

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON 25, D. C.

ACCOUNTING SERIES
RELEASES

(RELEASES 1 TO 77, INCLUSIVE)
Amended to March 10, 1956



UNITED STATES
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RELEASE NO. 1210¹

January 6, 1937

SECURITIES ACT OF 1933
Release No. 1210

SECURITIES EXCHANGE ACT OF 1934
Release No. 1004

HOLDING COMPANY ACT
Release No. 508

Treatment of Federal income and excess profits taxes and surtax on undistributed profits.

The Securities and Exchange Commission today made public a letter sent by its Chief Accountant, Carman G. Blough, in answer to a number of inquiries with respect to the treatment of Federal income and excess profits taxes and surtax on undistributed profits in financial data included in registration statements filed with the Commission. The text of the letter follows:

"Recently you requested my opinion with respect to the treatment of Federal income and excess profits taxes and surtax on undistributed profits in financial data included in registration statements filed with this Commission.

"In my opinion, provision should be made in the profit and loss or income statement for each of these taxes, whether the period covered by such statements is a full year or only a part thereof. If such provision is based, of necessity, substantially on factors the certainty of which is in doubt, this fact should be indicated and footnotes should be appended to the financial statements explaining such qualification.

"It may, however, be impracticable, if not impossible, because of uncertainty with respect to the registrant's dividend policy or the status of contract provisions restricting dividend payments, to determine or accurately estimate the liability for surtax on undistributed profits. In this event, no provision for this tax need be made but the omission thereof should be explained by footnote to the financial statements indicating therein the approximate maximum amount involved.

"The surtax on undistributed profits should be shown in the profit and loss or income statement separately from other Federal income taxes and if no such tax is incurred by the company, that fact should be indicated."

¹ Under the Securities Act of 1933. Numbers appearing on all of the following releases relate to the Accounting Series.

RELEASE NO. 1

April 1, 1937

SECURITIES ACT OF 1933
Release No. 1353

SECURITIES EXCHANGE ACT OF 1934
Release No. 1121

HOLDING COMPANY ACT
Release No. 590

Treatment of losses resulting from revaluation of assets.

The Securities and Exchange Commission today announced a program for the publication, from time to time, of opinions on accounting principles for the purpose of contributing to the development of uniform standards and practice in major accounting questions.

As the first of these interpretations, the Commission published a letter by Carman G. Blough, Chief Accountant, to a registrant discussing the propriety of charging losses resulting from company revaluations of assets to capital surplus rather than to earned surplus.

Many accounting problems have arisen during the course of the Commission's administration of the Securities Act of 1933, the Securities Exchange Act of 1934, and the Public Utility Holding Company Act of 1935, which have general application, and in these instances the Commission intends to publish opinions as they arise in specific cases.

Previously, the Commission issued an interpretation with respect to the treatment of Federal income and excess profits taxes and the surtax on undistributed profits in financial data. This opinion was published in Release No. 1210 under the Securities Act and should be considered part of this series.

The opinion of the Chief Accountant follows:

"The question under discussion concerns the propriety of a charge (representing a reduction from net cost values of plant and equipment to a valuation established by the executive officers of your company) to capital surplus instead of to earned surplus. The capital surplus to which this charge was made was created pursuant to resolutions of the stockholders and directors providing for the reduction of the par value of the issued and outstanding common stock for the specific purpose of taking care of this revaluation of plant and equipment.

"It is my understanding that the plant and equipment were originally built for, and have until a few years ago been operated in, the manufacture of a class of goods the production of which has been discontinued. Under these conditions, some of the buildings and equipment became useless or obsolete, several of the buildings having been razed prior to the write-off and others subsequently. Other portions of the plant were of unduly large capacity for planned future requirements. The write-downs in question were made in accordance with the instructions of the directors and stockholders as stated in their respective resolutions; namely, 'to the degree considered proportionate to the condition of each such asset with respect to the state of being partially or wholly obsolete, of over-capacity, of lessened utility value, of too high book value in comparison with replacement cost, or unduly costly in operation.'

"To my mind, the revaluation of the assets involved was simply a recognition by the company, as of the date of the write-down, of an accumulation of depreciation in values incidental to the risks involved in the ordinary operation of its business. This depreciation did not occur as of a given date; it took place gradually over a period of years coincident with the evolution of the industry. Thus it was an element of production costs applicable to an indefinite period prior to the write-down and as such would have been charged against income had it been discerned and provided for currently.

"It is my conviction that capital surplus should under no circumstances be used to write off losses which, if currently recognized, would have been chargeable against income. In case a deficit is thereby created, I see no objection to writing off such a deficit against capital surplus, provided appropriate stockholder approval has been obtained. In this event, subsequent statements of earned surplus should designate the point of time from which the new surplus dates.

"Accordingly, in my opinion, the charge here in question should have been made against earned surplus. In view of the stockholder action that has been taken, I see no objection to the deficit in earned surplus resulting from this write-off being eliminated by a charge to the capital surplus created by the restatement of capital stock."

RELEASE NO. 2

May 6, 1937

SECURITIES ACT OF 1933
Release No. 1426

SECURITIES EXCHANGE ACT OF 1934
Release No. 1181

HOLDING COMPANY ACT
Release No. 645

Independence of accountants—Relationship to registrant.

The Securities and Exchange Commission today published an opinion relative to the question of the independence of an accountant when certifying financial statements before the Commission.

The opinion is the second of a series of interpretations on accounting principles. It follows:

"The Securities and Exchange Commission from time to time has been called upon to determine whether, in a particular case, the relationship existing between a registrant and an accountant was of such a nature as to prevent him from being considered independent for the purpose of certifying financial statements to be filed in connection with the registration of securities under the Securities Act of 1933 and the Securities Exchange Act of 1934.

"In response to such requests, the Commission has taken the position that an accountant cannot be deemed to be independent if he is, or has been during the period under review, an officer or director of the registrant or if he holds an interest in the registrant that is significant with respect to its total capital or his own personal fortune.

"In a recent case involving a firm of public accountants, one member of which owned stock in a corporation contemplating registration,

subsidiaries of domestic corporations. The opinion, prepared by William W. Werntz, Chief Accountant, in response to an inquiry, follows:

"Inquiry has been made as to the propriety of including in consolidation with domestic corporations foreign subsidiaries whose operations are effected in terms of restricted foreign currencies, or whose assets and operations are endangered by the war conditions prevailing abroad.

"Foreign currency restrictions and war conditions are of such significance with respect to subsidiaries operating in affected territories as to require, in my opinion, that registrants consider carefully their policy with respect to the inclusion of such subsidiaries in consolidated financial statements. It is my opinion in general that the consolidation of such foreign subsidiaries with the domestic parent and other domestic or foreign subsidiaries may be misleading. However, if, notwithstanding the existence of exchange restrictions and war conditions affecting certain foreign subsidiaries at the time the financial statements are prepared, the inclusion of such foreign subsidiaries in the consolidated statements is considered desirable and in the particular case will not prevent a clear and fair presentation of the financial condition and the results of operations of the registrant and its subsidiaries, their inclusion is ordinarily permissible. If included, however, disclosure should be made as to the effect, insofar as this can be reasonably determined, of foreign exchange restrictions and war conditions upon the consolidated financial position and operating results of the registrant and its subsidiaries.

"In any case, the existence of currency restrictions and war conditions requires that careful consideration should also be given to the question of providing, and, if provision appears necessary, the extent of such provision, for impairment of the registrant's investment in such foreign subsidiaries by reason of the prevailing conditions and losses suffered by such subsidiaries."

RELEASE NO. 12

February 21, 1940

SECURITIES ACT OF 1933
Release No. 2179

SECURITIES EXCHANGE ACT OF 1934
Release No. 2414

Adoption of Regulation S-X—Amendments to Form 15 and Form 17.²

REGULATION S-X

The Securities and Exchange Commission has adopted a uniform set of accounting requirements which will apply to the majority of the Commission's registration and report forms under the Securities Act of 1933 and the Securities Exchange Act of 1934.

The new single accounting regulation will be substituted for the several existing sets of accounting instructions which have heretofore applied to the various forms. Moreover, the new regulation will have the effect of simplifying amendments and interpretations of

² Rescinded November 2, 1949.

accounting rules, inasmuch as such amendments and interpretations will apply to a single regulation instead of to a variety of requirements.

The new regulation, designated Regulation S-X, will govern the form and content of all financial statements and schedules required to be filed as a part of—

(a) Registration statements under the Securities Act of 1933 filed on Form A-2;

(b) Applications for registration of securities under the Securities Exchange Act of 1934, filed on Form 8-A, 8-B, 10, 11, 13, 14, 15, 17, 22, 23, or 24;

(c) Supplemental or periodic reports under Section 13 of the Securities Exchange Act of 1934, filed on Form 10-K, 11-K, 13-K, 14-K, 15-K, 17-K, or 24-K; and,

(d) Supplemental or periodic reports under Section 15 (d) of the Securities Exchange Act of 1934, filed on Form 1-MD or 4-MD.

The new regulation will be applicable to all filings made on these forms after May 31, 1940. However, if a registrant so elects, the provisions of the new regulation may also be applied to financial statements filed prior to that date.

In general, the new regulation constitutes a codification of existing instructions as to the form and content of financial statements as now contained in each of the several forms listed. Instructions as to the dates and periods for which financial statements are required to be filed, however, will be found in the respective forms.

As now organized, the regulation is subdivided into 12 articles. The first 4 articles contain rules of general application. The next 6 articles prescribe, respectively, the form and content of financial statements for commercial and industrial companies, investment companies, insurance companies, committees issuing certificates of deposit, bank holding companies, and natural persons. The remaining articles deal with the form and content of surplus statements and supplementary schedules. A comprehensive table of contents is included.

Some new requirements have been added in the new regulation, principally with a view to obtaining more informative disclosure as to such accounting policies as depreciation, depletion, and maintenance and as to such matters as advances to and from affiliates, directors, and officers. Additional flexibility to the requirements has been given through extension of the rules permitting the elimination of schedules and special information when the amounts involved are not material.

The new regulation incorporates a considerable number of the many well-considered and helpful suggestions received from the large group of accountants, registrants, and others, including representatives of the professional societies, to whom a tentative revision of the instructions was made available.

In view of the pending proceedings in the matter of *McKesson and Robbins, Incorporated*, and several other cases, the rules governing certification by accountants, although altered and clarified in some respects, have been retained in substantially the form now found in the General Rules and Regulations under the Securities Act of 1933 and the several major forms under the 1933 and 1934 Acts. Upon

completion of these proceedings, however, such rules are to be reconsidered with a view to revisions deemed necessary as a result of these cases.

The Securities and Exchange Commission also announced the adoption of an amendment to Forms 15 and 17 under the Securities Exchange Act of 1934, for use, respectively, by incorporated and unincorporated investment companies. The amendments incorporate as an item in the form the requirements for certain historical financial data which previously were called for in connection with the financial statements and are operative only when the new Regulation S-X is applicable.

The text of the Commission's action follows:

I. ADOPTION OF REGULATION S-X

The Securities and Exchange Commission, acting pursuant to authority conferred upon it by the Securities Act of 1933, particularly Sections 7 and 19 (a) thereof, and the Securities Exchange Act of 1934, particularly Sections 12 and 23 (a) thereof, and finding such action necessary and appropriate in the public interest and for the protection of investors, and necessary for the execution of the functions vested in it by the said Acts, hereby adopts Regulation S-X, governing the form and content of all financial statements specified in Rule 1-01 of the Regulation.

The foregoing action shall be effective February 21, 1940, except that financial statements filed as a part of any registration statement, application for registration, or report filed with the Commission prior to June 1, 1940, may be prepared in accordance with the applicable requirements as in effect immediately prior to the adoption of Regulation S-X.

II. AMENDMENT NO. 3 TO FORM 15—AMENDMENT NO. 2 TO FORM 17

The Securities and Exchange Commission, acting pursuant to authority conferred upon it by the Securities Exchange Act of 1934, particularly Sections 12 and 23 (a) thereof, and finding such action necessary and appropriate in the public interest and for the protection of investors and necessary for the execution of the functions vested in it by the said Act, hereby takes the following action:

A. Forms 15 and 17 are amended by adding after Item 38 of each of such forms a new Item 39, reading as follows:

39. Furnish the information required below with respect to capital shares as shown on each balance sheet required to be filed:

(a) If, since January 1, 1925, there have been restatements of capital shares which have resulted in transfers from capital share liability to surplus or reserves, state the amounts of such restatements and all related entries. No statement need be made as to restatements resulting from the declaration of share dividends.

(b) If, since January 1, 1925, there has been an original issue of capital shares, any part of the proceeds from which was credited to accounts other than capital share accounts, state the accounts and respective amounts credited thereto.

B. The Instruction Books for Forms 15 and 17 are amended by adding immediately after the instruction to Item 38 of Form 15 and Item 37 of Form 17, a new instruction reading as follows:

Item 39. 1. In applications filed with the Commission prior to June 1, 1940, this item need not be answered unless the financial statements required are prepared in accordance with the requirements of Regulation S-X.

2. This item does not call for an audit, but only for a survey or review of the accounts named. The answer shall, as such, be separately certified by either (a) the board of directors through its authorized agent, or (b) the chief accounting officer of the registrant, or (c) independent public or independent certified public accountants.

The foregoing action shall be effective February 21, 1940.

RELEASE NO. 13

February 20, 1940

Form of accountants' certificate.

The Securities and Exchange Commission today made public an opinion in its Accounting Series dealing with the form of accountants' certificates. The opinion, prepared by William W. Werntz, Chief Accountant, follows:

"In a recent case a registrant had not maintained cash books, journals, other books of original entry or ledgers during the period covered by the financial statements filed by it with the Commission. Its files, however, contained original underlying data such as canceled checks, check stubs, bank statements, purchase orders, vendors' invoices, sales orders, and duplicate sales invoices.

"In order to prepare financial statements it was deemed necessary by the independent accountants who certified the statements that the cash transactions and sales be recorded in books of original entry and in turn posted to a general ledger and that the books then be adjusted to an accrual basis. The entry and analysis of the transactions in formal books of account were carried out by one of the firm's junior accountants, loaned on a *per diem* basis, and by an officer of the company. The accountants maintained that this preliminary work consisted merely of classifying and summarizing records of transactions prepared by employees of the company at the time of the transaction. However, in many cases notations as to the purpose of disbursements had not been made on the check stubs contemporaneously with the transaction and accordingly it was necessary to rely in such cases upon the memory of an officer of the registrant in classifying and recording disbursements.

"Upon the completion of this preliminary work the certifying accountants found that satisfactory determination had not been made of the balances in certain of the registrant's asset, liability and income and expense accounts. In the second or audit phase of the engagement the accountants therefore deemed it necessary to undertake

Rule 12-34. Trust Shares Other than Periodic Payment Plan Certificates.
(For Unit Investment Trusts only)

1. Amount at which ----- trust shares were carried at beginning of period. ^{1 2}	\$-----
2. Additions during period resulting from:	
(a) Creation of ----- trust shares. ¹	\$-----
(b) Allocations of trust income for rein- vestment.	-----
(c) Other additions. ³	-----
3. Total additions	-----
4. Deductions during period resulting from:	
(a) Surrender and cancellation of ----- trust shares. ¹	-----
(b) Other distributions (or transfers to dis- tributable funds) of amounts credited to trust shares.	-----
(c) Other deductions. ⁴	-----
5. Total deductions.	-----
6. Amount at which ----- trust shares were carried at end of period. ^{1 5} Effective January 9, 1942.	\$-----

¹ Insert the applicable number of trust shares.
² State the basis of determining the amount.
³ State separately all significant items. If market appreciation of underlying trust property is included, the amount thereof shall be shown separately. Income required to be set forth in the statement of income and other distributable funds shall not be set forth here.
⁴ State separately all significant items. If market depreciation of underlying trust property is included, the amount thereof shall be shown separately. Expenses required to be set forth in the statement of income and other distributable funds shall not be set forth here.
⁵ The balance at the close of the most recent period shall agree with caption 8 of the related statement of condition.

RELEASE NO. 30

January 22, 1942

SECURITIES ACT OF 1933
Release No. 2764

SECURITIES EXCHANGE ACT OF 1934
Release No. 3133

Auditing of Inventories under Wartime Conditions.

To avoid any possible interruption in the production or delivery of war materials, the Securities and Exchange Commission today announced the establishment of a liberalized policy with respect to its requirements regarding physical inventory verification by independent public accountants.

Where the customary taking of inventory (including observance or test-checking by auditors) would curtail production of war materials, such procedures may be omitted so long as all reasonable and practical alternative measures are taken by the company and its independent public accountants to assure the substantial fairness of inventory amounts stated in the financial statements and proper disclosure is made.

Whenever inquiries on this point have been received from registrants engaged in the production of war materials, it has been the policy to discuss with the registrant and its accountants the extent

to which normal procedures may be followed without curtailment of production, and the extent to which it is reasonable and practicable to employ alternative procedures or to extend other normal procedures with a view to obtaining the most satisfactory possible determination and review of inventory amounts. Through the use of extended or substitute procedures, it has ordinarily been possible in these cases, for the independent public accountants to satisfy themselves as to the substantial fairness of the inventory amounts and thus to express their opinion without taking exception to the substantial fairness of the representations as to inventories, although their certificate indicated the extent to which the normal auditing procedures of observation or test-checking of the inventory had not been employed.

On the basis of such conferences and correspondence where full disclosure of the circumstances has been made in the financial statements and certificates, no objections have been raised to the omission of normal procedures with respect to statements for the current reporting period of companies engaged in the production of war materials.

The following statement of procedure, prepared by William W. Wertz, Chief Accountant, will be of assistance to registrants and their accountants faced with circumstances which make it necessary to curtail or omit certain normal auditing procedures as to inventories in order to avoid delay in production and delivery of war materials:

"The taking of an inventory has always been considered an important part of the accounting of a corporation in reporting its position and the results of its operations. Observation of the taking of inventory or the test-checking of the inventory has for some time been recognized as a normal procedure to be followed by independent public accountants in audits made for the purpose of expressing their professional opinion as to whether the financial statements fairly reflect the financial position of a company and the results of its operations in accordance with generally accepted accounting principles and practices applied on a basis consistent with that of the preceding year.⁴⁷ Under paragraph (b) (i) of Rule 2-02 of Regulation S-X, failure to employ any procedure generally recognized as normal must be disclosed and the reasons for such omission given. Paragraph (b) (ii) of such rule further calls for a representation as to whether the audit was made in accordance with generally accepted auditing standards applicable in the circumstances. Failure to employ the procedure under discussion would, where inventories were of material amount, necessitate an exception to any positive statement that such standards had been observed.⁴⁸ The existence of such an exception, moreover, would make the certificate subject to the citation of a deficiency in respect thereto. It may also be noted that it is generally recognized that where an exception is sufficiently material to negative the expression of an opinion as to the fairness of the presentation

⁴⁷ See Securities and Exchange Commission, Report on Investigation In the matter of *McKesson & Robbins, Inc.* (1940), particularly pp. 399 ff.; Testimony of Expert Witnesses In the matter of *McKesson & Robbins, Inc.* (1939), pp. 38 ff., 150 ff., 199 ff., 250 ff., 295 ff., 348 ff., 405 ff., 460 ff., 512 ff., 564 ff., and 608 ff. For a statement of present practice see American Institute of Accountants, Statements on Auditing Procedure, Bulletin No. 1 (October 1939) and No. 3 (February 1940).

⁴⁸ See Accounting Series Release No. 21, p. 36 (February 5, 1941).

made by the financial statements, the auditor should refrain from giving any opinion at all.⁴⁹

"Under present circumstances, however, it may in particular cases be impossible to take a satisfactory physical inventory without interruption of the production and delivery of war materials. It may also be impossible for the independent accountants to have such physical contact with the inventory as normal auditing procedure calls for. Where the book inventory records provide sufficient control over inventories, a temporary cessation of the periodic comparison with the physical stocktakings would ordinarily be less serious than where book records are inadequate or lacking. However, it is clearly in the public interest that as positive and effective substantiation of the inventory amounts be made as circumstances permit. The auditor by devising supplemental procedures based on the circumstances of the particular case and by extending the scope of normal procedures which do not require cessation of production should endeavor wherever possible so to satisfy himself as to the substantial fairness of the inventory amounts that his certificate, while indicating the omission of the normal procedure of observation or test-checking, need not contain an exception to the substantial fairness of the presentation of inventories.

"Where circumstances show that the observance of normal procedures with respect to inventories would result in interruption of production or delivery of war materials, it is the administrative policy of the Commission not to object to the omission, provided all reasonable and practical alternative and additional measures are taken by the company and its accountants to support the substantial fairness of the amounts at which inventories are included in the financial statements and provided further that by means of a letter the company indicates the necessity for omitting such procedures, and the financial statements and accountants' certificate contain appropriate disclosures and representations. In the letter to the Commission accompanying or preceding the annual or other report, but not as a part thereof, the company should give the following information:

"(1) Its priority ratings and the extent to which the company is engaged in production of war materials, in terms for example of the proportion of inventories, production or other appropriate basis.

"(2) A statement as to whether normal procedures in the taking of inventories are to be followed except where interruption to the production of war materials would result.

"(3) The delay that would be caused by shutting down to take inventory.

"(4) A statement as to whether it is feasible or practicable for the particular company to take reasonably accurate physical inventories while the plants are in operation or at times when the plants are shut down for other purposes. Such evidence would ordinarily include an indication of the number of shifts per day, the number of days worked per week or other standard period, and whether shut-downs as for repairs or rearrangements may be utilized for inventory taking.

⁴⁹ See, for example, American Institute of Accountants, *Statements on Auditing Procedure*, Bulletins No. 2 (December 1939) and No. 8 (September 1941); and Rule 5 of the *Rules of Professional Conduct of the American Institute of Accountants* as revised and adopted January 6, 1941.

"(5) If at the time of the last physical inventory it was necessary to make significant adjustments in order to reconcile book and physical inventories, a summarized statement of the general nature and amounts of such adjustments.

"Under the circumstances of cases of this kind Rule 2-02 of Regulation S-X requires, in my opinion, that the accountants' certificate contain at least the following information:

"(a) A specific statement of the extent to which normal procedures as to physical inventories were omitted, indicating if such information is not given in the statements themselves, the amount of inventories involved.

"(b) A specific statement of the reason why normal physical inventory procedures were omitted, that is, because their observance would result in a material interruption in the production of war materials.

"(c) A specific statement as to the extent of the accounting records and controls as to inventories and as to whether the accountants consider them adequate.

"(d) A description of the supplementary or extended procedures undertaken by the accountants in view of the absence of a physical inventory and the omission of normal auditing procedures in connection therewith. Such description need not be detailed beyond the point necessary to indicate the general nature and extent of the supplementary or extended procedures undertaken.

"In many cases, it is probable that by means of their alternative and extended procedures the independent public accountants will have satisfied themselves as to the substantial fairness of the amounts at which inventories are stated, and in such case a positive statement to that effect should be made. In some cases it may be that, while the scope of procedures followed will not be such as to have so satisfied the accountants, they will be able to take the position that on the basis of the work done they have no reason to believe that the inventories reflected in the statements are unfairly stated.

"Of course, if the scope of the work done or the results obtained from the procedures followed or the data on which to base an opinion are so unsatisfactory to the accountants as to preclude any expression of opinion, or to require an adverse opinion, that situation must be disclosed not only by an exception running to the scope of the audit, but also by means of an exception in the opinion paragraph as to the fairness of the presentation made by the financial statements. However, in such case, the company and its certifying accountants will be asked to furnish the Commission a statement showing that unusual circumstances exist which prevent the accountants from undertaking such additional procedures as would in the accountants' judgment enable them to satisfy themselves as to the substantial fairness of the inventory amounts. Ordinarily, such statement should be transmitted to the Commission in advance of filing.

"The disclosure made in the financial statements and certificate will of course be subject to the usual review in the light of the Commission's requirements and the circumstances of the particular case. It is implicit that, at the earliest opportunity, every reasonable effort will be made to take physical inventory, with normal observation and test-checking by the certifying accountants, and that any practicable improvements in the accounting records and controls of inventory will

be undertaken. Finally, it should be understood that waiver of objections with respect to the current annual report will not necessarily constitute a basis for similar action in respect of annual reports for subsequent years or statements filed in registrations for the sale of securities."

RELEASE NO. 31

February 5, 1942

SECURITIES ACT OF 1933
Release No. 2774

SECURITIES EXCHANGE ACT OF 1934
Release No. 3145

INVESTMENT COMPANY ACT OF 1940
Release No. 310

Amendment to Articles 5, 6, and 12 of Regulation S-X.

The Securities and Exchange Commission today announced the adoption of an amendment to Rule 12-16 of Regulation S-X so as to make it clear that note 5 to the schedule therein prescribed requires information relative to rents and royalties only if the aggregate amount thereof is significant. Rule 5-04 of Regulation S-X was also amended to make it clear that it is necessary to file Schedule XVII—Income from dividends—in support of each profit and loss statement filed. Since the schedule also calls for information as to the amount of the equity of the company in the net profit and loss of its affiliates, the schedule is required to be filed even though no dividends from such investments are reported in the profit and loss statement for the period of report. A similar amendment was made to Rule 6-04 of Regulation S-X.

The text of the Commission's action follows:

The Securities and Exchange Commission, acting pursuant to authority conferred upon it by the Securities Act of 1933, particularly Sections 7 and 19 (a) thereof, the Securities Exchange Act of 1934, particularly Sections 12, 13, 15 (d) and 23 (a) thereof, and the Investment Company Act of 1940, particularly Sections 8, 30 and 38 (a) thereof, and deeming such action necessary and appropriate in the public interest and for the protection of investors and necessary for the execution of the functions vested in it by the said Acts, hereby amends Regulation S-X as follows:

AMENDMENT NO. 6 TO REGULATION S-X

I. Note 5 to Rule 12-16 is amended by inserting immediately after the numeral "5" the following new sentence:

"If the aggregate amount of rents and royalties is not significant, a statement to that effect will suffice."

As amended note 5 to Rule 12-16 reads as follows: "If the aggregate amount of rents and royalties is not significant, a statement to that effect will suffice. State rents and royalties separately if either amount is significant. If significant in amount, state the aggregate annual amounts of the rentals upon all real property now leased to the person and its subsidiaries for terms expiring more than three

responsibilities comparable to those of a fiduciary, and that therefore the financial statements should clearly reveal amounts due from such persons, accompanied, where the amounts involved are substantial, by appropriate supporting details. Where an indebtedness results from a transaction between the company and one or more of the management, as individuals, the certifying accountants should employ every means at their disposal to insist upon full disclosure by the company and, failing persuasion of the company, should as a minimum qualify their certificate or disclose therein the information not set forth in the statements. Perhaps the most critical test of the actuality of an accountant's independence is the strength of his insistence upon full disclosure of transactions between the company and members of its management as individuals; accession to the wishes of the management in such cases must inevitably raise a serious question as to whether the accountant is in fact independent. Moreover, in considering whether an accountant is in fact independent, such accession to the wishes of the management is no less significant when it occurs with respect to the financial statements included in an annual report to security holders or otherwise made public than when it occurs with respect to statements required to be filed with the Commission.

The text of the Commission's action follows:

The Securities and Exchange Commission, acting pursuant to authority conferred upon it by the Securities Act of 1933, particularly Sections 7 and 19 (a) thereof, the Securities Exchange Act of 1934, particularly Sections 12, 13, 15 (d), and 23 (a) thereof, and the Investment Company Act of 1940, particularly Sections 8, 30, and 38 (a) thereof, and deeming such action necessary and appropriate in the public interest and for the protection of investors and necessary for the execution of the functions vested in it by the said Acts, hereby amends Regulation S-X as follows:

Rule 2-01 of Regulation S-X is amended by adding thereto the following new subsection (c):

(c) In determining whether an accountant is in fact independent with respect to a particular company, appropriate consideration shall be given to the propriety of the relationships and practices involved in all services performed for the company by such accountant, including the furnishing of a certificate or report as to any financial statements of such company which have been published or otherwise made generally available to security holders, creditors, or the public.

RELEASE NO. 38

December 19, 1942

Treatment in financial statements of postwar refunds of Federal excess profits taxes.

The Securities and Exchange Commission today made public an opinion of its Chief Accountant in its Accounting Series relative to the manner in which postwar refunds of Federal excess profits taxes should be treated in financial statements.

The opinion, prepared by William W. Werntz, Chief Accountant, in response to an inquiry, follows:

"You have inquired with respect to the propriety of the manner in which the company proposes to reflect in its financial statements the postwar refunds of Federal excess profits taxes which are provided for by Section 250 of the Revenue Act of 1942.⁵³ You state that the corporation's tax return will indicate that the corporation will be subject to an excess profits tax of \$1,000,000, that the company will therefore be entitled under the statute to a postwar refund credit amounting to \$100,000, and that within 3 months after the payment of the tax the company will be entitled to receive bonds of the United States in an aggregate face amount equal to the credit so established. You note that the Act provides that such bonds shall bear no interest, and only after, and not before, cessation of hostilities in the present war may the bonds be transferred by sale, exchange, assignment, pledge, hypothecation, or otherwise.

"As I understand it, you propose to deduct in your profit and loss statement excess profits taxes in the amount of \$900,000, the net amount of such taxes ultimately payable. However, disclosure will be made of the gross amount of the tax and of the net credit thereagainst. Concurrently, you propose to set up an asset account in the amount of \$100,000 to reflect the amount receivable as a post war refund and to reflect \$1,000,000 as a current liability. When bonds are received the caption of the account will be altered to indicate that fact. You thus propose to treat the total amount payable as, in effect, partially a payment of taxes and partially, to the extent of the postwar credit, as an investment in a special type of Government bonds.

"Upon the basis of the facts stated, the treatment you propose is, in my opinion, in accordance with sound and generally accepted accounting principles and practice and should be followed. However, in view of its special characteristics, the amount receivable as a post war refund should not, in my opinion, be presently classified as current assets or investments, but should rather be shown among 'other assets.'"

RELEASE NO. 39

December 19, 1942

HOLDING COMPANY ACT OF 1935
Release No. 3992

Amendments to Uniform System of Accounts for Public Utility Holding Companies.

The Securities and Exchange Commission today announced the adoption of certain revisions, effective January 1, 1943, to its Uniform System of Accounts for Public Utility Holding Companies. Since printed copies of the system of accounts as revised will not be available for distribution for some time, the amendments in mimeographed form are attached to this release. Under the provisions of Rule U-26 the revised system, subject to certain exceptions, is applicable to all registered public utility holding companies and their subsidiary holding companies. The principal exception covers holding companies which are also operating companies.

⁵³ New Part III, comprising Sections 780-783, Subchapter E of Chapter 2, Internal Revenue Code.