

University of Mississippi

eGrove

Association Sections, Divisions, Boards, Teams

American Institute of Certified Public
Accountants (AICPA) Historical Collection

10-15-1973

Address, 86th Annual Meeting of the American Institute of Certified Public Accountants, Atlanta, Georgia, October 15, 1973

John E. Moss

Follow this and additional works at: https://egrove.olemiss.edu/aicpa_assoc



Part of the [Accounting Commons](#)

ADDRESS OF HONORABLE JOHN E. MOSS
CHAIRMAN, SUBCOMMITTEE ON COMMERCE AND FINANCE
COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE
UNITED STATES HOUSE OF REPRESENTATIVES

86th Annual Meeting of the
American Institute of Certified Public Accountants

Atlanta, Georgia

October 15, 1973

IT IS A GREAT PLEASURE TO BE WITH YOU THIS AFTERNOON TO DISCUSS SIGNIFICANT CHANGES THAT ARE NOW TAKING PLACE IN OUR NATION'S SECURITIES INDUSTRY.

AS MANY OF YOU ARE AWARE, DURING THE LATE 1960'S, A "PAPERWORK CRISIS" ENGULFED THE STOCK BROKERAGE COMMUNITY. AS STOCK EXCHANGE VOLUME ROSE AND ROSE, BROKERAGE FIRMS WERE UNABLE TO HANDLE THE PAPERWORK INVOLVED IN PROCESSING THEIR CUSTOMERS' ORDERS. THE FIRMS LOST CONTROL OF THEIR BOOKS AND RECORDS WHICH LED, AS YOU MIGHT EXPECT, TO A LARGE NUMBER OF BROKERAGE HOUSE FAILURES. THESE FAILURES PLACED THE INVESTING PUBLIC IN PERIL SINCE THEY HAD ENTRUSTED A CONSIDERABLE AMOUNT OF CASH AND SECURITIES TO THEIR BROKERS FOR SAFE-KEEPING. IN RESPONSE TO THIS EMERGENCY, CONGRESS ENACTED THE SECURITIES INVESTOR PROTECTION ACT OF 1970. THIS LEGISLATION CREATED A FEDERAL INSURANCE PROGRAM FOR BROKERAGE HOUSE CUSTOMERS COMPARABLE TO THE FDIC'S PROGRAM FOR BANK CUSTOMERS. WHILE THE INSURANCE FUND WAS TO BE CREATED

BY ASSESSMENTS ON THE BROKERAGE COMMUNITY, THE LEGISLATION PLEDGED A ONE BILLION DOLLAR LINE OF CREDIT FROM THE UNITED STATES TREASURY AS A BACKUP. IN EIGHT OF THIS PLEDGE OF PUBLIC MONEY, CONGRESS DETERMINED THAT IT WOULD CONDUCT A STUDY OF THE SECURITIES INDUSTRY WITH THE HOPE OF INSTITUTING NEEDED REFORMS SO AS TO INSURE THAT THIS ONE BILLION DOLLARS NEED NEVER BE USED.

THAT STUDY WAS CONDUCTED DURING 1971 AND '72. I AM HAPPY TO SAY THAT THE INSTITUTE GAVE THE CONGRESS CONSIDERABLE HELP DURING THAT STUDY. REPRESENTATIVES OF YOUR COMMITTEE ON STOCK BROKERAGE ACCOUNTING AND AUDITING, AS WELL AS A REPRESENTATIVE OF ONE OF THE INSTITUTE'S LARGER MEMBER FIRMS, TESTIFIED BEFORE OUR COMMITTEE AND OFFERED SOME EXTREMELY PERCEPTIVE INSIGHTS INTO MANY OF THE PROBLEMS THAT WERE PLAGUING THE BROKERAGE COMMUNITY. AFTER 12 MONTHS OF HEARINGS, DURING WHICH TIME WE HEARD FROM OVER 85 WITNESSES AND COMPILED A RECORD OF OVER 4,500 PAGES, THE STUDY CULMINATED IN A 170-PAGE, 14-CHAPTER REPORT. ONE OF THOSE CHAPTERS DEALT WITH THE QUESTION OF ACCOUNTING AND AUDITING PROCEDURES FOR BROKERS AND DEALERS. WE FOUND THAT THERE WAS A CLEAR AND COMPELLING NEED FOR THE DEVELOPMENT OF UNIFORM ACCOUNTING PROCEDURES FOR THE BROKERAGE INDUSTRY. IT APPEARED FROM OUR TESTIMONY THAT THERE ARE A NUMBER OF DIFFERENT WAYS THAT TRANSACTIONS OF BROKERAGE FIRMS MAY BE RECORDED, CLASSIFIED, SUMMARIZED AND PRESENTED, MAKING ANALYSIS AND REGULATION OF THIS INDUSTRY EXTREMELY DIFFICULT. GENERALLY, IT APPEARED THAT MORE DEFINITIVE STANDARDS IN BROKERAGE HOUSE ACCOUNTING COULD HELP TO PREVENT ANOTHER CRISIS OF THE KIND EXPERIENCED IN THE LATE 1960'S.

THE COMMITTEE INTRODUCED LEGISLATION TO IMPLEMENT THE FINDINGS OF OUR REPORT, AND IN THAT LEGISLATION WE AUTHORIZED THE SECURITIES AND EXCHANGE COMMISSION TO ADOPT RULES PRESCRIBING UNIFORMITY IN THE ACCOUNTING PROCEDURES AND SYSTEMS OF BROKERS AND DEALERS.

DURING THE HEARINGS OF THE SUBCOMMITTEE IN SEPTEMBER 1971, WE HAD CONSIDERABLE TESTIMONY ON THE DESIRABILITY OF UNIFORM ACCOUNTING PROCEDURES AND SYSTEMS AS OPPOSED TO UNIFORM REPORTING. MY RECOLLECTION IS THAT MOST OF OUR WITNESSES - INCLUDING REPRESENTATIVES FROM THE ACCOUNTING PROFESSION, THE SEC, THE NEW YORK STOCK EXCHANGE AND THE BROKERAGE COMMUNITY, EXPRESSED A BELIEF THAT THE COSTS OF IMPLEMENTING UNIFORM SYSTEMS OF ACCOUNTS WOULD BE SO HIGH THAT SUCH A MEASURE WAS UNFEASIBLE. THERE WAS A GENERAL CONSENSUS THAT, FOR REGULATORY PURPOSES, UNIFORM REPORTING WOULD SUFFICE.

IT WAS MY JUDGMENT THEN, AND IT IS STILL MY JUDGMENT TODAY, THAT, WHATEVER THE COSTS INVOLVED, UNIFORM ACCOUNTING SYSTEMS ARE ESSENTIAL. FOR EXAMPLE, A PRINCIPAL REASON THE SEC HAS FINALLY RECOGNIZED THE INEVITABILITY OF MOVING TO COMPETITIVELY DETERMINED COMMISSION RATES WAS THE IMPOSSIBILITY OF DERIVING MEANINGFUL INCOME AND EXPENSE DATA IN AN INDUSTRY AS DIVERSE IN COMPOSITION AS THE BROKERAGE BUSINESS. EVEN UNDER A COMPETITIVE RATE SYSTEM, STANDARDIZED SYSTEMS OF ACCOUNTS WOULD GREATLY HELP THE REGULATORY PROCESS.

FURTHERMORE, ANY EARLY-WARNING OR SURVEILLANCE SYSTEM DESIGNED TO IDENTIFY A BROKER-DEALER APPROACHING FINANCIAL DIFFICULTY WHICH WOULD MAKE IT A POSSIBLE CANDIDATE FOR SIPC TRUSTEESHIP IS ONLY AS GOOD AS THE

FINANCIAL DATA UPON WHICH IT RELIES. IF INCOME AND EXPENSE DATA ARE IMPROPERLY CLASSIFIED OR INTERPRETED SO AS TO MASK INCREASING UNPROFITABILITY, THE RISK OF PUBLIC FUNDS HAVING TO BE COMMITTED IN A SIPC LIQUIDATION BECOMES THAT MUCH THE GREATER.

THE SUBCOMMITTEE ALSO DETERMINED THAT THE READILY ANTICIPATED "SURPRISE" AUDIT, REQUIRED BY EXCHANGE RULES, SHOULD BE REPLACED BY ANNUAL AUDITS ON A CALENDAR OR FISCAL YEAR BASIS. UNDER THE SURPRISE AUDIT SYSTEM, THE PERIODS UNDER AUDIT COULD VARY FROM 8 MONTHS TO 22 MONTHS, MAKING YEARLY COMPARISONS OF A BROKERAGE FIRM'S FINANCIAL STATEMENTS VIRTUALLY IMPOSSIBLE. THE LEGISLATION NOW PENDING BEFORE OUR COMMITTEE REQUIRES BROKER-DEALERS TO FILE WITH THE COMMISSION AND SEND TO THEIR CUSTOMERS CERTIFIED INCOME STATEMENTS AND BALANCE SHEETS PREPARED ON A CALENDAR OR FISCAL YEAR BASIS FOR THE CURRENT YEAR AND, AS A MINIMUM, THE PRECEDING YEAR. IN THIS MANNER IT WILL BE POSSIBLE FOR THE FIRST TIME TO ACHIEVE COMPARABLE FINANCIAL DATA AMONG BROKERAGE FIRMS. VARIOUS EXCHANGES HAVE ALREADY MODIFIED THEIR SURPRISE AUDIT RULES IN ANTICIPATION OF THE ENACTMENT OF THIS LEGISLATION.

THE NEED FOR THESE CHANGES IN THE ACCOUNTING AREA WILL BECOME CRITICAL WHEN THE OTHER REFORMS EMBODIED IN THE LEGISLATION BECOME LAW. AMONG THE FOREMOST OF THESE IS THE SUBSTITUTION OF COMPETITIVELY DETERMINED COMMISSION RATES FOR THE CURRENT SYSTEM OF FIXED RATES. IN A COMPETITIVE ENVIRONMENT BROKERAGE FIRMS WILL BE COMPELLED TO COST THEIR SERVICES AND TO DETERMINE WHAT FEES THEY MUST CHARGE IN ORDER TO COVER THOSE COSTS AND EARN A REASONABLE RETURN ON THEIR CAPITAL. I BELIEVE THAT THE BROKERAGE

COMMUNITY WILL NEED THE VERY CLOSE HELP AND COOPERATION OF THE ACCOUNTING PROFESSION IN MAKING THE TRANSITION FROM FIXED PRICES TO PRICES DETERMINED BY THE FORCES OF COMPETITION.

THERE HAVE BEEN THOSE WHO HAVE SAID THAT THIS TRANSITION WILL BE TOO DIFFICULT. AND SOME HAVE EVEN SUGGESTED THAT THE SECURITIES INDUSTRY BE TURNED INTO A GIANT PUBLIC UTILITY AND SUBJECTED TO PUBLIC UTILITY TYPE REGULATION. ONE BROKER OPPOSED TO THIS CONCEPT HAS SUGGESTED, NOT ALTOGETHER SERIOUSLY, THAT THIS IDEA HAS BEEN PUT FORWARD BY MEMBERS OF THE BROKERAGE COMMUNITY WHO ARE NOW EARNING LESS THAN A 5 PER CENT RETURN ON THEIR CAPITAL.

UNFORTUNATELY, THE SECURITIES BUSINESS IS A GREAT DEAL LIKE THE LITTLE GIRL IN THE FAMOUS LIMERICK: WHEN BUSINESS IS GOOD, IT IS VERY, VERY GOOD, AND WHEN IT IS BAD, IT IS HORRID. LET'S BE FRANK ABOUT IT, AS MOST OF YOU KNOW, 1973 TO DATE HAS BEEN "HORRID" FOR THE SECURITIES INDUSTRY. BUT I CERTAINLY DO NOT BELIEVE THAT PUBLIC UTILITY TYPE REGULATION IS THE ANSWER TO THE PROBLEM, AND I KNOW OF NO ONE IN CONGRESS WHO WOULD ADVOCATE SUCH AN APPROACH FOR THE SECURITIES INDUSTRY. INDEED IF WE LOOK AT A NUMBER OF OUR REGULATED INDUSTRIES, SUCH AS THE AIRLINES AND THE RAILROADS, IT WOULD NOT SEEM UNREASONABLE TO SUGGEST THAT PERHAPS LESS REGULATION AND MORE COMPETITION IS THE ANSWER, RATHER THAN THE OTHER WAY AROUND.

ANOTHER MAJOR CHANGE TAKING PLACE IN THE SECURITIES INDUSTRY IS THE CREATION OF A NATIONAL MARKET SYSTEM. THIS SYSTEM WILL LINK TOGETHER, BY MEANS OF A CONSOLIDATED TRANSACTIONAL TAPE AND A COMPOSITE QUOTATION SYSTEM, THE NUMEROUS STOCK EXCHANGES AROUND THE COUNTRY, AS WELL AS THOSE

BROKERS WHO MAKE MARKETS IN EXCHANGE LISTED SECURITIES. THE COMPOSITE QUOTATION SYSTEM WILL ALLOW A STOCK BROKER TO PUNCH A BUTTON ON A CONSOLE IN HIS OFFICE AND HAVE DISPLAYED ON A CATHODE-RAY TUBE THE BID AND ASKED PRICES FOR THE SECURITY IN QUESTION IN ALL THE MARKET CENTERS AROUND THE COUNTRY. THIS WILL ALLOW THE BROKER TO GO TO THAT MARKET CENTER WHICH WILL GET HIM THE BEST PRICE FOR HIS CUSTOMER. WHEN THAT TRANSACTION IS EXECUTED, NO MATTER WHERE IN THE COUNTRY IT IS EXECUTED, THE TRANSACTION WILL BE DISPLAYED ON A TRANSACTIONAL TAPE, SORT OF A SUPER TICKER TAPE. THUS, YOU WILL NO LONGER HAVE THE SITUATION THAT WE HAVE TODAY WHERE SOME TRADES IN LISTED SECURITIES ARE NOT PUBLICLY DISPLAYED.

THE NEED FOR THE NATIONAL MARKET SYSTEM IS MANDATED BY THE SIGNIFICANT CHANGE THAT HAS TAKEN PLACE IN OUR NATION'S SECURITIES MARKET. UNTIL FAIRLY RECENTLY INDIVIDUAL INVESTORS PLAYED THE MAJOR ROLE IN OUR SECURITIES MARKETS WITH INSTITUTIONAL INVESTORS PLAYING A SUBSIDIARY ROLE. RECENTLY, THAT SITUATION HAS BEEN REVERSED. TODAY INSTITUTIONAL INVESTORS ACCOUNT FOR APPROXIMATELY 70 PER CENT OF THE VOLUME OF TRADING ON THE NEW YORK STOCK EXCHANGE, AND THAT VOLUME HAS RISEN DRAMATICALLY FROM AN AVERAGE OF 3 MILLION SHARES A DAY IN 1960 TO AN AVERAGE OF OVER 16 MILLION SHARES A DAY IN 1972. WE URGENTLY NEED TO CREATE A MARKET SYSTEM WITH ADEQUATE DEPTH, BREADTH, AND LIQUIDITY TO HANDLE THIS CHANGED MARKET CONDITION. BUT EQUALLY IMPORTANT, WE MUST LOOK AT THE CONSEQUENCES OF ALLOWING LARGE INSTITUTIONAL INVESTORS TO CONTROL AN EVER-EXPANDING PERCENTAGE OF OUR NATION'S WEALTH.

THE PROBLEM OF ECONOMIC CONCENTRATION IS QUITE REAL. IN ITS INSTITUTIONAL INVESTOR STUDY, THE SECURITIES AND EXCHANGE COMMISSION PROVIDED COMPREHENSIVE DATA ON THIS TREND. THOSE DATA INDICATED, FOR EXAMPLE, THAT AS OF SEPTEMBER 30, 1969, ONLY THREE INSTITUTIONS CONTROLLED 25 PER CENT OF THE OUTSTANDING STOCK OF GULF OIL CORPORATION; THAT ONLY FOUR INSTITUTIONS CONTROLLED 35 PER CENT OF FORD MOTOR COMPANY STOCK, AND THAT ONLY FOUR INSTITUTIONS CONTROLLED 25 PER CENT OF THE OUTSTANDING STOCK OF SEARS ROEBUCK.

OF ALL THE INSTITUTIONS, BANK TRUST DEPARTMENTS ARE BY FAR THE LARGEST. THE SEC STUDY GAVE FIGURES AS TO THEIR HOLDINGS AS WELL, AGAIN AS OF SEPTEMBER 30, 1969. I FIND IT EXTREMELY DISTURBING TO DISCOVER THAT TWO BANK TRUST DEPARTMENTS CONTROLLED 20 PER CENT OF GULF OIL CORPORATION STOCK, FIVE BANK TRUST DEPARTMENTS CONTROLLED 25 PER CENT OF THE OUTSTANDING STOCK OF AVON PRODUCTS, AND FIVE BANK TRUST DEPARTMENTS CONTROLLED 15 PER CENT OF EASTMAN KODAK. BASED ON TRENDS SINCE 1969, I CAN ONLY ASSUME THAT THE AMOUNT OF CONCENTRATION HAS INCREASED.

I VIEW THIS MATTER AS BEING ONE WHICH DESERVES THE MOST CAREFUL ATTENTION OF CONGRESS. I ~~HAVE RECENTLY INTRODUCED~~ ^{WILL INTRODUCE TOMORROW} A BILL WHICH WOULD REQUIRE ALL INSTITUTIONAL INVESTORS TO REPORT THEIR PORTFOLIO HOLDINGS AND TRANSACTIONS TO THE SECURITIES AND EXCHANGE COMMISSION ON A PERIODIC BASIS. THESE REPORTS WOULD BE PUBLIC DOCUMENTS, AND WOULD BE SUBJECT TO ANALYSIS BY THE CONGRESS, THE SEC AND OTHERS. IT HAS BEEN URGED THAT THE CONGRESS GO FURTHER AND PLACE LIMITATIONS ON THE AMOUNT OF SECURITIES IN ANY ONE COMPANY THAT AN INSTITUTIONAL INVESTOR MAY OWN OR MAY TRADE

AT ANY ONE TIME. IN MY JUDGMENT AT THIS TIME WE SHOULD WITHHOLD PLACING SUCH LIMITATIONS ON INSTITUTIONAL INVESTORS UNTIL WE ARE ABLE TO STUDY THE FIGURES THAT SHOULD RESULT FROM THE DISCLOSURE LEGISLATION.

ANOTHER EFFECT OF THE INSTITUTIONAL DOMINANCE OF OUR MARKET PLACE IS THE INABILITY OF A LARGE NUMBER OF AMERICAN CORPORATIONS TO RAISE THE EQUITY CAPITAL THEY SO URGENTLY NEED TO DO THEIR BUSINESS. FOR THE SMALL GROUP OF STOCKS THAT ARE FAVORED BY THE INSTITUTIONAL INVESTORS AND WHICH SELL AT SUBSTANTIAL PRICE EARNINGS MULTIPLES, THE RAISING OF EQUITY CAPITAL IS NOT A PROBLEM. BUT FOR THE HUNDREDS OF FIRMS, BOTH NEW AND OLD, WHICH ARE NOT ON THE FAVORED LIST, AND WHICH SELL AT VERY LOW PRICE EARNINGS MULTIPLES, RAISING EQUITY CAPITAL HAS BECOME A SERIOUS PROBLEM. THE LOW PRICES AT WHICH THESE COMPANIES ARE SELLING HAVE ALSO ATTRACTED INTEREST THROUGHOUT THE WORLD. FOREIGN INVESTORS, WHO HAVE AN ABUNDANCE OF DEVALUED AMERICAN DOLLARS, AND WHO SEE EXTREMELY ATTRACTIVE INVESTMENTS IN LOW P-E MULTIPLE AMERICAN COMPANIES ARE BEGINNING, AT AN UNPRECEDENTED AND ALARMING RATE, TO BUY INTO AND CONTROL VITAL AMERICAN INDUSTRIES. I AM VERY DISTURBED BY THE POSSIBILITY OF AMERICAN COMPANIES ENGAGED IN INDUSTRIES SUCH AS DEFENSE AND ENERGY BEING TAKEN OVER AND CONTROLLED BY FOREIGN ENTITIES.

I HAVE TRIED TO SKETCH FOR YOU THIS AFTERNOON SOME OF THE MATTERS THAT CONGRESS IS INVOLVED WITH AT THIS TIME WITH RESPECT TO OUR NATION'S SECURITIES MARKETS. MANY OF THESE MATTERS INVOLVE YOU DIRECTLY--PROFESSIONALLY AS ACCOUNTANTS AND PERSONALLY AS INVESTORS. I BELIEVE THAT THE ACTIONS BEING TAKEN BY CONGRESS ARE GOING TO HELP STRENGTHEN OUR

SECURITIES MARKETS, WHICH HAVE BEEN AND WHICH WE WILL STRIVE TO MAINTAIN AS THE ENVY OF THE WORLD. NO ONE KNOWS ALL THE ANSWERS TO THE PROBLEMS FACING OUR NATION'S SECURITIES INDUSTRY, AND WE IN CONGRESS WELCOME YOUR COMMENTS, YOUR SUGGESTIONS AND YOUR COOPERATION IN THE MONTHS AHEAD.