

AMERICAN INSTITUTE OF ACCOUNTANTS
13 EAST 41ST STREET, NEW YORK, N. Y.

FRANKE, HANNON & WITHEY

444 Madison Avenue
New York

January 10, 1941

John L. Carey, Secretary
American Institute of Accountants
13 East 41st Street
New York, N. Y.

Dear Mr. Carey:

There is attached hereto condensed balance sheet of the A B C Company and the accompanying opinion of X Y Z Company, Certified Public Accountants. The balance sheet was given quite a wide circulation and the firm of public accountants whose opinion was attached to the balance sheet is a well-established and reputable firm.

The Special Committee on Auditing Procedure states in their report dated May 9, 1939, that "In the judgment of this committee the independent certified public accountant should not express the opinion that financial statements present fairly the position of the company and the results of its operations, and that they conform to generally accepted accounting principles, when his exceptions are such as to negative the opinion, or when the examination has been less in scope than he considers necessary. In such circumstances, the independent certified public accountant should limit his report to a statement of his findings and if appropriate his reasons for omitting an expression of opinion." (Underscoring made by the writer.)

The above paragraph also appeared in a modified report approved at the annual meeting of the American Institute of Accountants. The question has arisen in the minds of my associates as to whether or not the exceptions in the opinion were such as to negative the opinion. If so, did the firm err in giving an expression of opinion as to the financial statements?

We are not directly concerned with the opinion or the financial statements in the case cited, as our only interest in the matter is to obtain an expression of opinion from a responsible committee of the Institute as to whether or not this particular case represents acceptable practice. We have no objections to furnishing the name of the Company or of the accountants, but since it does not seem important to the question involved, the names have been omitted.

AMERICAN INSTITUTE OF ACCOUNTANTS

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It will be appreciated if you would refer this letter to the proper committee of the Institute for their opinion.

With kindest regards,

Yours very truly,

(signed) H. A. Withey

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Encs.

AMERICAN INSTITUTE OF ACCOUNTANTS

13 EAST 41ST STREET, NEW YORK, N. Y.

70 Pine Street.

January 16, 1941

Mr. H. A. Withey,
Messrs. Franke, Hannon & Withey,
444 Madison Avenue.

Dear Mr. Withey:

Your letter of January 10 addressed to Mr. Carey has been referred to me as Chairman of the Committee on Auditing Procedure.

I think that an answer to your inquiry would be obtained by reference to the pamphlet, "Inventories and Receivables of Department Stores, Instalment Houses, Chain Stores, and Other Retailers", issued as a Statement by this Committee and printed in the February 1940 issue of the Journal, as well as being one of the public information series of pamphlets.

You will note that the form of report which you send is almost identical with that suggested in the pamphlet referred to.

Presumably the accounting firm in question would not have issued such a report unless they had satisfied themselves by other means (though undoubtedly not as extensive means) as to the bona fides of the receivables and the inventories.

There may well be a question in your mind as to whether the auditors should make an exception if they have satisfied themselves, and whether they should give such an opinion if they have not satisfied themselves; in other words, perhaps the pamphlet went rather far in requiring an exception in such circumstances. This is a question on which there might be difference of opinion and one which is scheduled to come up for further consideration by the Committee.

Yours very truly,

Chairman,
Committee on Auditing Procedure

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AMERICAN INSTITUTE OF ACCOUNTANTS
13 EAST 41ST STREET, NEW YORK, N. Y.

A. B. C. COMPANY

CONDENSED BALANCE SHEET

AS AT JUNE 30, 1940

A S S E T S

Current Assets:

Cash on hand and in banks	\$447,414.55
Investments in marketable securities – at market quotations	5,212.50
Accounts receivable, less reserves	56,367.32
Merchandise inventory – at the lower of cost or market	<u>500,149.64</u>
Total Current Assets	1,009,144.01
Sundry receivables	13,607.58
Fixed assets, less depreciation	30,863.01
Deferred charges	<u>13,147.20</u>
	<u>\$1,066,761.80</u>

LI A B I L I T I E S

Current Liabilities:

Accounts payable and accrued expenses	\$73,434.48
Reserve for taxes	<u>107,863.14</u>
Total Current Liabilities	181,297.62
Capital stock and surplus	<u>885,464.18</u>
	<u>\$1,066,761.80</u>

The above statement is subject to final determination of Federal income taxes for the years ended June 30, 1937, 1938, 1939 and 1940.

The above statement is subject to the accompanying Accountants' Report, which is made a part hereof.

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X. Y. Z. CERTIFIED PUBLIC ACCOUNTANTS

ACCOUNTANTS' REPORT

To the Board of Directors,
A. B. C. Company.

We have examined the balance sheet of A. B. C. Company, as at June 30, 1940; have reviewed the system of internal control and accounting procedures of the company and, without making a detailed audit of the transactions, have examined or tested accounting records of the company and other supporting evidence by methods and to the extent we deemed appropriate except as stated hereafter.

Auditing tests and checks of accounts and records concerning accounts receivable, accounts payable and inventories have been made but upon instructions of the company we have not applied the generally accepted auditing procedure of direct communication with debtors and creditors or attendance at the physical count of inventories, nor have physical tests of inventories been made under our observation.

In our opinion, subject to the exception stated in the foregoing paragraph, the accompanying balance sheet, together with the comments thereon, presents fairly the position of A. B. C. Company, at June 30, 1940, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

X. Y. Z.

New York, N. Y.
August 9, 1940.