

Statement of Samuel J. Broad,  
Chairman of the Committee of the  
American Institute of Accountants  
to revise the Federal Reserve bulletin.

EXAMINATION OF FINANCIAL STATEMENTS  
BY INDEPENDENT PUBLIC ACCOUNTANTS

The bulletin, "Examination of Financial Statements by Independent Public Accountants," is in effect a re-statement of the guiding principles and approved methods which should prevail in public accounting practice and in corporate reporting.

Its issuance at this time is especially significant in view of the recent publication by the Securities and Exchange Commission of Form 10-K and other forms for annual reports by corporations. Its publication was timed so that it might reach the public accountants of the country as they were preparing for the year-end closing of their various clients preliminary to publication of annual reports to stockholders, to the stock exchanges and to the securities and exchange commission. The bulletin should serve to make future reports of corporations more informative than they have been in the past.

"Examination of Financial Statements by Independent Public Accountants" is a revision of the bulletin prepared by the Institute in 1929 and published in that year by the Federal Reserve Board under the title "Verification of Financial Statements." This earlier bulletin dealt primarily with examinations of financial statements for credit purposes. For some years past many accountants have been placing increased emphasis on the importance of accounting principles and consistency in their application and on disclosure of the basis on which the accounts have

been prepared. The trend in this direction has in the past two or three years been accelerated by the prominence given to such matters by the New York Stock Exchange and in regulations of the S. E. C. The Institute accordingly believed that the time was ripe to enlarge the scope of the bulletin so that it would deal with these matters and also cover examinations for stockholders reports as well as those made for credit purposes, and a committee of the Institute has been engaged in the task of revision for many months.

It is contemplated that the new bulletin will serve not only as a guide to the accounting profession in the performance of its duties but also as a yardstick by which bankers, investors, taxing authorities, stock exchanges and all others dependent upon the information contained in corporate financial statements can measure the adequacy of the examination made by independent accountants. It will be in a sense the “common law” of public accounting practice.

While the bulletin is specific in many particulars, it allows for that measure of elasticity and judgment which is essential in the practice of any profession if the way is to be left open for future development. To quote the bulletin itself:

“While there is general agreement on certain broad principles, there remains room for differences in the application of those principles which may affect the results reached in an important degree. It is a generally accepted principle, for example, that the investment in an industrial plant should be charged against operations over the useful life of the plant; but there are several generally accepted methods of achieving this result. Among the methods used are the straight-line method, the sinking-fund method, the combined maintenance-and-depreciation method and the diminishing-balance method. The charges against a particular year may vary materially, depending on which method is employed.

“Within certain limits it is less important what precise rules and methods are adopted by a corporation in reporting its earnings than that accepted principles shall be followed and followed consistently.”

In conclusion the bulletin states that the accountant should consider and be in sympathy with the growing demand that statements should be more informative and more easily understood by the reader and may well urge his client to meet this demand. It suggests, for example, that balance sheets and profit and loss statements might be presented in comparative form; or that there might be given supporting and supplemental statements showing changes in investments, property, plant and equipment and reserves, or more condensed summaries of changes in the financial position.

While making it clear that balance sheets and profit and loss statements will necessarily be modified to meet the need of each particular situation the bulletin contains suggested forms of financial statements which are considered satisfactory for the average industrial company.

The bulletin also embodies the form of accountants' report or certificate issued by the American Institute of Accountants in 1934 and approved by the New York Stock Exchange and the Controllers Institute of America. Commenting on this the bulletin says:

“The accountant's report or certificate should be as concise as is consistent with a clear statement of his opinion on the financial statements submitted. Explanations and disclosures which he believes to be desirable regarding accounting principles adopted should be inserted in the financial statements or in his report. Attention is directed to the importance of stating any qualifications clearly and concisely. Distinction should be made between those comments intended to be merely informative or to state the limitations of the scope of the accountant's

work (e.g., where part of the work has been performed by other accountants), and those which indicate dissent from particular practices of the company. Care should be exercised to avoid making any statement that is not literally true or which might give rise to unwarranted implications.”