FEI at 75
Born into Darkness: FEI in the 1930s

By Glenn Alan Cheney

As FEI celebrates its 75th year, each issue of *Financial Executive* will feature one of the 10 areas that helped mold today's corporate finance profession and highlight FEI's work toward shaping these key issues. We kick off the series with a look at FEI's formation during the early days of the Depression.

It was a terrible time in the U.S., the dark December of 1931. Eight million workers had no work. Banks closed. Businesses failed. Investment evaporated. Bankruptcy prevailed. The Dow Jones had dropped to a miserable 41, down from 400, and radicals were questioning the viability of capitalism.

News from the rest of the world was no better. England had just abandoned the gold standard, Japan had invaded Manchuria and Stalin was collectivizing agriculture in the Soviet Union. In Germany, the Nazis held 18 percent of the Reichstag and *Mein Kampf* was a bestseller.

Two days before the end of that year, eight corporate controllers met in New York City. Their conversation may not have bubbled with economic optimism, but their agenda carried a spark of hope. That agenda was to complete the final details to launch a new organization of financial executives, The Controllers Institute of America. They needed an organization that would let them agree on practical standards and an ethical ideal. They needed to define their profession, exchange ideas about its practice, educate themselves and others, and work with the government to improve the general economy. In short, they wanted to dignify the practice of accountancy at the level of corporate leadership.

The causes of the Great Depression had little to do with these financial executives, but if the nation's crisis had a cure, they believed it was, to a certain extent, in their hands. After all, it was an economic crisis, and they were the men who controlled the money.

The roots of the problem went back 10 years, across a decade of apparent prosperity supported tenuously by credit. Tax breaks for the well-off had engorged the wealthy. Production soared, but middle-class incomes didn't keep up. Consumers enticed by marvelous new vehicles and appliances felt the need to own what they could not pay for. Irrationally exuberant investors, wild with optimism, leveraged the stock market to breathtaking altitudes.

Then, in a week in late October 1929, the credit ran out. In the ensuing months, sales fell, profits plummeted, the stock market crashed, borrowers defaulted, lenders went broke and productivity slowed as if seized by rust. It wasn't just a downturn in the market: It was the collapse of an economy.

President Herbert Hoover, a staunchly pro-business Republican, defended the strength of the economy. The problem, he said, was in the federal budget. Only a balanced budget would sustain public confidence. So he slashed spending, raised taxes and refused to let federal assistance undermine American self-reliance.

But as his efforts reduced demand, they aggravated the crisis. In a last-ditch effort to protect the economy, Hoover signed the Hawley-Smoot tariff on imported goods, the highest import tax in U.S. history. As European nations retaliated with their own tariffs, international trade withered away, and America's Great Depression went global.

Early in 1932, the founders of the new Controllers Institute of America scraped together some cash and leased space at One East 42nd Street in New York City. The first four months were rent-free because nobody wanted the space. The full-year rent was $1,000. On February 4, The Institute had 50 members; that number doubled to 100 by April. They kept a tight rein on expenses and closed their fiscal year in August with a bank balance of $47.65.

> Financial Executives International (FEI) was born against a backdrop of deep economic troubles. The organization was launched to help financial executives set the professional and ethical tone for their peers for decades to come.

The country's finances went less well. As banks went broke, people lost their savings. Hearing rumors of a bank's demise caused citizens all but rioted to withdraw their money. As the end of 1932 approached, the whole banking system teetered on collapse, and the economy went from bad to worse to dismal. Investment dropped to 5 percent of its 1929 level. Inventory sat unsold, unemployment continued to rise and drought in the Midwest baked the national breadbasket to dust. Homeless people living in so-called "Hoovervilles" grew on the outskirts of towns. In June 1932, 20,000 hungry World War I veterans marched on Washington, D.C., demanding their bonuses, only to be dispersed by federal troops with tear gas and bayonets.

As the election of 1932 approached, President Hoover took a step to the left, offering emergency loans to banks and tossing a little money into public works. His calling on the nation's "haves" to be charitable to the "have-nots," was apparently too little, too late. In November, Americans elected the Democrat candidate, Franklin Delano Roosevelt, hoping that his New Deal might work better than the deal they had.

The country had never seen anything like it. And history would record the events following The Great Depression as a watershed crisis that would change the relationship between the federal government and the nation's people and businesses.

Roosevelt's large electoral majority gave him weight with Congress. To make certain that Congress understood his mandate, Roosevelt's inaugural address threatened a seizure of "broad executive power to wage a war against the emergency, as great as the power that would be given me if we were in fact to be invaded by a foreign foe." Whether in fear or desperation, Congress heeded the new president with a 100-day honeymoon. On March 6, he declared a nationwide bank holiday. Three days later, Congress passed the Emergency Banking Act, which provided for inspections of federal banks.

Over the next week, the U.S. Treasury Department and Federal Reserve examined the financial conditions of the nation's banks. Those found stable were allowed to reopen, and others were permanently closed. In the first of his "fireside chats," Roosevelt said: "I can assure you that it is safer to keep your money in a reopened bank than under the mattress."

If Roosevelt's assurance seems unnecessary today, it's only because of the Glass-Steagall Banking Act, passed that summer. Glass-Steagall created the Federal Deposit Insurance Corporation (FDIC), which backed deposits at member banks. Glass-Steagall also put up a firewall between two kinds of banks — commercial and investment. Commercial banks couldn't invest in, underwrite or distribute corporate securities. Investment banks couldn't accept deposits.

Roosevelt also used that first week in office to pass the Agricultural Adjustment Act of 1933 (AAA), an effort to stimulate the economy by giving farmers more purchasing power. It supported prices by paying farmers *not* to grow staples. The AAA made commodities into a kind of currency that allowed farmers to use their crops to buy supplies and equipment.

Then, in June of 1933, Congress passed the National Industrial Recovery Act (NIRA), creating the National Recovery Administration (NRA) and the Federal Emergency Relief Administration. The NRA allowed trade associations to agree on "codes of fair competition" that would help stabilize prices and production — cooperative activities that had been illegal under antitrust laws. The agreements that associations reached could, with the president's approval, be imposed on all companies in a given sector.

Roosevelt's sweeping presidential power lasted only a couple of years. The Supreme Court ruled that this presidential approval constituted the creating of law, which the Constitution reserves for Congress alone.

Nonetheless, the NIRA was a significant precedent. It demonstrated the value of private-sector cooperation — a concept that would figure heavily in accounting and finance. It also lent a certain federal power to private-sector initiatives. The NIRA also gave unions and workers new powers, which they were quick to use.

Over the next three years, millions of workers went on strike. Over 18,000 strikers were dragged from picket lines and thrown in jail, and scores were murdered. Despite the general desperation for jobs, few crossed the picket lines. During these turbulent times, just about everyone agreed on one thing: America needed a drink! All they had to do was amend the Constitution. So, on Dec. 5, 1933, President Roosevelt ratified the 21st amendment, ending 13 years of Prohibition.

On Jan. 31, 1934, the Gold Reserve Act transferred all gold and gold certificates from the Federal Reserve to the U.S. Treasury. A day later, the president raised the value of a troy ounce of gold from $20.67 to $35. The de facto devaluation of the dollar was meant to increase exports.

Hard times: In 1932, homeless people were fed in soup kitchens and lived in "Hoovervilles."

During these hard years, Roosevelt kept trying to work with a balanced budget or at least borrow no more than needed to prevent catastrophic suffering. But in 1934, John Maynard Keynes, a British economist, visited the

White House and presented a radical idea: that by spending its way into a deficit, a government could fuel an economy with the cash it needed to stimulate consumption, production and investment. Roosevelt doubted the Keynes counterintuitive "rigmarole of figures" — as did most economists — but he didn't forget it.

New Publication, Legislation

February 1934 brought two interesting developments: The Controllers Institute published the first issue of a new magazine, *The Controller* (see the "editorial comment" below from the first issue), with a subscription price of $4.00 per year; and Congress passed the Securities and Exchange Act (SEA), the most powerful piece of legislation that had ever hit public companies.

The SEA came on the heels of congressional investigations into a host of stock market scandals. Americans suddenly understood why the United Kingdom had been regulating its stock market for almost 100 years. The Act established the Securities and Exchange Commission (SEC) and gave it power over stock exchange rules, financial reporting and the trading of securities. Many shady but standard trading practices were outlawed as a host of new regulations were put in place.

The first issue of *The Controller* was published too early to mention the SEA or the SEC, but the lead article broached the hottest issue of the day: "Why Should We Not Return to [the] Gold Standard, with Limitations?" By March, *The Controller* was echoing the future. "Institute Seeks Facts Concerning Burdensome Questionnaires, Reports" was the title of one

Controllers meet: At The Controllers Institute of America's first annual meeting at the Hotel Roosevelt in New York City on Sept. 19-20, 1932, lunch was $1.50 and dinner was $4.00.

The
Controller

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Editorial Comment

This is the first issue of THE CONTROLLER. It marks another stride in the progress of the Controllers Institute of America. One of the main activities of the Controllers Institute is the study of professional and technical problems of the controller. This activity has disclosed many specific tasks to be done and numerous problems to be solved, calling for the skillful handling which controllers can give, leading to the standardization of practices, the protection and advancement of business interests, and a wise and efficient control of business operations from an economic standpoint.

The extraordinary growth of modern business, the need for efficient control and correct methods; together with the constantly increasing complexities of corporate activities, has laid upon controllers marked responsibilities. Hand in hand with these responsibilities has gone recognition to which his new status entitles him, so that wide opportunity for constructive service is presented to the controller.

The Controllers Institute, as an organization, purposes to provide means whereby controllers may more efficiently perform their difficult duties and, at the same time, secure for controllers independence of thought and action; together with the right to use their individual judgment in their official capacity and in the discharge of their duties. The Institute has proved a medium through which controllers of all types of American business can exchange ideas, experiences, and knowledge, to the individual and aggregate advantage of all concerned.

The time has now arrived to set up an instrument of communication between controllers for the dissemination of information with respect to problems, practices and methods in the field of controllership.

THE CONTROLLER is to be a regular publication, designed to present in print a free flow of discussion having to do with important subjects in the field of controllership. Its columns will be open to all, subject to reasonable editorial and space limitations.

Progress is in advance of the printed page, but it shall be the aim of the publishers and editors of this magazine to capture current thought, present day practices, and the conclusions reached by practical men with respect to the many questions in the domain of the controller, and to present them here.

The furtherance and careful handling of these tasks will be always in the minds of those responsible for this publication.

—DANIEL J. HENNESSY.

short call for contributions. Its last paragraph might well appear in a current issue of *Financial Executive*: "It is conceded that many of the reports required are unnecessary and that they are valueless when completed, because of the time required to compile them."

Though still a nascent publication, *The Controller* was already grappling with an industry/government tug-of-war that would last into the next century. The June 1934 issue continued the prescient reportage with three similarly ominous articles: "Controllers Protest Against Numerous Reports for Government," "Questions Concerning New Depreciation Ruling Answered" and "Complex Regulations Costly to Corporations." A case of déjà vu all over again?

In the larger economic picture, despite Roosevelt's New Deal, the economy remained all but comatose, and Roosevelt continued brewing his alphabet soup of federal agencies and programs. The Federal Housing Administration (FHA) provided mortgage relief; the Federal Emergency Relief Administration (FERA) directed grants to states; the Civilian Conservation Corps (CCC) made work for thousands of young men; the Tennessee Valley Authority (TVA) created jobs by controlling flooding, improving river navigation and building dams; and the Rural Electric Administration (REA) expanded the nation's power grid.

Economic collapse is always an invitation for political threats. In Russia, chronic poverty had helped spark the Bolshevik revolution, and in Germany, the hyperinflation following World War I was a rallying cry for the up-and-coming Nazi party. These foreign developments were not unnoticed in American boardrooms. The September 1934 issue of *The Controller* recognized the threat with: "Business Men Called on to Stop Drift into Communism or Fascism."

Then, a new wave of legislation in 1935 — the Second New Deal — brought more reforms and programs. The National Labor Relations Act of 1935 (NLRA), also known as the Wagner Act, gave federal protection to collective bargaining; The Public Utility Holding Company Act (PUHCA) limited the size and practices of utilities and their parent companies; the Social Security Act of 1935 (SSA) started not only a retirement fund and unemployment insurance but the principles of what some would later call the "welfare state."

In January of that year an article in *The Controller* again identified a problem that would plague the profession for decades: "A Public Accountant's Views as to Duties and Rank of Controller," authored by a CPA in Chicago, a Mr. Arthur Andersen. The first sentence of his article read: "During the past five years, most businessmen have had reason to doubt the theories and principles of business conduct which previously served them as dependable guides, and many concepts have perforce been changed."

How The Controllers Institute of America Grew in Early Years

Number of Members	Date
30	December 1931
100	April 1932
200	November 1933
300	June 1934
400	April 1935
500	January 1936
666	August 1936

Issues of *The Controller* continued with articles that would resonate through the decades. In February: "What Is Material Fact, What Is Prudent Investor?" In March: "Complicated Laws Weak Feature of Federal Tax System." In October: "What Is [the] Most Satisfactory Form of Reports to Stockholders?" In November: "When Controller's Ethical Standards Differ from His Company's."

As the New Deal agencies created new rules and regulations, executives wrestled with the vagaries of financial reporting. *The Controller* reported the frustrations of controlling the indefinable. In February 1936: "Writing of Reports to Stockholders an Art, Says Controller." In February 1937: "Law Requires Controller to Guess at Best Financial Policies." In March 1937: "What Are 'Accepted' Accounting Principles, Attorney Inquires."

The Fair Labor Standards Act of 1938 (FLSA), mandating minimum wages and maximum hours, was about the last of the New Deal legislation. That year was also the year that Roosevelt decided to try a little Keynesian economics. His first attempts at deficit spending were too conservative to work, but by the end of the decade, he had no choice. With the Nazis declaring their intent to take over Europe first and then the world, and with the Japanese invading China, he had to build an "arsenal of democracy," and the money for financing would have to come from the mint, not from pockets of impoverished taxpayers.

Ironically, the September 1939 issue of *The Controller* went to press on the first of the month carrying an article under the headline "Controller Just Back from Europe Believes There Will Be No War." Before its ink had dried, German tanks were rolling into Poland, and America's financial executives were about to face a problem that made the New Deal and Great Depression look easy.

In June of 1940, the Council of National Defense called for top-level financial executives to help with war-related business, and 16 members of The Controllers Institute of America immediately stepped up to respond. The Depression was behind them. Now it was a time of war.

Thus, the economic crucible of the 1930s gave birth to a new kind of government, a new kind of business environment and a new kind of organization linking the two. Over the next 75 years, The Controllers Institute would expand to become Financial Executives International (FEI), a global organization continually striving to provide professional and ethical leadership and become the voice of those it serves before regulators in Washington, D.C.

The next FEI at 75 feature: Globalization of Business.

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