

COMMISSION'S EXHIBIT #237

STATEMENT OF GEORGE W. BURPEE  
 IN THE MATTER OF  
 ENGINEERING VERIFICATION OF INVENTORIES

On February 25, 1939, Dr. Jackson, president of the American Institute of Consulting Engineers, addressed a letter to the Honorable William O. Douglas, then Chairman of the United States Securities and Exchange Commission, suggesting that if the Commission so desired, the American Institute of Consulting Engineers would be glad to present to the Commission suggestions as to the participation of engineers in checking of inventory and capital investment of corporations. A copy of President Jackson's letter to the Chairman of the Securities and Exchange Commission is submitted as exhibit A.

Upon favorable response of the Chairman, Messrs. Maurice R. Scharff and George W. Burpee, the writer, were appointed a committee to present these matters to the attention of the Securities and Exchange Commission. I beg leave to file a document entitled "Memorandum of the Function of the Engineer in Verification of Inventories and Property Account" as exhibit B; and as illustrating the practice described, a copy of excerpt from the consolidated balance sheet of December 31, 1938, of Schenley Distillers Corporation, illustrating the language used in describing the basis of determination of inventory and of plant and property, respectfully submitted as exhibit C; a copy of a certificate of Messrs. Coverdale & Colpitts to the board of directors of Schenley Distillers Corporation certifying as to inventories, respectfully submitted as exhibit D; and a copy of a certificate of Messrs. Coverdale & Colpitts to the board of directors of Schenley Distillers Corporation certifying as to sound values of certain fixed assets, respectfully submitted as exhibit E.

We would like to amplify the foregoing to emphasize that in discussion of the audit problems, the attention paid to receivables and inventories, on the one hand, and to property, plant, and depreciation reserves, on the other hand, is sometimes quite out of proportion to the relative capital investment in these items in many industries. The tabulations of "Selected Information," constituting a part of the reports on the Census of American Listed Corporations which have been published to date under the sponsorship of the Securities and Exchange Commission, show the following relative proportions of total assets for the industries indicated:

Report number	Industry	Percentage of total assets	
		Trade receivables and inventories	Land, buildings, and equipment, less valuation reserves
1	Steel producers.....	21.8	63.4
2	Meat packers.....	45.1	39.8
3	Chain variety stores.....	21.9	53.0
4	Automobile manufacturers.....	28.1	35.1

Of course, for the public utility industries, the relative capital investment in plant and property as compared with inventories and receivables is even greater. On the basis of data published by the United States Bureau of Census the percentages of total assets for the public-utility industry as of December 31, 1932, were, current assets, 6.1 percent, and plant and property, less reserves, 83.3 percent.

It is in no sense a criticism of the accounting profession to point out that no examination of the accounts alone can qualify an auditor to certify as to the existence, condition, and usefulness of the plant and property or as to the adequacy of the provisions and reserves for depreciation. It seems to us entirely appropriate, therefore, that accountants should attach to a balance sheet such a note as we quote from a recent report to the stockholders, for the year 1938, of an industrial corporation whose property, plant, and equipment, less reserve for depreciation, constitute more than 65 percent of its total assets, as follows: "Property, plants, and equipment were stated at appraised values for A division (1924); B, C, and D divisions (1926); E company (1924); with subsequent additions at cost"; or include in their certificate such a statement as we quote from another report of a public-utility company for the year 1938 as follows: "In our opinion, based upon such examination and subject to the fact that we are not in a position to express an opinion as to the provisions made for retirements of property, the accompanying balance sheet and related summaries of income and of surplus fairly present, etc."

In our opinion, notes and statements of this character constitute disclaimers of direct knowledge of the facts referred to and are, in effect, qualifications or reservations with respect to the opinion expressed by the accountant. It is our view that the accountant must state such qualification or reservation with respect to items which he has not investigated either directly or through the service of independent engineers retained for the purpose in order to make his report informative and not misleading.

The question frequently arises as to the possible effect of extensive verification of inventories and of property and plant accounts upon the practice of consulting engineering and upon its development into a seasonal business with a heavy annual peak similar to that which exists in some branches of accounting practice. The verification of inventories and the checking of the existence and condition of property and plant, we believe, lend themselves readily to organization on a continuous basis analogous to the continuous inventory system now in operation for providing an annual internal check on material and supplies inventories in many companies. We believe that engineers can properly certify as to conditions as of a certain date provided they have the opportunity to plan and direct a continuous check sufficient, in their opinion, to form the basis of such certification.

APRIL 25, 1939.