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Ladies and Gentlemen. It is appropriate, I believe, that my first public speech on securities issues would be here in my home town and I appreciate your invitation. I have turned down other requests because I didn't want to discuss the important and often very controversial issues being considered by the Securities and Exchange Commission until I had a chance to serve for a while and better understand the everyday activities of the Commission. Before my appointment, my knowledge of the Commission's functions was more from a legislative point of view rather than the administrative, regulatory and enforcement activities of the Commission.

This evening I would like to share my views with you on some of the issues and policy decisions facing the Commission. You should be aware, of course, that my comments do not necessarily reflect the views of the Commission nor any of the other Commissioners; as a matter of policy, the SEC disclaims responsibility for any speeches by its Commissioners.

Perhaps the most recent issue is the resignation of G. Bradford Cook as Chairman of the Commission. Mr. Cook's resignation brought sadness to the Commission but it did not bring despair or depression. During the 2 1/2 months I have served on the Commission, I developed a deep respect for his ability, his integrity and his desire to balance effective regulation with fairness. This view, I believe, is shared by the other Commissioners and the staff.

It was suggested in the press that Mr. Cook's action might tarnish the image of the Commission as a tough, incorruptible agency. I do not agree with that assessment. His selfless decision to resign in order to preserve confidence in the Commission even in the absence of a charge of wrongdoing because he felt that the effectiveness of the agency might be impaired should add a new luster to the agency's image. I have no reason to question the former Chairman's integrity, I commend him for his sacrifice, and I hope that his name will soon be cleared of any taint of impropriety.

In spite of his resignation, I can assure you that the Commission intends to move forward on the major issues which are so important to investors, the securities industry, the business community, and the people of this country. To do less would undermine the very purpose of Mr. Cook's resignation.

Yesterday, in mid-afternoon, Norman B. Leblanc, a business associate of financier Robert Vesco and formerly associated with the accounting firm of Coopers & Lybrand, suggested that the Chief Enforcement Officers of the SEC, Irving Pollack and Stanley Sporkin, were involved in a scheme which was tantamount to extortion and that Mr. Vesco's \$250,000 political campaign contribution was not made to obstruct justice. Considering the source from which this has come and the experience I have had with Mr. Pollack and Mr. Sporkin, such a charge is nothing but a fabrication and an attempt to destroy the credibility of the SEC. As you may recall, last November the Commission did file a civil complaint in this matter alleging a scheme to defraud public customers of \$224 million and is actively pursuing that complaint against Mr. Vesco who was recently indicted by a New York grand jury.

I don't want to discuss personalities any further, but I do want to emphasize that you can depend on the SEC to maintain its enviable record despite charges to the contrary by those who would like to reduce the agency's effectiveness. In addition, I want to clearly indicate that the SEC intends to do what it can to see that professionals dealing with the securities industry be held to that same high standard.

As to substantive issues before the Commission, I want you to know that by background and inclination, I favor the least possible government regulation and might be criticized by some as being pro-industry in my activities on the Senate Banking Committee and earlier professional work.

I also want you to know that I strongly support self-regulation in the securities industry. I favor maximum freedom from government dictates for individuals and business entities so long as their activities do not encroach on the rights of others. Unfortunately, the very nature of the securities business is such that it is uniquely subject to fraud and manipulation which do encroach on the rights of others.

For example, the sale of a piece of paper with fancy etchings and all kinds of promises by the salesman cannot in the absence of adequate information be fairly evaluated by the average investor. Unfortunately, there are those right here in Salt Lake City who would promise most anything for a fast buck.

In fact, Salt Lake City is known as the "shell capital of the world" because so many companies, silver, lead, zinc, gold, oil, uranium, and other companies have been organized and abandoned over the years and these company shells can be activated rather easily for the promotion of unworthy ventures.

Please don't misunderstand me. I am not saying all companies that use previously formed corporate structures and activate them with a new undertaking are improper. I am only saying these "shells" make good vehicles for fraudulent schemes and are often used.

The responsibility given to the SEC by the Congress was to provide the fullest possible disclosure to the investing public, and to protect the interests of the public and investors against improper practices in the securities and financial markets. Almost parenthetically, this is also a charge to maintain strong capital markets which, I believe, can exist only when public investors are provided with adequate disclosure and protections against fraudulent conduct.

Traditionally, the Commission has done well in meeting that responsibility and there is no question that we have the best capital markets in the world. This result has been accomplished only through prudent regulation and effective enforcement which is more strict than would have been necessary if individuals and firms could be trusted to be honest in their dealings. Unfortunately, there is no way to regulate only those who are not honest. Regulation must be across-the-board and admittedly a relatively few problem cases can make life difficult for many others. It is a fact, however, that the regulatory reports and procedures which are sometimes complained about are the very basis of an environment in which honest individuals can foster their enterprises.

This being the case, good regulation and enforcement is not anti-business or anti-securities markets, or anti-accountant. It fosters all of these while protecting the investor.

During the past few years, as our society has become more complex and impersonal, many of the restrictions on improper activities by individuals have weakened or disappeared. The family, the church, and the community in days past provided strong support for ethical conduct. In a community where one's activities were immediately known by his neighbors who were his friends and relations and close associates, unscrupulous conduct was generally proscribed.

Unfortunately, as the influence of these important institutions has declined, a greater responsibility has been placed on the government to foster and maintain ethical practices and fill the void that developed. Because the Securities and Exchange Commission has been given the responsibility to assure that the void is filled, it has taken that responsibility seriously. The Commission has, however, attempted to assure that governmental intervention be held to a minimum.

Presently we are in a phase in which there appears to be a serious crisis of confidence among investors. Securities issues which are usually of interest primarily to people on Wall Street, business firms and professionals such as accountants and attorneys, have in the past few months been front page news. The Equity Funding scandal, and the Vesco case are the latest of several recent incidents which have undermined investor confidence in our securities markets.

In addition to specific cases of abuse or fraud, some fundamental changes in investment patterns such as increased institutionalization of the market have impacted severely on market liquidity and price trends in particular securities. Those securities favored by institutions, primarily of large firms with shares outstanding, have very high P/E ratios while securities of many, very good smaller firms with record profits are selling below book value and these firms are unable, under such conditions, to raise new capital for modernization and expansion.

Large institutional investors are able to purchase securities at lower commission rates than individuals because of negotiated rates on larger transactions. They also have better access to investment analysts who sometimes obtain inside information which gives them an advantage over individual investors.

Because of these and other factors, individuals are leaving the market with further detriment to stock prices of liquidity. The Securities and Exchange Commission is trying to solve these problems by action on many fronts.

We have proposed a plan for a central market system in which increased competition would exist. We have indicated that we would establish procedures to assure that individual public orders would have price precedence over large negotiated orders. We have required practices by broker-dealers to safeguard customer cash and securities. We are presently working on guidelines which will reduce, if not eliminate, the use of insider information. We intend to require negotiated rates on smaller transactions than at present when that is prudent. We intend to request information on the security holdings and transactions of institutions. We are seeking legislation dealing with stock transfer agencies and depositories so that costs associated with the purchase and holding securities will be minimized. We are also seeking, through rule and legislation, to assure that institutions will not have an advantage over individual investors as the result of membership on securities exchanges.

But all of these changes will not bring about greater investor confidence unless we can assure that ethical standards are maintained by professionals dealing with securities. In my opinion there are two approaches that can be taken in seeking the goal of ethical conduct. One would be a takeover by the Commission of the full task with a massive increase in staff and budget and the dwindling of private efforts to deal with these issues. This would, of course, reduce freedom of individuals. The other approach, and the one I prefer very strongly, is that the Commission use its regulatory and enforcement authority to support private efforts of professionals and assure that ethical standards in securities-related professions are developed and followed.

What does this mean to the accounting professional? It means several things. First, the Commission will do all it can to support private professional groups which are working to upgrade the standards of their members. It also means that professional individuals will be required to meet a high standard of excellence.

As you know, the accounting environment, particularly in relation to principles of measurement, is undergoing a great change at the present time. The Accounting Principles Board is in the process of phasing out and the new Financial Accounting Standards Board has started its operations. The

Commission has always cooperated with the Accounting Principles Board since its inception in 1959 and with its predecessor, the Committee on Accounting Procedures, before that time. During the tenure of the Accounting Principles Board, great strides have been made in the improvement of accounting standards.

Nevertheless, some dissatisfaction arose in recent years regarding both the quality and quantity of its pronouncements. As a result, the now well-known study was made by a committee sponsored by the AICPA and chaired by former Commissioner Frank Wheat, which recommended that an independent seven-man, full-time board be established to replace the APB. The Commission endorsed the creation of the new board and reiterated its long-standing policy that accounting principles should be developed in the private sector in a letter to the AICPA on May 4, 1972, as follows:

"The Commission believes that the structure for the development of standards of financial accounting and reporting recommended in the 'Report of the Study on Establishment of Accounting Principles' will foster the continuation of the longstanding policy of cooperation between the Commission and professional accountants. Of equal importance, the recommended structure appears to be responsive to the need expressed in many quarters for improvement of investor confidence in accounting principles and in financial reporting generally."

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"In conclusion, we wish to reaffirm our strong conviction and our policy, dating back to 1934, that the development of accounting principles within the private sector is consistent with the public interest."

We are working closely with the new board. Chairman Marshall Armstrong and other board members, recently met with the Commission and also with the Chief Accountant, Sandy Burton and his staff, to discuss their plans and mode of operations and to exchange views on prevailing problems. We have already suggested a number of projects for the board to consider. The Chief Accountant has designated members of his staff to serve as liaison on each of the projects the board has started, in order that the Commission can keep abreast of the projects and to render any possible assistance.

In order to avoid any implication that the SEC could exercise undue influence on the board, the Commission declined an invitation for either the Chairman or the Chief Accountant to serve as a formal member of the Advisory Council to the Board. However, the board and the SEC will have to operate on the principle of mutual non-surprise if their joint efforts are to be maximized. Both entities are moving in this direction in their early contacts.

We expect this body to be successful. To the extent that it is able to obtain more inputs from diverse groups and undertake more meaningful and controlled research its authority will increase, since it will be able to defend its viewpoint in the ongoing dialogue on accounting principles. But it must proceed expeditiously. There are many major accounting problems requiring urgent solutions.

If the Financial Accounting Standards Board does not succeed, it is my opinion that the function will fall upon the SEC since the securities laws give it the statutory authority and the ultimate responsibility to assure that full and fair disclosure of financial data is provided in filings with the Commission. This would not only be a transfer from the private sector to the federal government, but in my opinion would also be a less efficient method for the establishment of principles of measurement in financial transactions and data.

In the area of the principles of disclosure of financial data by publicly held business institutions, the Commission has a primary responsibility. The various securities laws

specify that full and fair disclosure of a registrant's affairs is required. We have a large body of rules in Regulation S-X and in our filing forms which contain requirements for disclosure of financial data. In this area we expect to take the lead, although we will follow the policy of mutual non-surprise with the FASB which we feel it should follow with us.

In our basic approach we are trying to meet two needs: First, more detailed disclosures for professional analysts and sophisticated investors in order that they may have an in-depth understanding of a company; and second, better, more understandable analytical summaries for the benefit of the average investor.

Many professional analysts have been able to obtain much of this type of additional information from management through personal contacts and interviews, but by requiring it to be filed in public documents at the Commission, we would make it available to all who need it. In some cases companies might provide summaries of the data in their reports to shareholders and specify how the details could be obtained. This procedure will help resolve the difficult problem of how to restrict the use of information not available generally to the public--without reducing information necessary for investment decisions.

The required summarizations of the detailed data are not only necessary for the average investor but will also help to avoid the hidden fact problem which often occurs when a great mass of data is presented. It's not enough to say, "It's all there if you look." The registrant must provide both the details and the summaries to make all of the information meaningful. These differential disclosures will enable all investors to better appraise the quality of the earnings of their companies.

In the areas of auditing and accounting pertaining to the financial statements filed with it under the various securities laws, the Commission from its inception has refrained from detailed rule-making and has instead followed a policy of cooperation with the accounting profession in developing and improving standards. Responsibility in these areas was placed in the profession by Congress in the Securities Act when it specified that the financial statements filed under the Act shall be certified by an independent public or certified accountant. In the other principal



securities laws Congress provided the Commission with authority to require such certification, which it has done in most instances. Since the Commission was also given considerable authority over the financial data to be filed, we operate in partnership with the profession in meeting our respective responsibilities.

The Commission, through its accounting staff, influences the development of the standards by a continuous process of consultation with representatives of the profession, chiefly the American Institute of Certified Public Accountants, regarding the need for new or improved rules and guidelines and by commenting on proposals of the profession on these matters. Just this week, the Commission commented on the draft AICPA exposures regarding appropriate accounting for investment companies, companies in the development stage, and companies engaged in the defense business. The Commission may also take the lead in requiring additional accounting data in the interests of the investing public. Two major examples of our initiative in recent years were the requirements for funds statements and for line-of-business and product-line data.

Since we view accounting professionals as partners in our efforts to obtain the best possible disclosure in financial reporting, we will not hesitate to call attention to deficient professional work. There have been a number of recent cases which lead to concern about the quality of audit work done as well as the adequacy of the auditing standards developed by the profession, of which the Equity Funding case is a prime example. The implications in this case are serious in light of the massive fraud that was concealed for so long from three different auditing firms and various state regulatory agencies. The fact that it could happen indicates that something was seriously wrong. We must determine what it was and do whatever is appropriate to correct it.

Cases like this and others that have occurred recently, such as National Student Marketing and Four Seasons, have an adverse effect on public confidence in the securities market which, as I have stated, is the very basis of the market. We must take steps to prevent the occurrence of another such fraud and not just shut this particular barn door. We have already started the process of considering the matter by

gathering together a group of the affected parties to discuss the problems, but it is too early in the investigation to comment on possible audit deficiencies. Regardless of what the investigation shows, there must be a re-examination of procedures in the areas of fraud detection, computer auditing and insurance auditing.

It is encouraging to note that the AICPA has established a special committee to consider the matter. This may be the fastest and best way to correct any deficiencies in the procedures. This action is in accord with the profession's responsibility for improvement of auditing where needed. A few years ago the Allied Crude Vegetable Oil fraud caused the Institute to appoint a similar committee which developed new auditing procedures for goods in public warehouses, which were the basis for that fraud.

Of course, if deficiencies are found in the audit work, if the auditors did not meet their professional responsibilities, we can take actions which will have a deterrent effect. In cases of this type we can, and have, instituted disciplinary proceedings under Rule 2(e) of our Rules of Practice, we can, and have, sought injunctive actions, or we can make criminal references in cases of gross malpractice. We are cooperating with the disciplinary and quality control efforts of the AICPA and we hope to work with the Institute in developing sanctions where peers review practice to determine whether improvements have taken place which should have a preventive effect.

Just yesterday, at 5:00 p.m., the Commission announced that the public accounting firm of Laventhol, Krekstein, Horwath & Horwath consented to an order in settlement of a disciplinary proceeding, which included two new sanctions specifically designed to improve the quality of the firm's practice in the future.

The first of these calls for an inspection by a team of qualified professional accountants at the end of a fifteen month period to determine that Laventhol is conducting its professional practice in conformity with supervisory and control procedures which it developed in cooperation with the Chief Accountant of the Commission. This inspection, it is hoped, will be undertaken by a team selected by the American Institute

of CPA's who will report the results to the Commission. Discussions with the AICPA have been initiated in this regard.

The second sanction prohibits Laventhol from effecting a merger with or acquisition of another accounting firm for one year without first submitting to the Chief Accountant of the Commission evidence that steps have been taken, in accordance with procedures adopted by that firm, to assure that the quality of their professional engagements will not be diluted by the acquisition.

The Commission has also taken steps to strengthen the auditor's position in meeting his professional responsibilities by adopting rules which are intended to discourage "accountant shopping" by the registrant when there are disagreements with the accountant over matters of accounting principles or practices, financial statement disclosures or auditing procedures. We have also urged public companies to appoint standing audit committees, composed of outside directors, which we believe will be helpful to the independent accountant in providing assurance of the objectivity of the financial statements.

In only a very few of the problem cases that we have studied have we concluded that the audit work was defective in terms of existing professional auditing standards, thus requiring sanctions under Rule 2(e). In other cases the auditing work was adequate but poor judgment was used in appraising the accounting principles used by the client, so that unqualified opinions were given on presentations which were inconsistent with accounting or economic reality.

In one such case (Penn Central), the staff of the Commission has publicly criticized the auditors for "form over substance accounting." The report said:

"The problem of distinguishing form from substance is a significant and difficult one, yet successful discrimination is essential if financial statements are to be meaningful to investors and creditors .... Independent auditors bear a heavy burden of public responsibility in reviewing transactions with such a distinction in mind....

"In addition to the analysis of various individual transactions, the overall impression left by the financial statements is part of the responsibility of the public accountants. Statements cannot simply be the accumulation of data relating to individual transactions viewed in isolation."

In other words, the accountant has a responsibility to assure that the financial statements "fairly represent" the issuer's financial condition or earnings. He cannot certify as accurate, statements which are misleading even if he can justify each one of the steps he has taken, when viewed separately. Fair representation may, and often does, require more than just the use of selected generally accepted accounting principles.

While the Commission is concerned over the number and magnitude of problem cases that have occurred in recent years, we realize that the total number is small in relation to the thousands of audits conducted every year. This record, however, is not good enough, because of the severe impact a few deficient cases may have on the market. The profession must consider the costliness of these errors in undermining confidence in all financial reports. Accountants must take a broader overall view in appraising the fairness of financial statements. Your professional responsibility under the auditing and ethical standards require this, and you must strive to meet this responsibility. The Securities and Exchange Commission is dependent on the professionals, both accountants and attorneys, in achieving our objective of full and fair disclosure under the securities laws. Without your best efforts we cannot succeed. With our combined best efforts we will not fail.