



TO THE MEMBERS AND ASSOCIATES
OF THE AMERICAN INSTITUTE OF ACCOUNTANTS:

In response to numerous inquiries by members of the Institute as to what changes in the form of accountants' reports may be necessary or desirable because of the passage of the Securities Exchange Act of 1934 and the promulgation of regulations thereunder, the Special Committee on Cooperation with the Securities and Exchange Commission has reviewed the situation and reports as follows:

The question may be considered in relation, first, to certificates given in connection with annual reports to stockholders and, second, to those to be submitted with applications for permanent registration.

Dr. James M. Landis of the Securities and Exchange Commission, in his address January 14th before the New York State Society of Certified Public Accountants, made it clear that the Commission had not required the filing with it of annual reports to stockholders as at December 31, 1934. Rule KC-1 has been amended so as to make clear that during the period of temporary registration no such requirement is in existence. Dr. Landis also said that "with no such requirement in existence, the content and character of these reports from a legal standpoint is governed only by common-law liabilities."

A copy of that section of the instructions for Form 10 recently promulgated by the Commission which deals with accountants' certificates is appended hereto. No form is prescribed. Dr. Landis in his address pointed to this fact and also emphasized that throughout its regulations the Commission had considered flexibility as one of its main objectives. Thus there appears to be nothing in the Act or the regulations which necessitates a change in the form of certificate to accompany the annual reports for 1934. At the same time corporations and accountants will naturally desire to avoid, in financial statements and in certificates, the use of any procedure or method of presentation which may cause embarrassment later when Form 10 is filed. It therefore seems desirable to keep the requirements of Form 10 constantly in mind in preparing the annual report to stockholders. Dr. Landis' comment in dealing with the relation between the two sets of financial statements is of interest: "As a practical matter, one knows that major differences between the reports filed with the Commission and those sent to stockholders will not occur, but again as a practical matter, one hopes that a reasonable degree of condensation will take place. The analytical stockholder will always still have easily available the degree of elaboration that can be found in the reports filed with the Commission and the exchanges, reports that under the law are accessible at all reasonable times to any inquirer."

Had time permitted, the general practice in the case of those companies intending to seek permanent registration would undoubtedly have been to prepare Form 10 before issuing their annual reports, and this practice will probably still be followed by many companies. Corporate managements may also deem it advisable to state in the annual reports to their stockholders that they expect to apply for permanent registration and that more detailed

information as to the affairs of the company will be contained in the statements to be filed for that purpose.

In January, 1934, the Institute issued in booklet form correspondence between the Special Committee on Coöperation with Stock Exchanges and the Committee on Stock List of the New York Stock Exchange, in which there was included a suggested form for accountants' reports. This form has been rather generally adopted in connection with the annual reports of listed companies. This Committee believes that this form can advantageously be adopted as a basis for accountants' reports for use with the 1934 annual reports to stockholders. The Committee is hopeful that the form can also be used substantially as the basis for a common form of certificate under the various regulations of the Commission; but in any event it does not seem necessary at the present time to change for annual-report purposes the form of certificate adopted a year ago.

For convenience, a copy of the suggested form of certificate and of the accompanying notes is appended to this report. The last note reads as follows:

“It is contemplated that the form of report would be modified when and as necessary to embody any qualifications, reservations or supplementary explanations.”

The Committee desires to call attention to the importance, when such modifications are necessary, of making them illuminating and expressing them clearly. Distinction must be made between those comments intended to be merely informative or to state the limitations of the scope of the accountants' work (e.g. where part of the work has been performed by other accountants) and those which indicate dissent from particular practices of the corporation.

The Committee has found that ideas have sometimes been entertained as to matters falling within the scope of an audit which are at variance with those commonly held by accountants and the business public, as for instance, that it is a part of the accountants' duty to verify the titles to properties and to determine their present values. The question as to how far it may be necessary, in connection with statements filed under Form 10, to specify the limits of the accountants' responsibility in such respects and how this can best be accomplished is still under discussion between the Committee and the Commission.

Many questions in relation to the foregoing will doubtless arise and coordination of efforts in securing any necessary interpretations or clarification is obviously desirable. The members of this Committee are willing to serve in effecting such coördination to the extent that it may be desired.

Special Committee on Coöperation with
Securities and Exchange Commission,

SAMUEL J. BROAD

JOHN HOOD, JR.

RODNEY F. STARKEY

ANDREW STEWART

C. OLIVER WELLINGTON,

Chairman.

January 16, 1935

APPENDIX

Extract from Instruction Book for Form 10 for Corporations

The financial statements required shall be accompanied by a certificate of an independent public or independent certified public accountant or accountants. This certificate shall be dated, shall be reasonably comprehensive as to the scope of the audit made, and shall state the opinion of the accountant or accountants in respect of the financial statements of, and the accounting principles, and procedures followed by the registrant. In certifying to the financial statements of the registrant, independent public or independent certified public accountants may give due weight to an internal system of audit regularly maintained by means of auditors employed on the registrant's own staff. In such case the independent accountants shall review the accounting procedures followed by the registrant and by appropriate measures shall satisfy themselves that such accounting procedures are in fact being followed. Nothing in these instructions shall be construed to imply authority for the omission of any procedure which independent public accountants would ordinarily employ in the course of a regular annual audit.

Suggestion of a Form of Accountants' Report

(As prepared by the Special Committee on Coöperation with Stock Exchanges and issued in January, 1934.)

To the XYZ Company:

We have made an examination of the balance-sheet of the XYZ Company as at December 31, 1933, and of the statement of income and surplus for the year 1933. In connection therewith, we examined or tested accounting records of the company and other supporting evidence and obtained information and explanations from officers and employees of the Company; we also made a general review of the accounting methods and of the operating and income accounts for the year, but we did not make a detailed audit of the transactions.

In our opinion, based upon such examination, the accompanying balance-sheet and related statement of income and surplus fairly present, in accordance with accepted principles of accounting consistently maintained by the Company during the year under review, its position at December 31, 1933, and the results of its operations for the year.

Notes

1. It is contemplated that before signing a report of the type suggested, the accountant should have at least made an examination of the character outlined in the bulletin, "Verification of Financial Statements," as interpreted in the communication of the Committee on Stock List to the Governing Committee dated October 24, 1933.

2. The report should be addressed to the directors of the company or to the stockholders, if the appointment is made by them.

3. The statement of what has been examined would, of course, conform to the titles of the accounts or statements reported upon.

4. In the second sentence, any special forms of confirmation could be mentioned: e.g., "including confirmation of cash and securities by inspection or certificates from depositaries."

5. This certificate is appropriate only if the accounting for the year is consistent in basis with that for the preceding year. If there has been any material change either in accounting principles or in the manner of their application, the nature of the change should be indicated.

6. It is contemplated that the form of report would be modified when and as necessary to embody any qualifications, reservations or supplementary explanation.