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American Institute of Certified Public Accountants (AICPA)

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A Monthly Report on Federal Legislative Matters Affecting CPAs

AICPA
American Institute of Certified Public Accountants

Securities Litigation Hearings Play to Packed House

Advocates for reforming the securities litigation system squared off with defenders of the present system at two packed House of Representatives hearings this summer. From the impassioned language of consumer advocate Ralph Nader to the measured words of Securities and Exchange Commissioner Arthur Levitt, Jr., more than 12 witnesses brought their arguments to Capitol Hill.

Leading the charge for securities litigation reform was Rep. Billy Tauzin (D-LA), who characterized the nation's securities law as a "good law that has gone bad." The intent, he said, of SEC rule 10b-5, under which securities fraud class action suits are brought, is to protect investors from fraudulent activities. The effect of the rule, Rep. Tauzin charged, has been the reverse.

Securities fraud class action suits are not automobile accidents at the street corner, Rep. Tauzin said. A better analogy for the complexity and magnitude of the cases would be "aircraft carriers moving through the judicial system." Too often, the Louisiana congressman charged, these cases are brought against companies whose only crime is a drop or gain in the price of their stock.

Rep. Tauzin's bill, H.R. 417, was the subject of the hearings by the House Subcommittee on Telecommunications and Finance in July and August. The measure, the Securities Private Enforcement Reform Act, would help deter the filing of frivolous class action securities fraud cases. H.R. 417 is strongly supported by the AICPA, and has attracted nearly 150 co-sponsors.

Rep. Ed Markey (D-MA), the chairman of the subcommittee which held the hearings, is a skeptic about the need for broad securities reform. He had no harsh words for the profession, but also expressed no support for the profession's proposed solutions. However, he did reveal, in his opening statement kicking off the hearings, support for improving the "process of initiating and managing securities fraud class actions that will enhance rather than threaten the rights of investors, while possibly lessening the burdens felt by defendants." Chairman Markey also called on Congress to address "the unseemly race to the courthouse, the fees allegedly paid by some lawyers to brokers for referrals, and the rare but not unheard of practice of filing form complaints."

Rep. Billy Tauzin (D-LA)

A relatively calm atmosphere prevailed during the first day of hearings before the subcommittee. The primary witness was SEC Chairman Levitt. After first stipulating that

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the SEC has not taken an official position on the bill, he agreed with Chairman Markey that a consensus for reform most likely can be reached on some provisions of H.R. 417.

At the more contentious second hearing--a marathon session that lasted nearly six hours--a number of witnesses challenged the argument of reform advocates that there is a litigation explosion. Statistics were bantered between witnesses and panelists, with reform opponents maintaining that the number of cases filed has remained relatively constant.

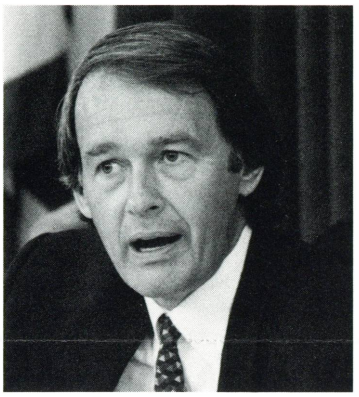
Another hotly debated topic at the second hearing was whether a proportionate liability standard, a key element of H.R. 417, should be adopted in lieu of the present standard of joint and several liability. Opponents of proportionate liability seem to fear that shareholders who are plaintiffs in these suits may not be adequately compensated for losses. A majority of witnesses at the second hearing lined up in opposition to proportionate liability; they included academicians, a representative of the North American Securities Administrators Association, and a partner from a California law firm that often files these suits. SEC Chairman Levitt also expressed reservations about adopting a proportionate liability standard. He told the panel, "...Proportionate liability is something that, as chairman of the Commission, I really am uncomfortable with...I think it denies investors certain protections which are our [the Commission's] fundamental right to preserve and to protect."

J. Michael Cook

J. Michael Cook, chairman and chief executive officer of Deloitte & Touche, ardently argued for adoption of a proportionate liability standard. "In the real world, in which we confront 10b-5 lawsuits, something has gone terribly wrong, and that something can be traced to the role of joint and several liability and the role it plays in prompting litigation and forcing settlements...." He blamed "market incentives" for encouraging plaintiffs' attorneys to pursue cases "without regard to the merits of the underlying claims." Establishing a proportionate liability standard, Cook asserted, would change the incentives so that attorneys would be forced to focus on cases with merit.

Outlook

These hearings in the House are likely to be the last substantive action by Congress in 1994 regarding securities litigation reform. The House hearings this summer and the Senate hearings last year represent a gain in the battle to achieve reform. The hearings heralded the opening of the public dialogue about the need for securities litigation reform, and the profession effectively made its case about the need for reform. As a result, the areas of greatest contention between the two sides in the debate are staked out. We now have the coordinates we need to plot our strategy for the upcoming Congress. The political task for the AICPA is to ensure that when Congress acts it includes reform provisions with direct benefit to the profession.



Rep. Ed Markey (D-MA)

House Strips GATT Funding Provisions Opposed by AICPA from Bill

A Treasury Department proposal strenuously opposed by the AICPA to repeal the LCM as a way to fund the cost of the Uruguay round modifications to the General Agreement on Tariffs and Trade (GATT) was stripped from the financing measure by the House Ways and Means Committee.

The Clinton Administration had targeted changes to the taxation of inventory transactions as part of the solution to its search for $12 billion to compensate for the loss of tariff income. The financing proposals would have disallowed the lower of cost or market (LCM) inventory method for all taxpayers; would have prohibited, prospectively, the use of components of cost in determining LIFO inventory for businesses utilizing the LIFO inventory method; and would have simplified significantly the price index computation for any taxpayer presently on (or electing in the future) the use of LIFO inventories.

The AICPA voiced its strong opposition to the proposal in a detailed, five-page letter in late July to members of the Senate Finance and House Ways and Means Committees and senior Treasury officials. The AICPA criticized both the substance of the proposals and the process by which Congress was being asked to consider them.

"We are strongly opposed to the repeal of the LCM inventory method, and we believe the process by which this major policy change has been initiated is

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a particularly unfortunate illustration of how tax policy should not be developed," stated Harvey Coustan, chair of the AICPA Tax Executive Committee.

Describing the 75-year-old LCM inventory method as "the standard by which all other inventory methods have been measured," Coustan stressed that the LCM inventory method is used by taxpayers in "virtually every industry" and that it is "recognized as an acceptable inventory valuation method by the accounting profession throughout the world, not only in the United States." Small businesses would be particularly hard hit by repeal of LCM, Coustan also warned.

Happily, the proposal to change present inventory accounting methods has hit rough sledding. The deal reportedly struck by House Republicans and Clinton administration officials to drop the provisions held up in the Ways and Means Committee's reported bill. However, the Senate Finance Committee did approve a GATT financing package that included the inventory accounting changes, and a conference version of the funding legislation will have to be hammered out. Therefore, the AICPA will be keeping a watchful eye on this entire process. In the words of oft-quoted philosopher Yogi Berra: "It ain't over 'til it's over."

Members interested in obtaining a copy of the AICPA's letter to Members of Congress should dial 201/938-3787 from a fax machine, follow the voice cues, and select document no. 305.

Task Force Develops Proposal to End Workload Compression Plague

A Top Priority, AICPA Board Declares

A solution to the workload compression problem plaguing CPAs has been developed by the AICPA's Workload Compression Task Force. The AICPA Board of Directors told the task force to move "full speed ahead" with the proposal and targeted the workload problem as one of the board's top legislative priorities for 1995. Incoming AICPA Chair Robert L. Israeloff championed the Board's call for action.

This year's jammed congressional schedule precludes us from taking the proposal to lawmakers right now, but when the 104th Congress convenes early next year, the Institute will launch its legislative campaign. In the meantime, AICPA representatives will be meeting with Treasury Department officials to get their support for the proposal. Securing Treasury's advance backing will put us in a much stronger position when we present the proposal to congressional leaders.

Specifically, the proposal would link a fiscal year election for a passthrough entity with a requirement that the electing entity--rather than the individual owners--make estimated tax payments to the government on behalf of its owners. Partnerships and S corporations remaining on a calendar year would not be subject to this requirement. An owner would not pay individual estimated tax on the entity income, but would report that income--and take credit for the estimated tax paid--on the next 1040 form filed.

Gerald W. Padwe, vice president of the AICPA Tax Division, noted that the proposal was crafted with an eye toward what was politically possible. "The proposal is one we believe has merit, particularly since it includes a funding mechanism to help meet the financing question that Members of Congress will surely raise," he said.

Michael D. Koppel, the Massachusetts CPA who chairs the Workload Compression Task Force, which developed the proposal after considering numerous suggestions from CPAs across the country, optimistically declared, "We are attacking the workload compression problem from a new direction and we think it can work."

AICPA Key Persons will be a critical part of our legislative campaign. It's you, as constituents, who can best explain how burdensome this section of the Tax Reform Act of 1986 has proven to be to you and your clients.

Keep Pushing to Implement CFO Act, AICPA Exhorts Congress

The AICPA exhorted Congress to keep pushing for full funding and implementation of the Chief Financial Officers (CFO) Act of 1990 to prevent mismanagement and waste of precious government resources.

At an oversight hearing on Capitol Hill, the AICPA warned Congress that "our country can no longer afford to treat federal financial management as an afterthought." In fact, the AICPA charged, "Neglect of this vital function over the years has contributed to poor allocation of scarce federal resources, inefficient operations, and at times outright fraud."

Joseph F. Moraglio, vice president of the AICPA federal government division, in testifying before the House Government Operations Subcommittee on Legislation and National Security, continued the Institute's long history as a leader in the fight to improve the federal government's financial management practices.

At the first of two hearings held by the subcommittee on the CFO Act, Moraglio praised the positive results of the Act as "clear improvements in management and the use of taxpayers' money." The most important benefit of the Act so far is as a road map, he said, because the Act's exposure of "significant

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weaknesses" in the government's financial systems brings into "sharper view just how much farther we have to travel toward sound federal financial management."

The Institute's prescription for a cure? Human and economic resources, Moraglio told the panel.

On the human resources side, Moraglio said the Administration's failure, for more than a year, to appoint someone to fill the nation's second most important financial management position "sends precisely the wrong signal about the priority and importance of financial management."

About the allocation of economic resources, Moraglio noted that the amount the Office of Management and Budget (OMB) spends on federal financial management as a percentage of its total budgets has remained essentially constant (at about 7 percent) since passage of the CFO Act. He charged that OMB needs additional resources to carry out its new responsibilities under the Act for government-wide financial management.

Full CFO Act Funding Won for DOT

Proof that there will be many skirmishes in the battle to improve federal financial management came earlier this year with a fight over a $1 million "cap" on spending for financial statement audits by the Department of Transportation (DOT). The Institute and other supporters of the CFO Act won this battle during debate in the House of Representatives on DOT's fiscal year 1995 budget when supporters of the cap backed down. Their capitulation allowed full funding of the CFO Act for DOT. The DOT was one of the high-risk agencies that Moraglio cited in his testimony. He noted that DOT's financial systems are "numerous, fragmented, and non-standard."

It's Good to See You Here in Washington!

Key Persons of the Illinois State Society and members of the Illinois congressional delegation exchange warm greetings at a luncheon in the U.S. Capitol building hosted by the AICPA on June 9, 1994. Illinois Key Person Sally Berger (standing center) *says hello to Rep. Bobby Rush (D-IL)* (standing left), *while Illinois' newest senator, Carol Moseley-Braun (D)* (standing right), *greets Key Person Lawrence Ragland* (seated center).

Berger and Ragland were two of 77 AICPA Key Persons who came to Washington to visit with their Members of Congress this year as participants in the AICPA Congressional Luncheon Program. The other states participating in the 1994 program were Arkansas, Missouri, Ohio, and Washington.

The Pennsylvania Institute of CPAs also made its annual trip to Washington, D.C. this summer to meet with Members of Congress from Pennsylvania at a breakfast meeting in the U.S. Capitol building. The Florida Institute of CPAs hosted a reception on Capitol Hill for members of its congressional delegation as part of the Institute's annual meeting which was held in Washington, D.C. this year.

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