



SECURITIES AND EXCHANGE COMMISSION
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REMARKS OF
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SECURITIES AND EXCHANGE COMMISSION

before the

ILLINOIS SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS

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As you know, the Commission has daily contact with the work of a great many professional accountants by virtue of the large numbers of registration statements, proxy statements and financial statements of every type of business activity which are filed with us each year. Consequently, the Commission has a distinct vantage point from which to assess the accounting profession.

The Congress, in drafting the Securities Acts, expressed great confidence in the competence and integrity of professional accountants by making provisions in the Acts for independent audits of the financial statements to be filed. In fact, I believe the Securities Act of 1933 was the first Federal law to recognize the independent status of the public accountant -- a relatively new profession at that time. Reliance upon this new profession was and still is widely recognized as a most important factor in accomplishing the objectives of the Securities Acts.

However, in recent years the financial press and other critics -- some legal, some academic -- have raised questions as to the strength of the accounting profession and its competence to provide the leadership necessary to cope with the problems of an increasingly complex business world. There is no doubt that successful administration of the securities laws requires the highest standards of competence, leadership and integrity from all who are involved. As a former accountant -- that's the way the press refers to me -- I am particularly concerned that members of the accounting profession maintain the highest professional standards.

Of course the leaders of the profession are, and have always been, concerned with these problems. Nevertheless, periodic reappraisals are necessary. A helpful contribution was recently made by Maurice Moonitz and A.C. Littleton in their compilation of Significant Accounting Essays, which are very timely although they originated over a long span of time. A speech given by Robert H. Montgomery in 1905, entitled "Professional Standards: A Plea for Cooperation Among Accountants," is just as timely today.

The editors characterized his speech as:

"a clarion call for the members of a young profession to band together to weed out the incompetent and the unfit and to upgrade the remainder."

His discussion of the relationship of one accountant to another is extremely pertinent. He made a strong plea for support of professional societies as a means of maintaining high standards. One short paragraph reflects the flavor of the whole and will serve as a springboard to consider briefly the present state of the profession.

"It must be remembered that no one of us is free from error. The best lawyers make mistakes and lose cases which they should win; the best doctors, through errors of judgment, kill patients whom they should save, and so even an accountant will sometimes make a mistake and the last, the very last, one who should criticise him or attempt to profit thereby is his fellow practitioner."

Moving forward 64 years, another authority considers that relations between accountants still need improvement. John Lawler, Administrative Vice President of the AICPA, in a report to Council in 1969, cited this factor as contributing to a "divided house of accounting." He warned against the rather fierce competition that exists among firms today and violations of the spirit, if not the letter, of the Code of Ethics. He remarked:

"In large measure, the maintenance of a high level of professional conduct depends on self-discipline."

His admonition to the profession contrasts sharply with Montgomery's plea, which follows:

"Some practitioners have fallen into the bad habit of seeking to advance their own cause by deprecating their colleagues -- a mode of conduct which leads only to reprisals and thus to a general decline in the level of professional behavior."

Harmonious relations among members of your profession are essential to the effective administration of the securities laws. Historically, the Commission when drafting regulations has sought the advice of the accounting profession.

In turn, we have supported the efforts of the AICPA to develop and refine accounting principles. Division within the profession can only weaken coordination and progress in this area. On this point another statement by Mr. Lawler is pertinent. He said there must be

"a willingness on the part of the majority to respect dissent -- but also a willingness on the part of the minority, after orderly debate, to permit timely decisions."

Efforts by some corporate managements to pit one accounting firm against another have not escaped notice. These efforts, to the credit of the profession, have been largely unsuccessful, but their very existence indicates that the accounting profession as a whole can never relax its efforts to communicate to all its publics its unswerving adherence to the principles of truth and fairness in financial reporting, which is the hallmark of the profession. These principles are universals and not barter to be employed for business purposes or to acquire new clients. Unfortunately, managements of accounting firms do not speak out as often as they should on this subject.

Their reluctance raises serious questions in the minds of some observers about the independence of the accountant who defends his client's position with great enthusiasm. Is he an advocate for his client or for the public interest, which under the securities acts should be his primary focus.

Most would agree that the pressure brought to bear by management to constantly improve earnings per share is at the root of your problem -- from management's viewpoint a decline in earnings is to be avoided if at all possible. When it is not possible to show such an improvement, management frequently is tempted to perform a thorough housecleaning -- referred to by some as taking a "bath," -- and thereby lay the basis for better times ahead.

Always remember, resistance to premature recognition of income or loss is a protection to the investor and protection of the investor is the goal of the securities laws. Timing is crucial in determining whether to recognize income or loss.

In some cases there is room for argument, but be especially cautious when dealing with skillfully drafted legal documents which may blind the auditor and may result in the triumph of form over substance. We have observed examples of this in financial reporting for long-term leases, franchises and real estate transactions.

As I stated earlier, your profession was given special and unique status when the securities laws were enacted. Ponder the responsibility which accompanies that grant of status. True, it is a burdensome one. Especially in a time when so many are unwilling to concede that people are capable of serving an interest other than their own. Those skeptics should read the history of the accounting profession -- for it is replete with examples of how well you have served the public interest.

Keep up the good work because your continuance as a viable, respected profession is essential to the proper implementation of the securities laws, a matter of great national importance.

Another view of the problem of administering the securities laws has been raised in the "Report on Selected Independent Regulatory Agencies" -- popularly referred to as the "Ash Report." This report places in current perspective the role and certain activities of regulatory agencies, including the SEC.

The Commission fared well in the report; and, if I may immodestly claim, was rated higher than any of the other agencies studied. Admittedly, this conclusion will come as no surprise to those of you who have dealt with the Commission. However, in order to avoid any question about my objectivity, hear for yourself what the report has to say under the caption "A Capacity For Response":

"The SEC is regarded as one of the ablest of the independent regulatory commissions. . . ., we believe the Commission has for the most part carried out its congressional mandate and in so doing has earned a measure of investor confidence."

This recognition of the true worth of the Commission has been earned for the most part by my predecessors and by our permanent staff of professionals and non-professionals, alike. When I first arrived at the Commission I spoke favorably of our staff. Today, almost two years later, I hold the staff in even higher esteem. In that time I have also learned that we Commissioners are the envy of many other government officials because of the quality of our staff.

As far as my own duties are concerned, during the early part of my term I wondered whether the inherent inefficiency of a five-member commission was more than offset by the varied backgrounds and collective wisdom of the Commissioners. As time wore on -- and I wore out -- from seemingly endless meetings, I wondered all the more.

In the past, I am told, Commissioners wrote their own legal opinions, reviewed all registration statements and participated daily in many of the activities now completely delegated to the staff. Today, the Office of Opinions and Review writes the majority and dissenting opinions on almost all cases. While participation by individual Commissioners varies, for the most part such participation is limited to the refinement of the policy question, if there is one, and editorializing. Very seldom is a legal question not presented adequately by the Office of Opinions and Review.

In fact most other legal matters, particularly those which are very complex, the Office of General Counsel analyzes, briefs and recommends a decision for the Commissioners. The same is true of accounting issues which are similarly resolved by the Commissioners on the basis of the recommendation of the Office of the Chief Accountant. The Commissioners, in my opinion, would bear a heavy burden of proof to sustain either a legal or accounting opinion which would be at variance with those of either the General Counsel or the Chief Accountant.

Furthermore, the Commissioners no longer review registration statements nor declare them "effective" except in the most unusual circumstances. All the functions I have mentioned at one time consumed a substantial amount of a Commissioner's time. While it is true the securities laws are

continually evolving because of their complexity and the nature of the activities to which they apply, nevertheless, over the course of 37 years much uncertainty has been eliminated and, of equal significance, a capable staff has been organized and maintained.

But what of the future? Do the accomplishments of the past provide the framework for the future? The Ash Report contends that:

"Effective regulation by the SEC is threatened in that:

- . the SEC has been unable to obtain adequate support and legislative authority largely because of its independence from Congress and the President.
- . the collegial form of organization impedes the ability of the agency adequately to respond to the growing needs of the securities industry and the investor, conflicts with comprehensive agency policymaking and planning, and contributes to delays."

The Ash Report is right.

There is no question that insofar as financial support is concerned, the Commission has not been the beneficiary of the federal largess. I invite comparisons by any Senator and the General Accounting Office of our performance and our cost over runs with any other government contractor. I support the President's program for Revenue Sharing. In exchange, perhaps the Commission will be named as one of the recipients. Unmindful of continued rebuffs to our pleas for a larger budget, my hope springs eternal.

I urge the Appropriations Committee and the Office of Management and Budget to read in the Congressional Record of the last Congress the criticisms of the Commission. I say, if the Commission had been even reasonably successful in obtaining the money and staff it has repeatedly requested, much of that criticism would not have arisen. We know what has to be done. All we ask is that we be given the tools to do the job.

Essentially the Ash Report recommends that the Commission:

"be transformed into a Securities and Exchange Agency headed by a single administrator. Regulatory responsibilities under the Public Utility Holding Company Act should be transferred to the power agency."

The Commission has already indicated its willingness to transfer to the appropriate agency our responsibility for regulation under the Public Utility Holding Company Act. Therefore, the recommendation of the Ash Report to transfer our responsibility evokes no disagreement from me. On the other hand, if Congress is reluctant to make this change, I would only ask we be given additional funds so that we might better discharge our responsibility.

In addition, I agree with the Ash Report conclusion that the five-member Commission should be replaced by an Agency headed by a single administrator, appointed by the President and confirmed by the Senate.

As the Ash Report states:

"Replacing the Commission with a single administrator would focus responsibility for agency performance on one person and improve agency administration by eliminating delays attributable to collegial decision-making."

A word of caution is necessary. The efficiency and effectiveness of the Commission cannot and will not be improved merely by moving the blocks around on the organization chart. There must also be a dedication towards another fundamental of good management, i.e., never put a specialist in a line function unless the individual has a demonstrated administrative ability. Or as I recall what was stated during the hearings attendant to the formation of the Commission, "Specialized expertise should be kept on tap -- not necessarily on top." The Commission has suffered over the years because of failure at times to adhere to this axiom of good management.

In support of the general proposals the report states further:

"The need for restructuring the SEC stems less from past failures than from the necessity for assuring that it will be able to respond to the ever increasing pace and complexity of the securities industry."

In addition to the general proposal for reform of the Commission, the Ash Report recommended:

"That administrative review proceedings be streamlined by limiting the scope and time devoted to them and that the judicial review function be transferred from existing Federal courts to a new Administrative Court."

The report gave as the rationale for this recommendation three disadvantages which result from Commission review of initial decisions by Hearing Examiners. Generally the criticism is that policy is developed on a case-by-case basis confined by the scope of the particular proceeding rather than by rule-making, both formal and informal, setting forth broad objectives in a comprehensive setting unlimited by a particular fact situation. The disadvantages as stated in the report are:

"First, commissioners tend to view themselves as judges atop an administrative-judicial hierarchy... .

Second, this preoccupation with quasi-judicial activities has diverted attention and resources away from the more important responsibility of comprehensive and anticipatory policymaking. ...

Third, overjudicialization of the agency review process has a generally debilitating effect on the administrative mechanism. ..."

The report goes on to point out, as I have previously stated, that to mitigate against delays and other consequences the Commission has established an Office of Opinions and Review which, in fact, takes on the work of the Commissioners.

We can all agree that the Commission was created as an arm of the Congress, independent of the executive branch, for the purpose of developing an expertise in an extremely complex field. This was done principally to provide maximum protection for investors. Another equally important objective was to assure the unimpeded growth of trade and commerce to the extent consistent with the primary objective.

I have concluded that over the years we have moved away from the latter intent of the Congress and that furthermore, the trend away violates the true objectives of justice and inflicts immeasurable harm on the rate of growth of trade and commerce.

Therefore, I agree with the Ash Report proposal as far as it goes -- it does not go far enough.

In addition to removing the judicial function from the Commissioners, I believe that the entire judicial function, that is, the function of our Hearing Examiners also should be removed from the auspices and control of the Commission and established in a lower level court system. Perhaps this would be a good time to reexamine the 1969 proposal by the Federal Trial Examiners Conference that the title "Hearing Examiner" be changed to "Administrative Trial Judge" and a separate federal judicial system be created.

Also, a seven man Board of Directors should be created to make all policy decisions and to evaluate the daily operations of the Commission from a broad, practical perspective. I believe the only compelling reason for retaining a five-member Commission is to be sure Commission decisions are tested against the judgments of practical and experienced men and women. The recommendation of the Ash Report for a single administrator when coupled with my recommendation for a Board of Directors should overcome the fears of those who otherwise recognize the need for reorganizing the Commission. As I envision it, the Board of

Directors would be chaired by the Administrator of the Commission and would be composed of members who would be from each of the following groups: the accounting, economic and legal professions; the mutual fund industry; the broker-dealer community; and, very importantly, a consumer-investor oriented individual. All seven members of the Board of Directors would be appointed by the President, subject to the consent of the Senate, for concurrent four-year terms coinciding with the term of the President or until replaced at the pleasure of the President. The Board would deal with only broad policy matters affecting the operation of the Commission and the industries which it regulates. Board members would be required to attend periodic meetings, perhaps monthly or bi-monthly, and would be compensated based on their attendance. The creation of such a Board, in my view, would not defeat the objectives of efficiency which would stem from the Ash Report proposal.

I would like to make one final supplemental recommendation to the Ash Report. The President has stated as one of his goals that of returning government to the people. I support that goal; I respectfully submit that as part of the program to achieve it, the federal government in Washington must be dismantled and regionalized wherever possible. While I have lived and worked in Washington for only two years, I am persuaded that the real and urgent needs and problems of our country do not manifest themselves either in the personal daily lives of those who live in the capitol or in the surrounding communities. The reflections from clean white buildings and immaculate parks can sometimes be a source of blindness to some of the problems of terrible concern to the rest of the nation. Further, I believe some of the attitudes and decisions of government would have more acceptability across the nation if the people could be reassured that the people in and around government were experiencing the same problems they were. Regionalizing the government to the greatest extent possible should help to convince the nation that their government is not only in touch with reality but is actively responding to their needs. In furtherance of this personal belief, I have suggested that the Commission undertake to regionalize its activities to a greater extent and I shall continue my schedule of trips around the country to obtain first hand a knowledge of the problems of those who are subject to the laws administered by the Securities and Exchange Commission.

The Ash Report emphasizes the concepts of action and results by government. It is not too soon. Our government, including the independent agencies, if it is to serve the people, cannot do so effectively and expeditiously by retaining because of emotions or indifference tired and unworkable forms of organization and structure. It must be organized to anticipate the needs of society and to respond rapidly in those instances when it will fail to predict the problems and needs which will suddenly arise. The Ash Report proposals, together with my own will result in a structure which is more capable of accomplishing those goals.

In the meantime the SEC stands as presently constituted and attempts to do the best job it can with the men and tools at hand. It has often been criticized and occasionally praised, but in summation I would say it is best described by a recent writer who said:

"The Securities and Exchange Commission is known as a considerate agency of government, the guardian angel of widows and orphans and the polite policeman of those in the securities business. It is happily endowed with a competent staff which has traditionally displayed a benign understanding of the difficulties of compliance with all the niceties of federal securities regulation."

In all fairness I must also tell you the writer then went on for three pages to expose our weaknesses.

I hope that what I have said today will be of some help to you, and that you agree we share a responsibility to protect the public interest. In the last analysis, just how well we succeed will not be determined only by laws or by organizations, but by the intent each of us holds within himself.

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