

EXCERPTS FROM
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There are three major facets of the responsibility of financial executives which I should like to emphasize today:

One is the standard of restraint. There is, of course, a clear legal restraint at the time of exposure to governmental processes--as, for example, when an issue of securities is registered with the Commission or a report is filed pursuant to the Commission's reporting requirements. This exposure will be significantly broadened if the Commission's pending legislative program--which has already passed the Senate--is voted by the House of Representatives. This bill extends the reporting, proxy and insider trading requirements to over-the-counter companies in which there is a significant public interest (750-500 shareholders and \$1 million assets). The bill warrants your full support. Extension of the disclosure requirements is bottomed on the importance of financials--of your work--to the investing public. The bill is only an attempt to make responsible financial reporting the general rule rather than a limited one. . . .

Outside these clear points of contact with legal standards, as in the case of a registration statement, the responsibilities are less sharply defined. In certain cases, the anti-fraud provisions of the

securities acts may check unwarranted enthusiasm by management in its announcements of a company's financial position. Yet there appears to be a large uncharted area--which might include appearances before Financial Analysts Societies, various publications by public relations experts, and projections of earnings--where the important standards must be self-imposed.

The basic question here is what standards should you--as responsible financial executives--set for yourselves in dealing with the public. The burden should rest more and more on management. The question is not "what will get by the S.E.C." This Commission should not represent the end of disclosure, but its beginning.

Finally, in the real estate industry, there have been evidences of "over-optimism" in adopting a program of cash distributions allegedly from cash flow but actually in excess of available funds generated from operations. In some cases companies were paying out money that was borrowed or just received from shareholders in a public offering. Chapter IV of our Special Study Report has well described it. There has been an abuse of the "cash-flow" concept. The phrase itself disturbs me. As our Chief Accountant, Andrew Barr points out, it is neither cash nor flow. It seems to suggest that this is a better basis than net income for judging results of operations.

In some cases you may say you cannot control your chief executive officer--a "salesman at heart." But the answer is first, that your joint efforts can make this type of chicanery unfashionable--in fact unacceptable; second, that someday you may be that chief executive officer.

Second is the standard of consistency. It must be recognized that in some cases there are still alternative accounting procedures, but there is no excuse for inconsistency from year to year for short-run appearance. Consistency may not always be a virtue, but if it is not observed, then there are no other principles to fall back upon. What would become of the concept of reliability and integrity of financial statement?

...I am not suggesting that management be frozen into a position; obviously a change from a less generally acceptable accounting principle to a more generally acceptable one (accounting principles do develop and refine) should not be deferred. But I would suggest that a change in treatment should ordinarily not occur except for sound accounting or business reasons. And, when such a change does occur, this fact--and its import--should be amply revealed and should continue to be revealed in any summary of earnings covering the period in which the change occurred.

There is a second--and different--type of consistency which I should like to refer to briefly: that is consistency between documents filed with the Commission and those released to the public. In one recent case, a company filed an annual report (Form 10-K) with the SEC in which its financials were presented on a consolidated basis and showed a consolidated loss of over \$1 million. This company distributed unconsolidated financial statements to the public showing a profit of over \$1 million. This, of course, is a grotesque example. Because of this type of problem, the SEC will recommend, in a forthcoming revision of the proxy rules, that financial statements contained in the annual report to stockholders must be consistent in all material respects with the reports filed with the Commission.

Third is the standard of uniformity. This is the most controversial: The question is how precise accounting principles can and should be?

The SEC has been criticized for not supporting the Accounting Principles Board on the tax credit. I shall not labor that question. Regardless of the solution there, you may be assured that the Commission's interest over the years has been to support the accounting profession, of which controllers and financial officers are an integral part, in narrowing areas of difference in financial reporting. This is still our view.

Writing in the Harvard Business Review, my friend and former colleague Professor Robert N. Anthony says we (SEC) should set the

rules. We have the power, and perhaps should lend more concrete rule making support to decisions reached by a body such as the Accounting Principles Board. But government should not be called on to do everything and actually we do not want to. (Some of us in government are conservative about the use of our powers.) We are, therefore, not prepared to accept the mantle which Professor Anthony has cast over us. At the same time you should bear this in mind: you can help in preventing the encroachment of government by participating directly in steps toward agreement upon accounting principles.