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Editorial

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A. P. RICHARDSON, *Editor*

EDITORIAL

International Congress of Accountants

The council of the American Institute of Accountants has resolved to act upon a suggestion received from the president of the International Congress of Accountants that the next meeting of that organization should be called for 1929 and that the place should be somewhere in the United States. The council directed the executive committee to appoint a special committee to make plans and to invite other organizations of accountants to coöperate. The executive committee acted promptly in accordance with instructions and a special committee has been appointed, invitations to coöperate have gone to other societies of accountants and arrangements are now being made for a preliminary meeting of the committee of the Institute with the committees of other societies to be held before the end of this year. The Institute's committee is representative of all parts of the country and no firm is represented by more than one member. It is impossible at this time to make any definite statement about the proposed congress. The programme will be comprehensive and it will be desirable to have the active and hearty support of all who are interested in accountancy. Men who attended the Amsterdam meeting in 1926 express the opinion that there will be delegates from nearly every European country, and it is confidently expected that all the American republics will send representatives. It seems probable that such a congress will select Washington as the place of meeting. There could be no better place and the facilities available there are adequate in every way. Visitors from abroad naturally will wish to see the national capital and the executive departments of government will certainly be glad to encourage a meeting which will do much to bring about better understanding between nations. This congress is to be a matter of importance, and accountants throughout the country should be willing to do all that lies within their power to make it the success which the honor of American accountancy requires that it

shall be. From time to time announcements of plans and of progress will be made in the publications of the Institute, and doubtless in other papers as well, and we urge all who read to take and to maintain interest in what will be done.

Treasury Department Circular 230

There has been a good deal of doubt in the minds of accountants as to the meaning and effect of one of the paragraphs of the treasury department's revised circular number 230 with reference to the certificates required of practitioners before the bureau of internal revenue. So many letters were received asking for an opinion on the subject that the matter was placed before the counsel of the Institute and we are glad to present his reply for the information of our readers. It will appear that the fears which many accountants expressed that the requirements can not be literally observed do not seem well founded. Counsel says:

> "In accordance with your request for an opinion as to the proper method of complying with paragraph 2 (f) of treasury department revised circular No. 230, I have studied that circular and discussed its purpose and scope at the treasury department. My opinion follows:
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> "Paragraph 2 (f) of circular No. 230 (revised July 1, 1927) provides as follows:
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> > "Every affidavit, argument, brief or statement of facts prepared or filed by an attorney or agent as argument or evidence in the matter of a claim or tax matter pending before the treasury department shall have thereon a statement signed by such attorney or agent showing whether or not he prepared such document and whether or not the attorney or agent knows of his own knowledge that the facts contained therein are true."
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> "This paragraph can best be understood in the light of the evil sought to be prevented. Unscrupulous practitioners have prepared both for submission by taxpayers and for submission by themselves to the department false statements. In such cases the difficulty of proving who is the real culprit is obvious. In some cases the practitioner does not appear at all; in others he attempts to shift the responsibility to the taxpayer or to some third person.
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> "The object of the present paragraph is to insure that every practitioner preparing or filing a paper shall state to what extent he assumes responsibility for the document. It is not to embarrass honest practitioners. The two questions asked do not have to be answered categorically 'yes' or 'no.' The true facts may and should be stated. For instance, a practitioner might state that a brief was prepared in his office and under his supervision and direction; that certain (specified) exhibits were prepared at his request by the taxpayer, or an appraiser or whoever did prepare them; that the facts or certain of them (specifying) he knows to be true or that the facts were furnished to him by the taxpayer or another and that he believes them to be true.
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> "In short, it is my opinion that the department wants to know the facts as to how and by whom the document was prepared and how far the person or persons preparing it or furnishing it assumes responsibility for its veracity.

"From what has been said above it follows that the signing of a firm name to such a statement does not accomplish the end sought. That end is to fix individual responsibility and to prevent this responsibility from being shifted when trouble arises. If a firm (either of lawyers or accountants) prepares or files a document, some enrolled attorney or agent must assume responsibility for it, or make it clear that no responsibility is assumed."

Cost of Floating Securities

A well-known lawyer at a recent meeting of the New York State Society of Certified Public Accountants propounded the suggestion that it would be well to adopt in this country a provision of law similar to that contained in the English companies acts with reference to the information which must accompany every offering of corporate securities. He spoke of the difference between the price paid by bankers or syndicates of bankers for stocks and bonds and the price at which the same securities are offered to the public—a difference which is called in the jargon of Wall street "the spread." This is not a new idea. It has been uttered many times. But it is always interesting and always will be until the time comes when every detail to which the investor is justly entitled is made available to him. (The requirements of many of the so-called "blue-sky" laws of the states call for the exposition of detail, but there is no uniformity and the information seldom reaches the public.) It matters not whether the difference between the price received by the issuing company and that paid by the public is considered commission or profit upon sale and purchase—the effect is the same. It is true, and generally known to be true, that the charge for underwriting an issue of securities is often out of all fair proportion to the amounts received by the borrowing companies. It is always a difficult matter to float a large volume of new securities without aid of one or more influential banking houses whose standing and clientele assure a sale of anything that looks reasonably safe and sound. Theoretically it should be possible for the company which needs money for working capital to advertise its wants, and, when there is such an abundance of money as there has been in America for several years past, it should be a perfectly simple matter to obtain funds directly from the investor without the intervention of a middle man. But we all know that this theory is good only as a theory. Practically the lender and the borrower, if the link between them is in the form of securities, never meet. And the costs of the services which the investment banker renders are high in inverse ratio to the merit of the bonds, debentures or stock which are con-

cerned. In other words, the more reputable bankers are content with a smaller spread because they endeavor to restrict their energies to the best class of securities. When a really good medium of investment is coming to the market there is not a dearth of underwriters and, consequently, even if the bankers were inclined to charge excessive fees or profits for their efforts, they would be forced by the fact of competition to accept a lower compensation. But the reputable banking house is not addicted to the practice of extorting the uttermost farthing, even if it can be obtained. It is the other kind of banking venture—venture is a good word—which charges and overcharges to the disadvantage of both lender and borrower. Such a concern spreads the spread to unconscionable extent—and unfortunately it is to that kind of concern that many borrowers are forced to appeal. The less evident the strength of an issuing company the more difficult it is to enlist the support of good bankers, and so the investment shark comes in and swallows up all that he can reach. It is quite certain that the proposal to require full information of costs, commissions, spread, etc., will be vigorously opposed by those houses which have profited most richly by the past and present absence of compulsory publicity. But, on the other hand, the banker of good repute should and doubtless would welcome the utmost frankness about his dealings. The public is pretty generally foolish when it invests—always when it gambles—but it is not so utterly asinine as to ignore danger signals which would be displayed if we had laws demanding that the profits of promoters and underwriters be shown in full. The public can probably be trusted to take note of the disparity between profits of five per cent. and fifty per cent.

The Desirability of Publicity

A little more than a year ago there was quite a flutter in the financial centers about some rather startling allegations to the effect that the public was being grossly deceived by the published accounts of corporations whose securities were the media of common investment. These stories were not all well founded, but there was a sufficient amount of truth underlying the general criticism to arouse the people who have money to invest and also the exchanges, the bankers and brokers. As America is today the richest nation in the world and as its wealth is more widely distributed than the wealth of any other country, it naturally follows

that the investing public is a very substantial percentage of the nation as a whole. What stirs the investor, therefore, stirs the whole people directly or indirectly. For a few months there was reason to believe that we were to have a great reform. Accountants seized the opportunity to write and speak for the cause of frank publicity. Exchanges professed a zeal for the work of improving conditions. Everyone who had anything to do with money or the sale of money was filled with enthusiasm—a kind of religious fervor swept over us. But a year has gone by. The conditions are not changed. There is little more frankness than there was. It begins to appear that the effect of the revival is, like the effect of many noble plans, almost exactly nil. Most of us have forgotten that the banner of the crusade was ever raised. We have stopped at Stamboul. Yet if there was a cause last year, there is one today. Every accountant admits quite eagerly that things are not altogether as they should be. He would like to see absolute exposition of detail for the benefit of the public. There are, of course, always some intimate internal details which have no bearing upon the stability of a concern and could only be made known to the advantage of competitors. But it is seldom indeed that the company which is sound and onward-going has anything to lose by telling the whole truth. There are so many ways in which the reader of a financial statement may be deceived that it is unnecessary to attempt to recite them here. The accountant has been preaching the crusade for years but his voice has not prevailed; he has been accused of self-interest. Of course, he would like to see full statements of conditions because he would be called upon to prepare them. But when outsiders who could have no ulterior purpose to serve, excepting perhaps an excusable willingness to ascend the rostrum, directed the attention of the people to the facts it was suddenly discovered that the accountant had not been such a false prophet as he had been held to be. The accountant was not altogether unselfish in crying for reform, but if a great good to the whole people involves a small good to a particular class of the people that does not seem sufficient reason for postponing or rejecting it. It is rather silly to refuse a blessing because it is to be universal. However, it is unnecessary to argue that point now. What is before us is the sad and astonishing failure of the public to insist upon reform when the need for reform has been not only revealed but acclaimed. Truly, the American public is a marvellous entity. It is not physically inert or even

lazy, but at times it does appear to be extraordinarily apathetic. The oldest observer of Wall street would not have believed that within a year from the excitement which followed the call for facts the whole incident would have passed without action and have been forgotten. Perhaps the bull market which ran so long a course made people lose sight of everything else. If there had been a falling market, a shortage of money, a psychological or an actual depression in business, people would have had more time to devote to reform. No one longs for a dull market, but it may have its advantages.

The British Law and Practice

Now, what is there in this proposal that the profit of the underwriter be disclosed which makes it any more probable of effect? Certainly the accountant is not directly interested. It means nothing to him as an accountant whether the spread between purchase and sale be revealed or not. And it is not quite clear to us what the speaker who made the proposal thought that accountants could do to advance the plan which he had in mind. Possibly accountants as a class could urge publicity in the cause of fairness to all concerned; but it seems to us that the matter is one for legislation, and it is notorious that the accountants' influence upon general legislation is not considerable. The speaker, however, referred to the British custom and the law which governs the issuance of securities and here he raised a question in which accountants have a vital interest. We have said times out of number that the greatest need, from the accountant's point of view, is the enactment of legislation in all our states embodying the principles of the English companies acts. There are many features of the system of regulating companies in Great Britain which might not apply here, but for the most part the laws and regulations which have been found satisfactory in that country could be adapted to the conditions in the United States. The provision relative to the election of auditors is one to which we have referred frequently. The choice of auditors by shareholders rather than by directors is absolutely sound in theory and practice. The rule that auditors shall not be changed except for cause or at their own wish is also salutary. And there are many other requirements which might be imported and would do much to allay the doubts which have been properly expressed here as to the sufficiency of the statements which companies issue. On the

question of what shall be disclosed about expenses of flotation and sale of securities the English act provides as follows:

81.— . . .

(h) The amount (if any) paid within the two preceding years, or payable, as commission for subscribing or agreeing to subscribe, or procuring or agreeing to procure subscriptions, for any shares in, or debentures of, the company, or the rate of any such commission: provided that it shall not be necessary to state the commission payable to sub-underwriters; and

(i) The amount or estimated amount of preliminary expenses; and

(j) The amount paid within the two preceding years or intended to be paid to any promoter, and the consideration for any such payment; and . . . . .

89.—(1) It shall be lawful for a company to pay a commission to any person in consideration of his subscribing or agreeing to subscribe, whether absolutely or conditionally, for any shares in the company, or procuring or agreeing to procure subscriptions, whether absolute or conditional, for any shares in the company, if the payment of the commission is authorised by the articles, and the commission paid or agreed to be paid does not exceed the amount or rate so authorised, and if the amount or rate per cent. of the commission paid or agreed to be paid is—

(a) In the case of shares offered to the public for subscription, disclosed in the prospectus; or

(b) In the case of shares not offered to the public for subscription, disclosed in the statement in lieu of prospectus, or in a statement in the prescribed form signed in like manner as a statement in lieu of prospectus and filed with the registrar of companies, and, where a circular or notice, not being a prospectus, inviting subscription for the shares is issued, also disclosed in that circular or notice.

(2) Save as aforesaid, no company shall apply any of its shares or capital money either directly or indirectly in payment of any commission, discount, or allowance, to any person in consideration of his subscribing or agreeing to subscribe, whether absolutely or conditionally, for any shares of the company, or procuring or agreeing to procure subscriptions, whether absolute or conditional, for any shares in the company, whether the shares or money be so applied by being added to the purchase money of any property acquired by the company or to the contract price of any work to be executed for the company, or the money be paid out of the nominal purchase money or contract price, or otherwise.

(3) Nothing in this section shall affect the power of any company to pay such brokerage as it has heretofore been lawful for a company to pay, and a vendor to, promoter of, or other person who receives payment in money or shares from, a company shall have and shall be deemed always to have had power to apply any part of the money or shares so received in payment of any commission, the payment of which, if made directly by the company, would have been legal under this section.

90. Where a company has paid any sums by way of commission in respect of any shares or debentures, or allowed any sums by way of discount in respect of any debentures, the total amount so paid or allowed, or so much thereof as has not been written off, shall be stated in every balance-sheet of the company until the whole amount thereof has been written off.

An Instance of Good Practice

There is, however, a new spirit at work in the financial world and in course of time it will so prevail that the obscure methods of an earlier day will be entirely abandoned—at least it

seems probable. Of course every well informed man knows that not one half the villainy of which financiers have been accused ever existed outside the fancy of political demagogues and their disciples, but it is equally true that some very damnable things have been done and perhaps are still being done in the name of investment. Thousands of people have been deceived and thousands of families have been impoverished by the plausible wiles of men and companies engaged in the business of selling what seemed to be securities. There have always been honest bankers and brokers, but it must be admitted, even by the most devout apologist, that in years which the ancient among us can remember well there was a lamentable abundance of dishonesty, baseness and thievery to be found wherever financial affairs were handled. That time, however, is happily past and the business of finance is a business at least as fairly and openly conducted as any other. The shark of Wall street is in bad odor and he would soon starve to death if everyone would listen to the warnings which are everywhere displayed. It is a great pity that a business which is so intimately concerned with the life and happiness of a great majority of the people should have been defamed and obstructed by the unprincipled practices of some of its early participants. The average man of Chicago or San Francisco or Atlanta or New York knows that as a whole the investment business is conducted well, but if the average man of a great city will travel a little way from home and visit with his brother, the average man of the small town, he will be astonished to find how almost universal is yet the belief that every financier—using the term in its true sense —is merely a slightly polished footpad. The resident of Smithville or Jonesburg would sooner risk the perils of the hold-up belt in Chicago or New York than enter unarmed and unaccompanied a broker's office in the financial districts of those cities. It is well to remember the truth. It helps to explain the readiness with which a style of political oratory is received by the country at large. However, it is quite certain that if the investment business had always been conducted on the present plane it would be in general favor. It suffers today from past misdeeds. It labors under the burden of the policy or impolicy which was summarized in the phrase "The public be damned." Russia is the victim of sovietism because of its over-indulgence in the wine of tyranny. All this by a too roundabout way is leading up to a reference to something which was mentioned in the daily papers not long ago,

but does not seem to have attracted the attention it deserves. It would be an excellent means of wiping mist from the spectacles of the public if the facts about this affair were known. The case to which we refer was an application of the principle which many of our good mercantile houses have adopted "Your money back if you are not satisfied," and it was applied to so considerable a matter as an issue of debentures which in the language of the market place had "gone bad." The banking house of Hayden, Stone & Co., sent the following letter to the protective committee for debenture holders of the Shipman Coal Co.:

NEW YORK CITY, October 4, 1927.

SHIPMAN COAL COMPANY DEBENTURE HOLDERS
PROTECTIVE COMMITTEE:

Dear Sirs:

As you know, we have been carrying on negotiations with various coal companies operating in the anthracite field looking toward the further development of the properties of the Shipman Coal Company. We proposed to each of several different companies that we would furnish one half, if they would furnish the other half, of any additional capital needed for these properties and that they take over the management thereof. We regret to say that each has refused to proceed because of the showing in underground developments made during the past year.

In the meantime, we have been furnishing money to receivers, acting under court appointment, to keep the mines pumped out. Being satisfied that further expenditure would be useless, we have determined to notify the receivers that we will not provide further funds and also to notify the lessors of the company's property to this effect.

We could not conscientiously advise you to spend your money on this property. If you do not, the receivers doubtless will arrange immediately for the sale of the company's assets, which consist of operating equipment having practically a scrap value only.

We understand that you, as a debenture holders' committee, have claims, the enforcement of which is now being considered against the officers of Shipman Coal Company and/or Weston Dodson & Co., Inc., or its officers who were managing the operation of Shipman Coal Company.

Under these circumstances, because of those who, relying on us and our investigations, put their money into these securities, we hereby make the following voluntary offer to you and through you to debenture holders whom you represent:

If you will begin and prosecute to final judgment all necessary and proper actions and take any other steps proper to endeavor to establish and enforce your claims, including those against those connected with the management of these properties, we will defray the actual cost of such proceedings; and, in the end, will reimburse all depositors for the difference between the net amounts, if any, that may be finally recovered by you through such actions or proceedings and the par value of the debentures deposited by them.

Please communicate with the debenture holders, and after such expression as you may obtain from them, advise us of your action upon this offer.

Very truly yours,

HAYDEN, STONE & CO.

We have been told that this is not the first time that a loss has been made good by an investment banking house, but, if it is not the first, it is at least among the first and it affords a splendid

object lesson of what may be called the new day in finance. Of course many people will say that the protection of investors was necessary in order to save the good name of the house, and that is true; but that argument does not destroy the moral of the story—it strengthens it, rather. It indicates the change in conditions which now makes it necessary to amend the old warning to read "Let the seller beware." The action of the bankers in this case may not be quickly followed by all who deal in securities today, but it is at any rate a hint of what may be done some day. There is much talk of the guaranty of deposits—perhaps that will come. It seems to be only a short distance from that to the guaranty of investments which may be brought about by two causes, both good, namely, altruism and self-protection.