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GEORGE C. MATHEWS: AN EARLY COMMISSIONER OF THE SEC

Abstract: George C. Mathews, one of the first commissioners of the Securities and Exchange Commission, was charged with general supervision over accounting matters brought before the Commission. Under his leadership, the office of Chief Accountant was established, Accounting Series Releases were initiated, and the basic framework for handling accounting matters was formulated.

The Securities Act of 1933, a product of the "New Deal" legislation, was proposed by the Roosevelt administration. The primary objective of the Act was to protect investors from false information in the securities markets. First administered by the Interstate Commerce Commission, the 1933 Act was transferred to a Securities and Exchange Commission (SEC) in 1934. It is often called the "truth in securities" law, and the Senate Committee on Banking and Currency listed the following as being among the major purposes of the Securities Act of 1933:

1. To prevent the exploitation of the public by the sale of unsound, fraudulent, and worthless securities through misrepresentation; and
2. To place adequate and true information before the investor.[1]

To accomplish these objectives, the Act required any firm issuing securities for public sale to file a registration statement and to provide a prospectus that contained most of the information filed with the Commission. The SEC did not attempt to judge the merits of an issue, but assumed that disclosure of information would allow the investor to make an informed choice among alternative investments.[2] An integral part of this philosophy was the work of one of the first Commissioners of the SEC, George C. Mathews.

George C. Mathews, born 1886 in Northwood, Iowa, was graduated from the University of Wisconsin in 1908. After graduation, Mathews spent a year at Oregon Agriculture College (1909-1910) as an instructor of general business subjects before joining the Railroad Commission of Wisconsin as a rate expert (1910-1912), Apart from a brief period with a public accounting firm (1916-1917), Mathews held positions with the state of Wisconsin, each of which demanded a greater degree of managerial and technical ability. Starting in 1912 as a statistician in charge of the Utility Rate Department, Mathews later became director of the Securities and Statistics Division (1925-1931) and then was appointed director of the Securities Division and at the same time Chief Examiner, Public Services Commission of Wisconsin (1931-1933). Mathews left the state of Wisconsin in 1933 to become receiver for the bankrupt Middle West Utilities Company.[3] However, through Senator Robert M. La Follette, Jr. (Republican, Wisconsin), Mathews was appointed a member of the Federal Trade Commission in charge of securities in 1933. The function of monitoring the sale of securities was, a year later, transferred to the newly established Securities and Exchange Commission, at which time Mathews became a Commissioner.

Mathews, along with Robert E. Healy from Vermont, was one of the two Republicans appointed to the SEC in the summer of 1934. While conservative by nature, Mathews was described as a zealot on the question of preventing the flotation of fraudulent securities.[4] His appointment, though due in part to political considerations, was primarily based on Mathews' years of experience in the state of Wisconsin. There Mathews had helped develop security (called "blue-sky") legislation. In a speech made in 1929, he revealed his attitude toward blue-sky legislation.

> The essential feature of blue-sky legislation is the intent to prevent fraud and unfair practices in the sale of securities. It is not the function of such legislation to protect the purchaser of securities against such danger of loss as may be inherent in the security which he buys. Neither is such legislation designed to prevent the purchaser from speculating if he desires to do so. It is designed to assure, as far as its administration can accomplish this purpose, that the buyer of securities is not misled as to the real nature of what he buys, that where he is buying speculative securities he be sufficiently advised of that fact, and that he have in return for the risk which he assumes, a fair chance for speculative profit.

> Blue-sky legislation is in a measure paternalistic but that paternalism is not intended to limit the individual in taking risks with his money. It protects him only to the extent that it interferes with the right of someone else to sell him securities which in themselves are fraudulent or unfair or to sell him any securities by fraudulent or unfair methods.[5]

The key theme in Mathews' philosophy was that the "buyer of securities is not misled" and that security regulations were "not intended to limit the individual in taking risks." Both of these concepts led him to conclude that disclosure was the primary ingredient of a free economic system, a belief Mathews maintained throughout his tenure at the SEC.

Since Mathews had some accounting training and a background in administering "blue-sky" laws, he was chosen to supervise accounting matters brought before the Commission. Initially, Mathews had two concerns, to establish basic rules or guidelines from which one could administer the newly created Commission and to formulate the structural framework necessary to insure that the newly created guidelines were consistently applied. To accomplish the former, Mathews often communicated directly with accounting firms, stating the Commission's thoughts concerning a particular problem. Since Mathews was given great latitude concerning accounting matters, his comments reflected his own concepts as well as the attitude of the Commission. For example, in a letter dated December 3, 1934, shortly after the SEC was formed, Mathews stated the function of disclosure through financial reporting:

> I should like to correct also any impression that you may have that the Commission regards your present proposal as a *compromise* [emphasis added]. The Commission's duty is to have the facts accurately stated and adequately disclosed. It cannot settle any issue raised in a registration statement or a matter of compromise.[6]

The second area of concern to Mathews, establishing a structural framework, took longer but possibly has had a more profound effect on the Commission. He began by bringing into the Commission people with similar philosophy toward financial reporting as his own. Most notable of these was Carman G. Blough, who was hired in the fall of 1934 as a financial analyst, but quickly promoted to assistant director in the Registration Division in 1935, and then made first Chief Accountant of the Commission later in the same year (1935-1938).[7] The two were also close friends. Together they formed a partnership that helped formulate the basic structure within the SEC for handling financial reporting. This structure, which to a large extent still exists, allowed the American Institute of Certified Public Accountants and later the Financial Accounting Standards Board to grow into effective rule-making bodies.

Shortly after the SEC was organized in 1934, Congress passed the Federal Public Utility Act of 1935. In an interesting speech given at Northwestern University on October 14, 1935, Mathews pointed out the differences between the Securities Act of 1933 and the ". . . new task with which the Commission is confronted."[8] After noting that the 1933 Act pertained to sales of securities sold to the public through the mails or in interstate commerce, Mathews continued to advance the philosophy of full disclosure.

> Its [the Commission] only function is to make sure that certain information regarding the security and the issuer is made available to the public. Of course, publicity tends to discourage some of the more flagrant abuses, but many registration statements not limited to those of utility companies, reveal continuing financial practices which may be severely criticized.
>
> Under the Securities Exchange Act of 1934, the Commission is given extensive authority to regulate the business of dealing in securities, but here also its powers over the companies whose securities are traded in on the market are essentially limited to requiring the disclosure of adequate information for the guidance of investors.[9]

Later in the speech, while discussing the Federal Public Utility Act of 1935, Mathews advocated that a more positive stance be taken by the government.

> One of the most important and one of the most difficult tasks given to the Commission is that of regulating the keeping of accounts by companies which are subject to its jurisdiction. This is covered by Section 15. You are, no doubt, familiar with many of the complexities that have resulted from the natural desire to make a favorable impression on the investor and at the same time not to appear too opulent to the rate payer and the tax collector. *In most instances, it would obviously be desirable to have all companies keep their books in the same way.* [emphasis added] Not only would this save a great deal of time

> and money in rate and tax litigation, but it would give the investor an intelligent basis for judgment. Considerable progress towards uniformity has resulted from the Uniform Classifications of Accounts for Electric and Gas Utilities adopted by the National Association of Railroad and Utilities Commissioners. The adoption of any further standardization of accounting methods is a tremendously difficult problem and one which must be approached with great deliberation. At every stage, of course, there will have to be the fullest cooperation with State Commissions as well as with the Federal Power Commission.[10]

It appears that Mathews either was not aware, or possibly not concerned with the differences in accounting procedures dictated by the two acts. There may be several reasons for his not taking note of these differences. First, Congress in the body of the later legislation made it extremely clear that many public utility holding companies had abused their privileged position and needed to be closely regulated. For Mathews to have advocated a position similar to the Securities Act of 1933 would have substantially weakened his position on other matters. Second, Mathews was appointed receiver for the Middle West Utilities Company (June-October, 1933). During that period, Mathews could see the problems associated with such holding companies. Third, Blough stated that Mathews and he were fully aware of the administrative problems associated with the formulation of accounting principles, and were adamantly against the establishment of a uniform set of accounting procedures that would affect all business concerns.[11]

This, however, did not stop Mathews from continuing to strongly advocate a more uniform application of accounting principles. In 1936, Mathews wrote a letter to Eric Kohler, president of the American Accounting Association, noting the disparity of opinion among accountants regarding many matters which to him seemed to be fundamental to financial reporting. Mathews said that "While accounting probably can never be an exact science, there must be basic principles whose general recognition would tend toward soundness and uniformity. The delineation and development of these principles is as much within the field of scientific research as any problem in the natural sciences."[12] There were, however, practical limits on the conduct of scientific research by practicing accountants.

> First of all, the profession of accountancy has by no means reached its goal, either as to standards or as to

> qualifications of practitioners. Secondly, it is a highly competitive business with a clientele which is often very insistent on its views as to how its business conditions and results should be set out. The public accountant who insists on rigid compliance with standards much beyond those generally accepted is, at the least, at a competitive disadvantage.[13]

Mathews then found himself in a quandary: though he did not advocate the development of standardized accounting practices, he felt the accounting profession, due to economic competition, would not be able to develop a strong basis from which one could produce uniform accounting methods. While never completely unraveling this discordancy, Mathews was at least willing to work within the confines placed before him. Instructing Blough to make speeches indicating the need for further development of accounting principles, Mathews also began to speak out and write articles to stress the need for more consistency in the use of accounting principles. A list of Mathews writings and presentations appears at the end of this paper.

Mathews stated in a 1937 address before the Convention of the Investment Bankers Association:

> We have only recently reached the point where serious consideration is being given to the use of the powers conferred by Section 19 (a) for the purpose of announcing rules to govern the handling of certain accounting matters. To the extent that these powers are invoked, I anticipate that their use will be a matter of gradual development. The attempt to secure a general recognition of sound principles and practices should not blind us to the dangers of rigid standardization. If the purpose of accounting is to secure a correct picture of financial condition and results, great care must be taken that the picture not be distorted by application of rules which may defeat the purpose.[14]

Again, in a September 1938 article, Mathews stressed the problems associated with developing uniform accounting principles. He said:

> The Commission also responds to the accountant's desire that he should not be given a too rigid standard, for it recognizes that the practitioner has the firsthand experience with actual materials and problems of business. The environment itself operates as a stimulant

> to creation and development of accounting principles. The books and records of living business suggest alternatives to the auditing accountant, possibilities of whose very existence a reviewing administrative body may be unaware. And, if several years of administration of the legislation have taught us anything, it is that in large portions of the field of accountancy, we cannot predict that tomorrow's case can be adequately handled by today's technique.[15]

Coupled with these measures, Mathews began to see the need to publish opinions concerning accounting matters that would have universal appeal. On April 1, 1937, *Accounting Series Release (ASR) No. 1,* "Treatment of Losses Resulting from Revaluation of Assets," was issued. Blough in a letter dated April 5, 1937, summarized the new release. Surplus would have to be flagged in all subsequent statements filed with the Commission in such a manner as to clearly reveal the facts relating to the write-off of the property and the effect that the write-off would have had upon earned surplus had it been handled in accordance with the opinion stated in the *ASR.*[16] Interestingly, even though Mathews strongly advocated following the opinions stated in the ASR, he was willing to accept a registration that violated the principles communicated in the release provided the accountant stated in the audit opinion which alternative procedure had been followed.

This concept of adequate disclosure being the sole governing factor in accepting a registration was stretched and finally, to a degree, broken with the passage of *ASR No. 4,* "Administrative Policy on Financial Statements." The registration that led to this *ASR* concerned the Northern States Power Company. In 1934, the company filed a registration which disclosed that it had, in 1924, written up fixed capital and investment accounts by about $8,000,000, with a corresponding increase to the capital surplus.[17] The Commission thought the practice "improper" but accepted the statement in a three to two vote, provided there was a footnote disclosing the questionable practice. Mathews was able to influence the majority of the Commission, consisting of James Landis, Chairman, and James D. Ross (known as J. D.) to vote for the disclosure requirement. This was probably not very difficult for "Mathews . . . , on whom his friend Landis leaned more than any other Commissioner, and whose ability to digest and interpret facts, has made him invaluable."[18] About J. D. Ross not much is known, apart from the comment of William O. Douglas in *Go East Young Man,* "in the early SEC days J. D.'s job was a sinecure."[19] Possibly he always voted with Landis, or perhaps against Douglas.

William O. Douglas and Robert E. Healy were not satisfied with the decision, and during the two years 1936 and 1937, were able to modify it. During this period, the Commission meetings often resulted in heated debate between Mathews and Douglas each advocating their own philosophy.[20] However, not until the membership of the Commission changed did the precedent established by the Northern States Power Company case change. James Landis left to become Dean of Harvard Law School, and was replaced as chairman by Douglas on September 21, 1937. Landis's successor, Jerome Frank, was a lawyer who had been recommended by Douglas. Additionally, a fifth new member of the Commission, John W. Hanes, replaced J. D. Ross. The American Institute of Certified Public Accountants, then called the American Institute of Accountants, had little influence on the decision process. John Carey, secretary for the Institute, stated that they did not lobby the SEC to influence the final outcome but relied on what he termed "truth."[21]

On February 12, 1938, the Commission directed Mathews to select a committee of accountants within the Commission, headed by the Chief Accountant, Blough, to begin work on "rules prescribing accounting practices and procedures." The report of the special staff committee on accounting, issued February 28, 1938, recommended that financial statements not prepared in accordance with generally accepted accounting practices be deemed misleading despite disclosure. Further on, the committee introduced the concept of "substantial authoritative support."[22] Both of these concepts were incorporated in the draft of *ASR No. 4.* Mathews must have been shocked by this turn of events, for when the Commission met on April 13 he was the only Commissioner present to record a negative vote.[23] *ASR No. 4* was released April 25, 1938.

One can only speculate why there was a separation of views between Blough and Mathews. Possibly Blough believed that the concept of full disclosure had to have certain limitations, while Mathews felt otherwise. In any case, Blough left the Commission to join Arthur Andersen & Co. shortly after *ASR No. 4* was released.[a] Mathews stayed with the Commission to the end of his

[a]For further discussions on the personality and contributions of Carman G. Blough refer to the following articles in the Fall 1982 issue (Vol. 9, No. 2) of *The Accounting Historians Journal*: Richard A. Scott and Elizabeth G. Ward, "Carman G. Blough: His Personality and Formative Years," pp. 53-60; and William D. Cooper, "Carman G. Blough's Contributions to Accounting: An Overview," pp. 61-67.

appointment before, ironically, joining Northern States Power Company as vice president and comptroller in 1940, a position he held until his death in 1946. Although he lost his debate with Douglas on *ASR No. 4,* Mathews was able to defuse any ideas the Commission had on establishing accounting rules and principles. Moreover, during the period Mathews was with the Commission many procedures and policies were begun that still exist today.

FOOTNOTES

[1]Securities and Exchange Commission, *Second Annual Report,* p. 1.
[2]Skousen, p. 19.
[3]*Who Was Who in America,* p. 350.
[4]Cooper, p. 29.
[5]Mathews, "Blue-Sky," pp. 1-2.
[6]Mathews, letter to Butler.
[7]Burns and Coffman, pp. 3-9, 73.
[8]Mathews, "Regulation," p. 1.
[9]Mathews, "Regulation," p. 2.
[10]Mathews, "Regulation," p. 17.
[11]Cooper, Interview.
[12]Mathews, letter to Kohler.
[13]Mathews, letter to Kohler.
[14]Mathews, "Bi-Partite," p. 468.
[15]Mathews, "Accounting," pp. 227-228.
[16]Blough, Notation.
[17]Barr, p. 6.
[18]Rodell, p. 126.
[19]Douglas, p. 267.
[20]Cooper, Interview.
[21]Cooper, Telephone.
[22]Special Staff Committee on Accounting, Report.
[23]Securities and Exchange Commission, Meeting, April 13, 1938.

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