Invariably they have said, in effect, "We don't want to do away with the SEC. We want to make sure that their regulations are in our own best interest." That attitude is what you might expect from any regulated industry. Factions in society continually try to secure control over the police power of the state to secure through political means what they could not secure through free market persuasion.

Some scholars have offered this hypothesis: when securities regulation was being considered fifty years ago, auditors knowingly used the confusion between accounting (as language or speech) and auditing (as commerce) to prevent tighter SEC control over auditing. I have no primary evidence on that hypothesis.

I am saying that Congress has the Constitutional power to regulate auditing, but not beyond the line where freedom of speech is abridged. Inconvenience to auditors and regulators facing diverse FADS is a question of efficiency and effectiveness. Claims of "necessary" should not be allowed to dominate, obscure, or reduce Constitutional rights. Even if we were to have no other choices--and I believe there are other options--allowing Congress through the SEC to abridge the freedom of speech in management's choice among FADS is too high a price to pay for the escape of auditing from regulation.

But there is a sense in which the First Amendment might protect auditors also. If SEC regulations restrict, proscribe or mandate the professional advice that auditors as spokesmen can give to investors through attesting to FADS, then even the regulation of auditing commerce might be limited as unconstitutional if speech were abridged.

The question of how auditors can attest, in your words, "to what is happening in all that confusion"...that is an efficiency/effectiveness issue. It ought to be resolved without violating the absolute intent of the First Amendment.

Question. I don't ever remember that SEC prohibited a firm that used historical cost in its public statements from, for example, taking an advertisement in the Wall Street Journal and saying what its net income was under replacement cost. Can't firms publish supplements to the required data?

Answer. Yes they can use other means for communicating. My concern is for the official statements to stockholders. Let's consider FASB standard No. 34. I will not here argue the merits of the standard. I cite

it as a recent instance in which the FASB, buttressed by the police power of the SEC, has indulged in censorship--forbidding management to say something. Standard No. 34 requires capitalizing interest on construction work in progress, even an implicit interest on work financed internally without explicit debt. The final paragraph says that in the year of adoption, firms may not restate prior years' reports to conform with the new standard. That is censorship. All firms that must register with the SEC are governed by SEC endorsement of FASB. SEC/FASB censorship may deprive investors from receiving in their official annual reports information that would be useful for decisions.

Question. The government requires that you fill out your income tax returns with dollars rather than with apples or with some other commodity value standard. Isn't that an abridgement of your freedom of speech to deny you the choice of a language using numbers as measurement?

Answer. No. Government can require for its legitimate purposes the information it needs in the form it wants. I have been assured by the Supreme Court that my tax return is private information. Government officials who use my income tax return for purposes other than collecting tax have gone beyond their just powers. I am free to tell the public, if I wish, what my income and tax were in terms of either dollars or apples. The income tax law does not make either my public speech or my public silence a crime. When the Internal Revenue Service says, "Compute your tax this way" it is not telling you how you must speak to your neighbor or to your commercial association. You can criticize the government for collecting tax at all, or in a particular way. It is

not a First Amendment issue for the government to tell you to file your tax form in a certain way.

Question. What is the investor going to think in the absence of SEC mandatory standards?

Answer. I don't know what the investor thinks now. Neither does anyone else. Accounting information may be an infinitesimally small element of an investor's decision. And surely all investors are not alike in their ability or desire to consider fully the relevance of non-FADS information, such as the political and economic situation of the world, of our country, of one industry, or of expected consumption needs. We simply do not have enough wisdom about investor decisions to warrant rejection of the First Amendment for the sake of arbitrary, mandatory uniformity of FADS.

Question. We are not living in 1776. Adam Smith isn't here in 1980. The situation has changed considerably. You have to see who the beneficiary is, what government is trying to do, and the best way to do it. If the people are complacent, don't we need the government to decide?

Answer. You are talking about complacency in a very dangerous sense. My concern is more basic than mere accounting. I view FADS regulation as just one aspect of danger to a free society. If the government regulates this kind of speech, then it will have this kind of thought control. The Constitution and the Bill of Rights does not make political, religious, cultural, or commercial complacency a crime--even though complacency may cause the end of a free society.

Question. Government regulation comes out of a feeling that certain business elements in society take unfair advantage of the common citizens who don't have the power of corporate management. Society desires

to control dishonest manipulation of information. If this regulation is what society and government desire, why do you object to preventing deception?

Answer. There is no brief answer to the wide range of issues that your question raises. First, let me reject as emphatically as I can the notion that society ever does anything, or that government ever does anything. A major defect in the intellectual process is to personify an abstraction and then attribute causality to it. Only individual persons ever decide or do anything. Not an abstraction like government, or corporation, or even an accounting department. (However, it is sometimes convenient to use such linguistic short-cuts provided we don't forget that only persons act.) Persons may decide to associate in ways that allow specialized functions for each one. I see no reason why the First Amendment applying to natural persons should not apply also to natural associations, regardless of whether the purpose of the association is to serve God, as a religious group, or to serve Mammon, as a business.

Second, even if "society" could decide something, the claim that "society wanted securities regulation" could not withstand careful scrutiny. We should ask, which individual persons decided to impose such regulation? Politicians made a scape-goat of accounting. The real cause of the 1933 depression, following the crash in 1929, was governmental error, particularly error in monetary policy and international trade. An atmosphere of crisis was fueled by promises from politicians who were going to get this country moving again. (And we still hear the same old, tired, rhetorical cliches.)

Third, the business corporation is not created by the government. Therefore logically government cannot derive from non-creation any unalienable right to regulate. Philosophically, a person has a property right in himself, an unalienable right. And he has, by being a person, a right of association. These rights preexist any government. State corporation laws should be viewed as merely requiring registration, like a birth certificate. Government no more creates corporations than it creates babies or marriages. Government should be viewed only as acknowledging that the birth of a baby or of an association has taken place.

Finally, I do not object to the goal of preventing deception. I would like to prevent deception in auditing, in all commerce, in politics, in culture, and in religion. The problem is not in stating an ideal goal. The problem is in choosing among the alternative means the process that will most effectively attain the desired goal without causing extensive harm in other areas. The Constitution of the United States is a fundamental statement of a social contract in which agreement was expressed that only certain limited means were allowed government agents in the pursuit of our public good. Other means, such as abridging freedom of speech, would cause such extensive harm, that they were withheld from the government, even as tools to catch deceptive criminals.

Question. Doesn't the limited liability aspect of corporations give to business associations some powers that persons as outsiders don't have? Shouldn't that unequal power be controlled?

Answer. You seem to emphasize one side of a contract. Certainly the investor has limited liability. But he pays a price for that benefit in reduced control. The corporation has a right to sue, but that means it is a lot easier for you as a citizen to sue the corporation rather than sue all the individual investors. Limited liability, unlimited life, and all the qualifiers that usually go with articles of incorporation are not really exceptional. Partners could write into a partnership agreement--even a professional partnership--all of the criteria we usually think as essentially defining a business corporation.

You must remember that there are market forces at work controlling business corporations in a much more efficient manner than FADS regulation ever will. At least four kinds of competition exert social control over business: competition in the markets for products, for employees and managerial skills, for financial investment, and for corporate control.

Question. Those controls didn't work in the 1920's. What makes you think they would work today?

Answer. What is the evidence they did not work? I suggested earlier that the main cause of world wide depression was political government rather than free market businesses. The notion that there was prevalent crime and corruption in business more so than in politics is a myth. The SEC hasn't prevented fraud. We have no evidence that the SEC has prevented damages to society that would have been greater than the cost of SEC to government for monitoring, to firms for compliance, and to both for litigation.

I am not worried about business getting big. I am worried about business securing through the political process a preverse transfer of wealth through price fixing, production quotas, or mandatory consumption. SEC regulations can be viewed as a misallocation of resources through mandatory production of surplus controls.

Question. If we restrict the SEC to regulating auditing under the commerce clause, and accept the FASB as a private association, wouldn't we come right back to where we are now anyway?

Answer. Right back where we are now? I don't think so if you hold strictly to the absolute interpretation of the First Amendment. The regulated auditor would not have the power to tell a corporate manager what FADS to use. If the SEC restricted its purview to auditing practices, being strictly neutral with regard to language, there is no way we could get back to our present situation where the SEC can determine that speaking certain words will be crime. Whatever uniformity we were to obtain in accounting would be voluntary, not governmentally coerced.

Question. Without standards for both accounting and auditing, how could auditors ever decide and attest to any kind of fairness?

Answer. The auditor's attestation should be descriptive only. I don't know what "fairness" means. I am suspicious of regulators who presume they know what is "fair" and in the "public" interest.

Question. But that is not being realistic. In an age of mass communication, some business can make a claim that is harmful to a lot of people. By the time any suit has gone through civil court action, we do not in fact get redress of the grievance. Aren't you too idealistic?

Answer. The one reason we are content with saying that murder is a crime is that it is very difficult for the victim to secure redress of his grievance. In general our criminal procedures focus on punishment rather than restitution to the victim. With regard to "word crimes," it is much harder to say who has been harmed. The SEC doesn't know who would be hurt and what extent if it destroyed its list of accounting crimes. It seems clear to me that if the SEC had not required historical cost accounting in the 1930's, businesses would have experimented much sooner and more confidently in ways to report the effects of inflation. Inflation, I might add, like depression is caused more by decisions of government than by decisions of business.

Question. Federal agencies besides the SEC regulate accounting for different purposes. State governments regulate, too. They set prices, subsidies, output quotas, rates of return, and so on. Do you see any First Amendment conflict when agencies like the Interstate Commerce Commission or state utility commissions prescribe accounting methods?

Answer. Your question involves at least three separate issues. First, the Bill of Rights was written and interpreted originally for protection against only the federal government. Increasingly Courts have interpreted the Fourteenth Amendment of 1868 to incorporate the Bill of Rights for protection against state governments as well. In this light, state agencies no more than federal agencies can regulate speech without violating the First Amendment. So we are in fact talking about protection against all levels of government.

Second, I see no First Amendment issue when, for purposes of collecting taxes or regulating commerce, governments demand confidential

information in the form needed...so long as the statutes are necessary and proper. Regulations become improper when agencies abridge in any way the freedom of commercial associations to speak or to remain silent in public. Freedom of speech does include the right to remain silent before the public.

The third issue is more subtle. Persons are entitled to protection against government actions that affect them adversely. Consider the consumer who observes a government agent setting prices, rates of return, output quotas, and consumption levels. For the sake of argument, let us take the very minimal definition of First Amendment protection: speech freedom for political purposes. One may argue that for the citizen to make a rational decision about the proper allocation of resources, he needs free market information. Government control of prices, quantities, and profits deprives the citizen unjustly of the accounting information necessary to make informed political decisions. Thus freedom of speech, in the sense of the public citizen's right to know, may be abridged by regulatory agencies which prevent the creation and publication of FADS necessary and proper for political decisions. To my knowledge, this line of reason has never been developed, but it does suggest major implications from the First Amendment. It seems clearly relevant to the SEC since that agency acts, directly and indirectly, as both censor and inquisitor when it specifies FADS for reports to the public.

Question. If corporations report whatever they want, whenever and however, then the recipient who really cares will face a total mess. How would we ever benefit the readers of corporate reports if they

can't compare one company with another because there are no uniform standards?

Answer. I'm not convinced that mandatory standards are necessary, or even on balance beneficial. Artificial uniformity, no matter who sets the standards, does not assist meaningful comparison among corporations. The appearance of uniformity may actually disguise many significant differences, lulling the reader into believing that comparisons are simple. However, let me respond on a deeper level.

Let's assume you are correct that government should set accounting standards and should leave no options for the private sector. For such regulation of speech to be proper, the First Amendment should be changed to read, for example,

"Congress shall make no law abridging the freedom of speech except in the area of FADS."

The Constitution gives you two ways for changing the absolute into a qualified First Amendment. Congress must propose amendments which then must be ratified by two-thirds of either state legislatures or special state conventions. Without such a Constitutional process of change, Congress mocks the public everytime it makes laws that abridge the freedom of speech. When Congress ignores the Constitutional process for changing the Constitution, it infringes on truly fundamental rights of the people, causing great danger to a free society. If you and a majority of the people think accounting should be exempt from First Amendment protection, then at least go about making the Constitutional change in a valid way.

Question. You must admit there is little prospect for a Constitutional convention to re-write the First Amendment. But if it is correct that

SEC regulation of accounting is unconstitutional, what can be done about it?

Answer. I know of two legal societies now alert for an appropriate case to which they can devote time in an appeal to the Supreme Court for overturning the present regulatory regime. Remember that legal cases are always decided on specific grounds in a specific claim. The court looks at both specific facts and specific laws. The courts do not accept general abstract theory as the dispute to be settled between litigants. Under the separation of powers in our government, general political theory issues are the public's domain for forming a Constitution, and specific politics is the legislative domain for implementing the public's general theory. The Courts test in only specific cases whether legislation is consistent with the Constitution. The Supreme Court will not accept just any old case to review the question of who gets hurt by the unconstitutionality of FADS regulation. In my opinion, both managers and investors as well as the public are harmed more than helped by Congress abridging freedom of speech.

I can't predict the details of what the specific case will look like. But I do predict that lawyers sympathetic to the First Amendment will find a case that can go to the Supreme Court. The Court is not likely to eliminate the SEC altogether because Congress does have power to regulate commerce. Of course, it is not impossible that Congress itself could deregulate speech FADS like it deregulated the airlines industry. But I don't see that present members of either Congress or the Court are likely to go far enough. They haven't gone through an intellectual conversion like Justice Douglas did. Unfortunately, he didn't live long enough to hear arguments in an accounting speech case.

Question. You say accounting is a kind of commercial speech and that Justices Black and Douglas would include accounting under First Amendment protection. Is that a conclusion of your own, or do you have some evidence that they actually saw accounting this way?

Answer. There is evidence that when Douglas was associated with the securities laws, he did not pay careful attention to the difference between accounting and auditing. Later, in his own words, he changed his mind about the First Amendment and commercial speech. I reach on my own from his absolute interpretation of the First Amendment this inference: if Black and Douglas had been faced with the clear contention that FADS are speech, they would have argued on the Court that the language aspect of SEC power is unconstitutional. But that is only speculation.

My interpretation, in line with what I know of Black and Douglas, is that in order to have a just society, there is no alternative to these primary assumptions: each person has an original property right in himself and in his labor, and a right of association. These are prior to government. The only purpose of government is to ensure these rights. To protect these rights against abuse by governments, we must become and remain more vigilant, especially with regard to freedoms under the First Amendment.

Question. I associate quite a bit with accountants, and I don't have any reason to believe they are thinking much about the First Amendment one way or another. Do you think accountants will undergo a change of mind like Black and Douglas did?

Answer. The fact that accountants have not yet paid attention to the First Amendment issue in FADS regulation is no grounds for thinking that when they are faced with the issue they will endorse federal control of speech. Accountants in both industry and auditing will chafe more and more under regulatory restrictions. That irritation will cause them to hunt alternatives. Many economists argue that government regulation has gone far beyond the point of diminishing returns. The conservative swing in American politics may bring about further reduction of federal intervention in our private and commercial lines--not on grounds of efficiency alone, but on grounds of personal and associational freedom.

Question. There are other aspects of the Constitution besides the First Amendment. When you give absolute priority to freedom of speech, aren't you ignoring the interdependency and qualitative characteristics of other rights?

Answer. Certainly there are conflicts between persons. For example, one may claim that his right to a fair trial would be damaged by freedom of speech which someone else is claiming. The courts should and do resolve conflicts of interest in civil disputes. The First Amendment is absolute against Congress. It says there shall be no law abridging freedom of speech. At a minimum this means Congress shall have no power to declare speech FADS subject to criminal prosecution, or power by statute to either set or delegate setting in advance civil damages for FADS.

Rather than ignoring Constitutional interdependencies, I am trying to maintain for each branch of government the powers that are necessary

and proper for it. Where speech, including FADS, is concerned, voluntary consensus supported by tort action among the people is the proper way to discover which grammar will prevail and which will disappear. Criminal sanctions for speech FADS are a threat to freedom. Private litigation over conflicting rights is necessary for a free society.

Question. Do you have any estimate as to how many auditors and accounting professors would be put out of jobs if the SEC's power to regulate FADS were ended?

Answer. The securities laws have been called the full employment practices acts for accountants and lawyers. I don't know how many jobs would be affected in such a resource reallocation. One possibility is that more private jobs would be created by the diversity of FADS and the need for specialists in accounting language translation. From my optimistic point of view, de-regulation of FADS would benefit our free society in whatever manner human resources were voluntarily reallocated.

Let me end by saying that getting FADS out of SEC control would not plunge the country into chaos. Corporations do have incentives to report the efficient amount of accounting data. They do have incentives for independent auditors attesting their public reports. Civil remedies are available where managers and auditors cause damage. Federal agencies cannot, under our Constitution, validly exercise any prior restraint to declare through censorship that certain words in public are criminal, or through inquisition to declare that certain silence in public is criminal. The Emperor has no First Amendment clothing! We Sovereign People should see that fact clearly...even though regulators may not feel the slightest bit embarrassed by their flashing.



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