View metadata, citation and similar papers at core.ac.uk

brought to you by CORE

provided by eGrove (Univ. of Mississippi)

Accounting Historians Journal

Volume 37
Issue 2 December 2010

Article 5

2010

Development of modern auditing standards: the strange case of Raymond Marien and the fraud at Interstate Hosiery Mills, 1934-1937

Jan Richard Heier

Maria A. Leach-Lopez

Follow this and additional works at: https://egrove.olemiss.edu/aah_journal

Part of the Accounting Commons, and the Taxation Commons

Recommended Citation

Heier, Jan Richard and Leach-Lopez, Maria A. (2010) "Development of modern auditing standards: the strange case of Raymond Marien and the fraud at Interstate Hosiery Mills, 1934-1937," *Accounting Historians Journal*: Vol. 37 : Iss. 2 , Article 5.
Available at: https://egrove.olemiss.edu/aah_journal/vol37/iss2/5

This Article is brought to you for free and open access by the Archival Digital Accounting Collection at eGrove. It has been accepted for inclusion in Accounting Historians Journal by an authorized editor of eGrove. For more information, please contact egrove@olemiss.edu.

Accounting Historians Journal
Vol. 37, No. 2
December 2010
pp. 67-93

Jan R. Heier
AUBURN UNIVERSITY, MONTGOMERY
and
Maria A. Leach-López
AUBURN UNIVERSITY, MONTGOMERY

DEVELOPMENT OF MODERN AUDITING STANDARDS: THE STRANGE CASE OF RAYMOND MARIEN AND THE FRAUD AT INTERSTATE HOSIERY MILLS, 1934-1937

Abstract: In February 1938, the police arrested Raymond Marien, a small, bookish man, for forging checks at Interstate Hosiery Mills, Inc. During the ensuing investigation, the New York Attorney General's office found that Marien had "juggled" the books of the corporation and that these accounting irregularities inflated Interstate Hosiery Mills' assets by $1.9 million or about 40% of the company's assets. In an irony of history, the company's external auditors, as it turned out, employed Marien. The extensive investigation conducted by the SEC into Marien's manipulations found that, save for forged checks amounting to about $2,000, Marien and others were exonerated from any financial gain in the fraud due to the increased value in Interstate's shares. In the end, the fraud and the SEC rulings would serve as a foundation of many modern accounting and auditing principles related to auditor independence, supervision, and management responsibility.

INTRODUCTION

The American Institute of Certified Public Accountant's (AICPA) [2009] trial-board proceedings from March 2009 reported that the Institute disciplined a CPA from New York under rule 101 of the Code of Conduct. According to the complaint, "The auditor created journal entries, coded deposits, and disbursements for reporting in the general ledger without obtaining client approval. As a result, the auditor audited his own work." This was a classic case of a lack of independence on the part of an auditor. The AICPA suspended the member and required him to complete 50 hours of continuing professional education and submit to a peer review. The AICPA's decision highlights the importance placed on the concept of independent audits, with the genesis of rules that can be traced to a 1938 Securities and Exchange Commission (SEC) ruling that dealt with Interstate Hosiery Mills, Inc. (IHM) and Raymond Marien, an employee of the firm's independent auditors.

The following paper details the story of Raymond Marien's fraud at IHM. As the evidence will show, the exact amount of the fraud or the methods followed to accomplish it were never pinpointed definitively. Thus, the paper will present the balances from various sources to give as complete a picture as possible of the financial events that led up to the SEC's report and ruling even though the numbers may not directly reconcile. The materials used as evidence in the paper come from SEC case reports; contemporary newspapers, magazine, and journal articles; as well as later Accounting Series Releases (ASRs) that quoted and used the ruling. In addition, the paper includes a brief history of the company; a discussion of the dual investigations by the New York attorney general and the SEC into the alleged accounting irregularities; and the life of Raymond Marien, the primary character. Finally, the resultant 1939 SEC ruling is explored as it relates to the development and application of modern auditing standards related to supervision, independence, and management responsibility.[1]

THE ORGANIZATION OF IHM

According to the *New York Times* (*NYT*) [1929a, p. 47], IHM was organized as a Delaware corporation. Its purpose was to acquire the stock of several competing hosiery companies and consolidate mill operations. These companies included the Brilliant Silk Hosiery Company of Bloomfield, New Jersey; the Finery Silk Hosiery Company in Clifton, New Jersey; and the Lansdale Silk Hosiery Company in Lansdale, Pennsylvania just north of Philadelphia. The new company named Selig, the former sales manager of the Gotham Silk Hosiery Company, as the chief operating officer of the new concern, with several managers from the consolidated companies named in supporting positions. The *NYT* [1929c, p. 42] published a stock prospectus for the new company that noted the financials were examined

[1] Two 1939 editorials evidenced the importance of the SEC ruling. The first, written by Carey [1939] in the *Journal of Accountancy*, will be discussed later in the paper. The second in *The Texas Accountant* [1939, p. 8] commented that the "case is of sufficient importance to justify thorough study of the Commission's release."

by "Messers Haskins and Sells." The article also mentioned that the consolidation of the three mills would "...result in the formation of a company equipped to serve the trade with an unusually wide variety of merchandise distributed through varied channels producing a complete line covering a wide range in price of woman's plain and fancy full fashioned silk hosiery."

IHM completed the consolidation through the exchange of 110,000 shares of its stock for the shares of the three predecessor companies. Another article in the *NYT* [1929b, p. 40] reported pro-forma 1928 income for the combined company at an estimated $386,000 or about $3.51 per share on $4.1 million in sales. The company also reported that there was no funded (long-term bonds) debt or preferred stock, but it did have $159,000 in mortgages outstanding on properties with an appraised value in excess of $1.78 million.

A few days after the merger, the second *NYT* [1929b] article reported that the investment banking firms of Ernst and Co. and Strupp and Co. took the newly consolidated company "public" and asked for trading privileges on the New York Curb Market. This request came with the issuance of 78,500 shares of newly issued, no-par IHM common stock with a prospectus price of $30.00 per share. The prospectus indicated that the purpose of the $2.5 million offering was for "the immediate expansion... inasmuch as two companies have been operating day and night shifts and one company has been under the necessity of purchasing annually from outside sources several hundred thousand dollars of merchandise....Substantial savings are expected through the consolidation of dyeing, finishing, and shipping departments."

To sweeten the deal, the prospectus also announced that the Board of Directors had declared an initial 45¢ per share dividend for June 29, 1929. While the newly formed company settled in their new location on the thirteenth floor of 232 Madison Avenue, the Curb Market admitted IHM for trading on March 7, 1929. IHM was now in operation, but it would soon face Black Tuesday (October 24, 1929) and the Great Depression.

For the next four years, the company would struggle through the depression reporting decreases in prices of hosiery several times as demand waned. There was an eventual reduction of the dividend rate in 1930 from 45¢ to 35¢ per share to conserve cash [*NYT,* 1930a, p. 47]. In addition, the *NYT* [1930b, p. 39] listed several of IHM's judgments against customers that had a problem paying their bills. To stabilize sales, the company, along with other hosiery manufacturers, created an industry financing company to help its customers stay in business especially around the holidays in 1930 [*NYT,* 1930c, p. 49]. The company would not show an economic turn-around until mid-1932. In that year, the company posted profits of 82¢ per share after showing moderate losses the previous two years [*NYT,* 1934a, p. 34]. Prices of finished hosiery began to rise in 1933 at about the same time DuPont introduced rayon, a stronger synthetic thread, to America's textile manufacturers [*NYT,* 1933, p. 20]. During 1934, the company complied with the new registration requirements for publicly held companies under the 1933 Securities Act, putting it under federal regulation that included the proper disclosure of its financial condition [*NYT,* 1934b, p. 33]. The IHM came out of the depression with a strong income report in February 1934 of $462,000 or $4.81 per share [*NYT,* 1934a, p. 34]. In the end, the company would survive the worst economic downturn in U.S. history only to confront a more daunting set of problems in early 1938.

DISCOVERY OF ACCOUNTING IRREGULARITIES

Troubles at the New York Curb Market: According to the *Wall Street Journal* (*WSJ*) [1938a], on February 15, 1938, the officials of the IHM arrived at their offices on Madison Avenue in New York like any other day. The company was in its tenth year. During the day, the New York Curb Market[2] informed the company that it was about to suspend the trading of IHM's stock after the company itself reported that several accounting irregularities had been found in its yet to be released 1937 annual report. These irregularities included the wanton falsification of the company's annual reports for the published years 1934 through 1936 and the unreleased year of 1937. The irony of the situation was that none of the company's officials were accused of this fraud. Rather, the accused was Marien, an employee of the company's auditors, Homes & Davis (H&D). The story became a minor sensation in the newspapers of New York City until the more salacious and deadly revelations about McKesson-Robbins[3] pushed it to the back pages a few months later. Felker [2003, p. 45] pointed out that the actions of the people in the IHM case "reflect the origins [of the SEC's] longstanding views on the role

[2] The New York Curb Exchange was the former name of the American Stock Exchange.

[3] McKesson & Robbins was a New York drug manufacturer whose management defrauded stockholders through the "manufacture" of false accounting documents that were not properly reviewed by its outside auditor, Price Waterhouse.

of and responsibilities of executives and auditors." Felker further commented that the IHM case thrust the principles of auditor independence, supervision, and management responsibility to the forefront of the profession and fundamentally changed the philosophy of auditing in much the same way that the more famous 1938 McKesson & Robbins case changed the way audits were conducted.

Homes & Davis CPAs: The *NYT* [1939b, p. 37] reported that Henry Homes and Morton Davis founded the CPA firm H&D in 1917. The firm's offices were on Fifth Avenue, not far from IHM's corporate offices. IHM originally retained H&D as its auditors in 1928 to prepare pro-forma financials used in the upcoming March 1929 prospectus. H&D was probably selected because of the firm's previous connection to one of its subsidiaries, Finery Silk Hosiery. In addition, the firm had a reputation as experts in the field of textile and apparel industry accounting [*NYT*, 1923, p. E10]. At the time of its association with IHM, there were about 90 employees, including Marien, working for the CPA firm.

Raymond Marien: McCarten [1962, p. 443] mentioned that Marien began employment at H&D circa 1928. He was described as a "slight, clerkish man in his late thirties [with] intelligent eyes magnified by rimless glasses." The *NYT* [1938b, p. 8] reported that he neither drank nor smoked, giving the impression "of conservatism and utter reliability." The *SEC Report* [1939, p. 711], regarding this incident, mentioned that Marien had interviewed for the job at H&D in May 1928. This was in response to an advertisement in the *NYT*. Marien informed the firm that he was a graduate of the University of Montreal[4] and had eight years of "public accounting experience, including industrial, mercantile, banking and brokerage assignments." He then reportedly told the CPA firm that he had been working for F.A. Bergeman, a local New York bookkeeping firm, from 1920 to 1928. H&D sent a request to Bergeman and received a letter of reference from that company indicating that Marien was "a thoroughly competent senior accountant." It highly recommended him for his "keen analytical ability, sound mental training, his tact, his loyalty and the thoroughness of his work." H&D ap-

[4] According to McCarten [1962, p. 444], Marien entered the University of Montreal at age 14 and worked for the Canadian Ordinance Bureau during World War I.

peared to have completed its "due diligence" and hired Marien "without further investigation."

As it turned out, the letter from Bergeman must have been a forgery. McCarten [1962, p. 449] reported that Marien had actually been working as an auditor for Price Waterhouse and Company on the D'Orsay (a New York perfume importer) account during the time he reportedly was working for Bergeman. This is the first of many contradictory stories in the press about this case. Earlier in the decade, the *NYT* [1925, p. 23], reported that the Paris police had arrested one Erasmus Raymond Marien after he had jumped bail on a charge of stealing $16,000 from D'Orsay, Inc. The article implied that Marien had worked for the New York office of D'Orsay and had looted the local checking account before leaving for Paris. In fact, Marien was an auditor for D'Orsay's CPA firm, Price Waterhouse. After his arrest in Paris and extradition to the U.S., Marien apparently plead guilty to the theft charges. The *NYT* [1938b, p. 8] reported that the court convicted Marien on the outstanding indictments and that he was sentenced to an "indeterminate period in jail not to exceed three years." McCarten surmised that Marien's relatively light sentence in this instance was the result of his explanation to the judge that he had used the money to feed his family and not on "dissipations." It is very difficult to say without the actual records, but Marien may have stayed in the "Tombs" [5] for about a year and a half, and probably was released from jail several months before he interviewed for the job at H&D. McCarten suggests that the New York City parole officials immediately lost track of Marien as he promptly reinvented himself by working at odd jobs and by making a minor change from his given name of Erasmus Raymond to simply Raymond.

From the available reports, it is difficult to say when H&D sent Marien to IHM's Lansdale, Pennsylvania mill, but in March 1930, the CPA firm named Marien the senior auditor at that location after a staff resignation.[6] One very confusing question arises with this near-permanent job appointment. Why did H&D send an employee from the New York office to Lansdale, about 120 miles from his home, when the position could have been staffed out of the firm's Philadelphia office which had opened about four years prior to Marien's employment [*NYT*, 1924, p. 40]? Marien's own penchant for lying could have been the basis

[5] The "Tombs" is the colloquial name for Manhattan's central holding jail.

[6] The *SEC Report* [1939, p. 712] hinted that Marien was the accountant in charge of the first audit of IHM in June 1929.

for this decision. During the SEC hearings, Marien's supervisor, Theodore Phillips (the person who had hired him), testified that his employee seemed to have had a better knowledge of the silk and hosiery business than he did. As it turned out, Phillips would endure most of the criticism faced by the CPA firm for his lack of supervision over Marien. Even as Marien's misdeeds became known, Phillips later testified that "he was the best accountant he ever had…industrious conscientious and glutton for work" [*WSJ*, 1938e, p. 36], but he also admitted the Marien acted both as the senior accountant on the job and the supervisor "so his falsifications escaped unnoticed" [*NYT,* 1938h, p. 23].

After Marien's first year in-charge of the Lansdale audit, IHM's officials asked H&D if he could supervise the bookkeeping staff there since the company had no controller at that location. This fact, coupled with an unbridled confidence in Marien's ability and veracity, was the beginning of a long string of problems. McCarten [1962, p. 445] comments that the company eventually entrusted him with "complete control over all its accounting matters" at the plant. By 1934, except for the mill's cost accountant, Marien was the sole contact between the plant and the corporate offices in New York, going so far as to "certify" the materials that he personally had reviewed as the supervisor of the bookkeeping staff. Nobody at this point seemed to question this apparent conflict of interest or foresee any future difficulties with auditor independence. While Marien diligently went about his duties between 1934 and 1938, IHM's stock price grew nearly six-fold from $7.00 to $42.00 per share [*NYT,* 1938b, p. 8]. McCarten [1962, p. 445] wryly noted, "...in back of this bustling prosperity stood the inspired accounting of Marien."[7]

The end for Marien, aged 45, came rapidly in February 1938 when Harold Greenwald, IHM's corporate secretary, received a note from its bank in Lansdale informing him that his request to forward certain cancelled checks to Mr. Marien could not be honored because a clerk had already dispatched that month's bank statements to the company. This mistake by the bank's clerk turned out to be quite serendipitous. Greenwald quickly realized that he had a problem because he knew that he had never sent such a request to the bank. Upon investigation, he found the two checks, totaling $800, had been forged by Raymond Marien, their trusted accountant. After confessing

[7] The *NYT* [1938c, p. 29] reported that New York investment journalist Leo Bercow was "fired by enthusiasm" to recommend IHM's stock based on the company's falsified cash position.

his forgery, H&D officials fired Marien, but in a strange turn of events, IHM's officials asked that he remain in his position to complete the annual report from the Lansdale mill that the company needed for its annual meeting in two weeks. *SEC Report* [1939, p. 710] noted that Greenwald "thought it improbable that there were any irregularities other than the forgeries." He could never have envisioned the troubles that were about to beset IHM; troubles that would eventually change the fundamental philosophy behind external audits.

THE NEW YORK STATE INVESTIGATION

The *NYT* [1938b, p. 8] reported that IHM caught Marien forging four other checks for an additional $1,200 during the time he stayed on at the mill. This forced H&D to remove him from the position on February 8, 1938. The CPA firm dispatched an unnamed replacement from the New York office to the Lansdale mill. In the course of familiarizing himself with the accounts, the new accountant asked to compare the books at the mill with those of the corporate offices in New York. Within a short period, it was clear that $2,000 in check forgeries was not the real problem caused by Marien. By February 10, the new accountant reported to Davis, a founding partner of the CPA firm, that it appeared that there were large discrepancies between the books of IHM's New York office and the books of the mill. McCarten [1962, p. 446] noted that, "the Homes & Davis operative discovered that the New York books, on which Interstate was paying off,[8] bore only the sketchiest relation to reality." He went on to write, "for almost four years Interstate had been basing salaries, dividends, bonuses, and general financial policy on balance-sheets which Raymond Marien had just made up out of his own head." This revelation brought the full weight of the law down on both Marien and the company.

On February 16, 1938, the police arrested Marien at his home, an apartment in Sunnyside, Long Island, where he lived with his wife and three adolescent children.[9] He was booked into the familiar confines of "The Tombs," where he was questioned

[8] In using the verbiage "paying off," it should be noted that McCarten was a journalist and not an accountant. One would presume that he meant IHM's payment of dividends or bonuses and not illegal gambling debts.

[9] McCarten [1962, p. 444], reported that Marien married a Toronto socialite whose wealthy father disagreed with the marriage. She stood by Marien through these troubles and, after he went to prison, worked as a waitress to support her family.

by the New York State Attorney General's Office.[10] McCarten [1962, p. 446] wrote that Marien soon confessed to his "juggling" the books, stating that he was "overworked and under nervous strain." The *NYT* [1938d, p. 2] reported that Assistant New York Attorney General Ambrose V. McCall told his supervisors that Marien "had confessed that he had exaggerated the corporation's assets in the public balance sheets for several years." The newspaper went on to write that the accountant said that he "had falsified the accounts on a 'crazy impulse' at no profit to himself."[11]

Even with a confession in hand, the Attorney General's Office continued its investigation, seeking to learn if the officers of the mills had profited from the falsified statements. Accordingly, McCarten [1962] related that investigators from the Attorney General's Office questioned Marien almost daily trying to understand what he had done. Marien, for his part, taunted them by "expounding on financial theory and practice," while admitting to investigators what items he had "fudged," and explaining that none of the problem could be corrected without his help. As it turned out, his financial manipulations were actually "second-rate" in nature. The SEC report would conclude that had someone at the company actually read the reports from Marien, the problems at the company would have been discovered, a theme parroted by many sources.

During all of the interrogations, Marien never varied his story, and he never implicated any other official at IHM. To rule out an insanity plea, an investigator sent Marien to Bellevue Psychiatric Hospital for an evaluation where he was found to have "superior intelligence" [*NYT*, 1938i, p. 13]. Marien even went so far as to write letters to the attorney general explaining how ignorant his investigators were. While in jail, Marien also became what modern parlance would call a "jail-house lawyer" by preparing writs of *habeas corpus* on behalf of other prisoners.

In May 1938, McCall, acting for the then New York Attorney General Bennet, conducted further hearings into the matter. The *NYT* [1938e, p. 33] reported that the first witness for these hearings was Henry I. Hann from S.D. Leidesdorf and Co., the firm that conducted the re-audit of the IHM. Hann testified that

---

[10] In the intervening six days between discovery and Marien's arrest, the company and its auditors informed both the Curb Market and the SEC of the problems leading to the market's trading suspension on February 15, 1938.

[11] According to the *NYT* [1938g, p. 35], Marien was in the Tombs "on default of $15,000 bail."

Marien had just "added $100,000 here and $100,000 there" at the Lansdale mill and reported the following inflated income:

1934	1935	1936	1937
$374,966	$195,772	$409,127	$951,122

Hann's testimony further showed the extent of the problems when he noted that IHM would have actually shown a loss of $56,799 for 1937 without Marien's manipulations. This forced the officers of the corporation to return all but $90,000 of the $269,000 paid in bonuses since 1934. Hann testified that the discrepancies could easily have been found by Marien's supervisors at H&D or the officials at IHM had they done something as simple as comparing the central-office books with those of the mill. Hann ended his testimony by demonstrating that the company was still solvent despite the accounting problems.

At this revelation, it appears that the principals from the companies involved tried to distance themselves from the scandal. For example, a *WSJ* [1938c, p.17] article of February 18, 1938 reported Homes, the managing partner of H&D, testified that "monthly statements made up by [Marien] were sent to officers of Interstate but they had not been checked against the company's books or the inaccuracies would have been apparent." Next, Greenwald, IHM's treasurer, testified that the company had no head bookkeeper (a modern controller) at the New York headquarters. Because of this odd situation, there was apparently no accountant on staff to compare the mill and corporate books. Fundamentally, Marien had kept impeccable books for the mill, but falsified the reports he sent to the New York corporate office where his manipulations would have easily been discovered if proper internal-control procedures were in place. Finally, the *WSJ* [1938b, p. 12] reported that Selig, the president of the IHM, testified that he had "no knowledge that the assets shown on the books were in excess of actualities."

The *WSJ* [1938d, p. 13] from May 25, 1938 further enhanced the information about the fraud by reporting that IHM's 1937 earned-surplus account was $1,721,000, but should have been $223,000 without Marien's manipulations. The actual profits of the company between 1934 and 1937 should have been approximately $440,000 compared with the reported $1,118,000. The inflated profits led to overpayment of income taxes and an excess dividend payout of nearly $400,000 in addition to the improper bonuses paid to IHM's officials. By 1937, the manipulations had inflated the company's assets by nearly $1.9 million, including inflated inventory of $904,000, accounts receivable of $701,000, and cash of $234,000. This pattern of inflated assets began in 1934 and grew as follows:

1934	1935	1936	1937
$391,000	$496,600	$756,000	$1,900,0000

Earlier articles discussing IHM's case failed to explain how Marien accomplished this financial manipulation other than to comment that he "wrote-up" the accounts, even though the primary manipulation turned out to be an understatement of "prime cost of sales." The understatement eventually caused the higher than normal net-income figures. Using the information published by the *WSJ* [1938a, p. 11], Exhibit A below shows a composite balance sheet for IHM as of 1937 year-end. From the figures given, the assets shown on the manipulated balance sheet must have been in excess of $5 million, meaning that nearly 40% of the firm's assets were non-existent.

In the end, New York's investigation left the complicated process of explaining the manipulations and their consequences

EXHIBIT A

Interstate Hosiery Mills
Estimated Balance Sheet
December 31, 1937

Developed from materials published in the *Wall Street Journal* [1938a, p. 11]

Assets		**Liabilities and Equity**	
Cash	$151, 586	Accrued Taxes	$30,613
Net Receivables	575,896	Notes Payable	714,500
Miscellaneous Receivables	942	Sundry Liabilities/ Accrued Taxes	50,648
Inventories	1,010,177		
Sundry	37,640	Non—current Serial Notes Payable	80,125
Patents and Goodwill	1		
Net Plant and Equipment Depreciation and Mortgages	1,279,318	Capital Stock (par 20)	1,963,820
Deferred Charges	52,699	Surplus	266,553
Total Assets	$3,108,259	Total Liabilities and Equity	$3,108,259
Note: There is a $2,000 error in the reported liabilities and equity items compared to the reported total.			

to the coming investigation by the SEC. In addition, New York officials could neither implicate any of IHM's officers in the fraud nor prove that Marien had financially benefited by his actions. All they had were the forged checks written on the First National Bank of Lansdale. When Marien was arraigned before Judge John Freshchi on forgery charges, he pled "not guilty," even though he had confessed his misdeeds to both officials of IHM and his H&D employers [*NYT*, 1938f, p. 30].

THE SEC INVESTIGATION AND FINDINGS

As the news of the problems at IHM filtered through the New York financial community, the New York Curb Market informed the company on February 16, 1938, "that they had suspended trading in the company's stock pending an investigation." The *NYT* [1938a, p. 42] reported that the company had to postpone its annual meeting scheduled for that week and would issue a new financial report after a new audit firm (S.D. Leidesdorf and Co.) had an opportunity to complete its work. In response to the problems at IHM reported by the *NYT* and the *WSJ* over the previous four months, the regional SEC office in New York announced hearings for June 28, 1938 to determine if IHM's stock should be permanently withdrawn from registration and trading on the Curb Exchange. Officials from the SEC became involved due to the concern that the rapid growth in IHM's stock value resulted from the company's misrepresentation of its financial condition. In addition, the SEC [1939, p. 711] wished to investigate if the statements in annual registration forms fairly represented the condition of the company since the SEC "had reason to believe the financial statements for the years 1934, 1935, and 1936, filed with [the] Commission…were false and misleading." Finally the SEC's investigation sought to determine if H&D "knew, or in the exercise of reasonable diligence, should have known," that there were problems with IHM's financial condition.

In November 1938, a preliminary report filed by the SEC found that both IHM and H&D were at fault for the accounting irregularities. Both the company and its CPA firm challenged the preliminary report. On December 6, 1938, all the parties involved made "oral arguments" before the SEC. This later investigation would report a cumulative $1.6 million of total accounting irregularities for 1934-1936. The corresponding $1.9 million in overstated assets reported by the *WSJ* [1938d, p. 13] is a cumulative balance-sheet figure that included amounts from the unpublished 1937 IHM annual report. The SEC was not interested in these numbers because the company had never released the inflated 1937 annual report that the company corrected before it became part of the fraud. McCarten, however, detailed the differences (Exhibit B) between Lansdale mill's correct books and the numbers sent to New York in 1937.

EXHIBIT B

McCarten's [1962] Published Balances

Account Title	New York Accounts	Lansdale Accounts	Difference provided by authors in italics
Cash	$386,073	$151,839	*$234,234*
Accounts Receivable	1,263,543	561,605	*701,938*
Inventory	1,840,393	936,034	*904,359*
Total account changes	3,490,009	1,649,478	*1,840,531*
Profits	582,541	-56,759	*525,782*
Total Assets	$4,859,508	$3,382,558	*$1,476,950*

The overstated cash, accounts receivable, and inventory amounts in the unpublished 1937 statements mirrored those included in the *SEC Report* [1939, p. 718]. However, the inflated profits reported by the *NYT* [1938e, p. 33] do not agree with those reported by McCarten, and the inflated asset totals reported by the *WSJ* [1938d, p. 12] do not agree with those reported by the SEC [1939]. Any attempt to reconcile the balances published by the different publications is impossible without the original documents. To make the process of the fraud even more confusing, the overstated amounts, especially for cash and receivables, were accomplished without manipulating sales.

Brink [1939, p. 21] wrote that the cash management for IHM was handled outside of the reports created by Marien since "the Vice-President received a current report on bank balances in the form of entries made in a book kept by his secretary." This report, and not Marien's reports, was used to monitor IHM's cash position. A comparison of the two would have shown the overstatement problem; however, it was a moot point due to its lack of financial impact. Brink [1939, p. 21] also pointed out that a review of the receivables and sales balances included in the audit report would have indicated "a relationship that could not have been possible under the credit terms and collection record of [the company]." Again, the New York and Lansdale records were never reconciled.

The *SEC Report* [1939, p. 712] said that Marien's manipulations did not take place in the actual account books of the Lansdale mill. Rather, he manipulated trial balances (the previously mentioned balance sheets) that were sent to New York to be consolidated with the reports from the other mills. As it turned out, either H&D, IHM, or both should have found these manipulations quite easily if someone had bothered to compare them with source documents. The SEC, though, did not seem too concerned with these overall problems because it concentrated on manipulation of inventories and the understated cost of goods sold, which actually were the culprits in inflating IHM's profits. In the final analysis, the SEC probably felt that the inflated income, and its corresponding earnings per share number, did more to help boost the stock price of the firm than the inflated assets.

According to McCarten, Marien deflated the cost of goods sold by manipulating what the SEC called the "prime cost of sales." In this case, he had to falsify raw-silk contracts and prices from the commission knitters and throwsters (producers and exporters of raw silk) with whom IHM dealt. The SEC noted that during the audit season, Marien supervised approximately 20 audit staff from the CPA firm. Each staff member was responsible for different parts of the ledger, with one conducting an audit of cash and another the confirmation of receivables while part of the staff dealt with inventories. Marien, however, conducted the valuation of the raw-materials inventory. This valuation supposedly included reviewed market reports for raw silk which he ultimately changed to have the effect of understating the cost of goods sold or, as IHM titled it, "prime cost of sales." The *SEC Report* [1939, p. 714] then mentioned that Phillips, the partner on the engagement, testified that he specifically accepted Marien's valuation of raw materials because he was not familiar with the silk market.

The overstatement of the principal balance-sheet accounts was reported by the SEC [1939, p. 708] and is shown in Exhibit C, along with author-developed analytics to help determine the process of the fraud and its possible early discovery. Exhibit C shows that the overstatement of assets in "principal balance sheet accounts," in each year under scrutiny closely follows the gross profit overstatement. The *SEC Report* [1939, p. 708] indicated that it appeared Marien was increasing the asset accounts like inventory and decreasing the cost of goods sold, resulting in overstated assets and an overstated earned-surplus account.

EXHIBIT C

Interstate Hosiery Mills
Analysis of Financial Irregularities by the SEC: 1934 to 1936

Developed from *SEC Report* [1939, p.708]
Shaded numbers were developed by the authors.

	1934		1935			1936		
	Reported	Current Year Overstatement	Reported	Current Year Overstatement	Cumulative	Reported	Current Year Overstatement	Cumulative
Cash	472,529	22,044	485,136	45,956	68,000	145,682	(843)	67,157
Accounts Receivable	923,772	124,858	547,883	77,752	202,610	866,773	53,012	255,622
Inventories	546,876	195,731	985,603	5,422	201,153	1,473,392	349,059	550,212
Total	1,943,177	342,633	2,018,622	129,130	471,763	2,485,847	401,228	872,991
Sales	7,275,936		7,545,401			9,446,001		
Cost of Goods Sold	6,360,452		6,856,040			8,321,667		
Gross Profit (GP)	915,484		689,361			1,124,334		
GP overstatement		373,781		150,628			415,631	
Total and GP Overstatement Difference		(31,148)		(21,498)			(14,403)	
Trends Developed by the Authors								
Sales-to-Receivables	7.88		13.77			10.90		
COGS-to-Inventory	11.63		6.96			5.65		
Gross-Profit Ratio	12.58%		9.14%			11.90%		
Correct GP Difference	7.45%		7.14%			7.50%		

There were internal measurements besides the financial statements that should have alerted management to problems at Lansdale. First, as reported by the SEC, the sales-to-receivables ratio increased during the three years (1934-1936). Second, inventory turnover should have immediately raised some concerns because the increased inventories compared to cost of goods sold should have alerted officials to possible over-production problems. Finally, the gross-profit ratio should have been suspect as well. The corrected gross-profit ratio is the same for 1934 and 1935, and it can be assumed that the ratio would not have been that much different in 1933. Anybody making this simple calculation would have noticed that the ratio had almost doubled from one year to the next, then dropping sharply from 1934 to 1935, and rebounding in 1936. Based on the SEC report, IHM priced its products conservatively.

In the end, discovery of Marien's forged checks and subsequent disclosure of accounting irregularities apparently occurred by accident and not through the proactive mechanisms of internal control, supervision, and proper segregation of duties. Scheduled supervisory visits to the mill and reconciling account balances at corporate headquarters with account balances at the mill would have gone a long way to mitigate the troubles caused by Marien. But again, apparently nobody checked. Such a lack of planning and supervision would be at the heart of the SEC's criticisms of the CPA firm.

THE SEC FINDINGS AND RULING

Supervision: On March 18, 1939, the SEC published a report titled *In the Matter of Interstate Hosiery Mills, Inc*. The report brought the supervision of Raymond Marien (who had never testified) under close scrutiny. Phillips testified that he had acted as both Marien's supervisor and work-paper reviewer on the IHM audit until 1931. Thereafter, Marien conducted the work without any supervision and only cursory review by Phillips, who "was more concerned with the completion of all of the items on the audit program." He testified that he did this by "thumbing through confirmations" and reviewing schedules that would tie to later corporate consolidations.

Phillips also said that he did not review the auditor's "summary mill cost sheets." A review of these documents over a period would have shown a history of "prime cost ratios"[12] that

[12] The ratio is calculated by dividing the prime cost of sales (in this case, raw silk) by the mill's related sales.

could be compared to the reported figures, similar to a modern analytical review of gross-margin percentages. Then, a deviation from the historical data should have given Phillips pause to think and react to a possible problem (see Exhibit C). According to the SEC, its investigation revealed that profits were overstated principally by understating "prime cost of sales" (modern cost of goods sold) in the profit-and-loss statements. Essentially, it appears that Marien purposely overstated the ending raw-materials inventories. This error corresponded to the understatement of cost of goods sold. How and why he did this is still unclear, but the process can be seen in the following example[13]:

	Beginning Inventory	Add Purchases	Available Inventory	Less Ending Inventory	Cost of Goods sold (Prime Costs)	Sales	Gross Profit	Prime Cost Ratio	Gross Profit %
Correct	25,000	225,000	250,000	20,000	230,000	700,000	470,000	.3285	67%
Overstated	25,000	225,000	250,000	30,000	220,000	700,000	480,000	.3143	69%

Assuming all other costs of manufacturing (e.g., direct labor and various overhead accounts) were not manipulated, the overstated ending inventory decreased cost of goods sold and increased gross profit. This in turn created a downward trend in the prime-cost-of-sales-to-sales ratio and increased (or overstated) gross profits. This was the prime reason for the suspension of trading privileges at the New York Curb Market.[14]

Even though Phillips did not review the mill reports, the trial examiners, Adrian Humphrey and Pierce Bradley, dismissed this analytic review process as a means of identifying the inventory problems because Marien's manipulations of the trial balances hid any problem from prying eyes.[15] Though Philips tacitly seemed to be exonerated in this area, in light of the true inventory balances at the mill as reported by production manager Charles Frankel [SEC, 1939, p. 718], the upward trend in Marien's reported inventory balances and decreasing inventory

[13] The manipulation of inventories was obviously intentional; an unintentional inventory error is self-correcting in the next accounting period providing no other errors occur.

[14] The SEC seems to say that the original investigation by New York State either ignored the prime-cost-ratio issue or overlooked its importance. The SEC mentioned the ratio data should have been put into evidence even though, in a contradictory comment, "there was nothing in the falsified profit figures themselves which would have aroused suspicion."

[15] The fraud could have been identified earlier if the ratios had been significantly different from historical trends, but Marien just seemed to make small changes over time.

turnover accompanied by an increase in accounts-receivable turnover should have necessitated an investigation and reconciliation with actual inventories. This very likely would have uncovered Marien's deceit sooner rather than later. Marien may have prolonged this deceit by creating some manipulations that gave the opposite effect of actually widening the ratios, making it appear that inventories were actually increasing on an historical basis. How he did this was not explained.

The SEC examiners did not, however, fully exonerate Phillips from negligence because in his lack of extensive work-paper review, he failed to notice that the trial balance, which is included as part of any set of work-papers, had obviously been manipulated with sheets replaced and doctored. Here the fraud should have been apparent to both Phillips and IHM officials because Marien did not bother to renumber the papers. Simply put, the trial-balance pages that were numbered 1 of 7, or 2 of 7, etc. were actually eight pages with Marien's handwriting on the false page along with an incorrect footing. The expert witnesses brought in by the SEC [1939, p. 715] to review H&D's practices actually seemed to support Phillips' work saying it was:

> …generally sufficient for a reviewer to question the accountant in charge of an audit as to anything unclear or unusual, accepting without check or verifications answers which appear to be reasonable; he does not necessarily examine the trial balance or other working papers in detail; he ascertained the existence of confirmations, but need not attempt to relate the amounts confirmed to the figures in the report he is reviewing.

The SEC examiners took exception with these practices, which were apparently quite prevalent within the auditing profession, and remonstrated that they were insufficient and "required thorough revision." The *SEC Report* [1939, p. 716] then went on to say that this type of partner or supervisory review should first ensure "the integration of the original work papers with the financial statements and second a searching analysis of the ultimate facts developed in the course of the actual audit." In a rather lengthy discussion of the lack of supervision by H&D, the trial examiner succinctly pointed out that a work-paper review that was more than just perfunctory in nature would have "exposed the irregularities in this case."

Supervision of the staff would become a hallmark of the work of CPAs with the introduction of Generally Accepted Auditing Standards by the Committee on Accounting Procedure in 1948. In particular, the standards of field work highlighted that "work is to be adequately planned and any assistants are to be properly supervised" [Holmes, 1951, p. 4]. Arens and Beasley [2003, p. 32] write that, "supervision is essential in auditing because a considerable portion of the field work is done by less experienced staff members." In the case of H&D, the formal audit program used by the company made it clear that it had planned its audit of IHM well, but that the lack of supervision, due to either complacency or laziness, had caused many of the problems for the firm. Marien's propensity for lies and deception probably exacerbated those problems.

In the end, the SEC [1939, p. 715] failed to find that the review made by Phillips, customary at H&D, "was less extensive than that ordinarily made by accounting firms." William Werntz [1939, p. 1], the chief accountant of the SEC, commented on the IHM and McKesson & Robbins cases as "evidence of the inadequacies in the procedures and practices in auditing." He continued in his speech before the Ohio Society of CPAs on September 7, 1939, commenting that the *SEC Report* "…indicated it was satisfied that an adequate review would have exposed the irregularities and if the views of the registrant's expert witnesses were to be accepted as to the usual practice followed by [CPAs], in reviewing the work of those responsible for the opinion that the practice requires thorough revision." An internal peer review similar to that used in modern audit firms may have found the problem of the lack of supervision on the IHM audit well before the problems came to light.[16]

Independence: Over and above the falsified documents, the trial examiners went on to question whether H&D had actually completed an "independent audit." The SEC went on to criticize the process of the "mill auditors" completion and "certification" of the "monthly detailed audit." It felt that these reports were not audited in the "true sense of the word," and that H&D were false in designating the monthly reports as audited. The *SEC Report* [1939, p. 717] stated that the "certified reports could not accurately be described as an independent audit for the amazing extent Marien had taken upon himself in the function of bookkeeping as well as auditing for Interstate." As discussed previously, the officials of both companies never saw any conflict

[16] The SEC [1949, pp. 12-13] noted that problems of lack of supervision not only have to be addressed for junior employees, but for audit partners as well.

between Marien's dual responsibilities as auditor and bookkeeping supervisor. Testimony stressed that the standard journal of the mill (in actuality, the mill's ledger) was in Marien's possession, and that he made entries in it even though officials of the CPA firm said this was against company policy. Davis, partner in the firm, testified, "if the accountant is permitted to do original work, the purpose of the audit is lost" [SEC, 1939, p. 717].

The SEC's comments expanded a ruling from a 1937 ASR that an accountant cannot be deemed independent if he is an officer or director of the registrant or holds a significant financial interest [SEC, 1976, p. 1]. By 1950, Rule 13 of the AICPA's rules of professional conduct reiterated this concept [Holmes, 1951, p. 35]. Almost 60 years later, Section 210 of the Sarbanes-Oxley Act bolstered independence rules by banning CPAs from auditing books that they helped prepare or accounting systems that they either designed or helped install.

In addition to the standard journal, Marien, at the request of IHM officials, also kept a "private ledger" that included accounts that management wanted kept secret from its employees. The SEC did not seem to think this was an inappropriate course of action, probably because Lansdale was a unionized mill. The problem was that Marien had control over these records with their contents (probably additional income), bypassing the income statement and posted directly to surplus after the closing of the mill's regular books. Though H&D apparently did not know that Marien was completing original write-up work, it was obvious that IHM officials approved of this arrangement. Such work by Marien, in the opinion of the SEC, made the books of the Lansdale mill unaudited. The SEC [1939, p. 717] rebuked the practice by reporting, "Marien's unchecked control not only renders the Homes & Davis' [audit] certificates false as to scope of the audit made, but also imposes upon Interstate considerable responsibility for Marien's misdeeds." The independence issues highlighted in the IHM case were used by the SEC [1972] in a monograph to explain the guidelines and examples of situations involving the independence of accountants.

Management Responsibility: The findings against H&D did not let the officials of IHM off the proverbial hook because the SEC took exception with its review and control practices as well. For example, reports coming from Frankel, the Lansdale mill's cost accountant, showed a different cost-per-dozen hose manufactured than Marien's reports. These discrepancies were never investigated by the company. The SEC [1939, p. 719] concluded that the understatement of cost by the H&D accountant resulted in an "overstatement of the average gross profit per dozen on sales amounting to about 44 percent in the annual report for 1936 and 150 percent for the first six months of 1937." Brink [1939, p. 21] commented that the realization (production) schedules and related orders "furnished to the officers should have proved a basis for detecting the overstatements."

Greenwald, who actually made the purchases of silk for the company, should have also seen a "red flag" had he compared his record of silk prices with Marien's reports. These reports would also have been identified as false had there been a comparison of monthly cash and receivables reports generated in New York with those coming from Landsdale. In the SEC's [1939, p. 719] opinion, "if management had made any effort at all to check the information in the H&D reports against that furnished by their own employees, Marien's inventions would have been discovered as soon as they began." In the end, the SEC found that the officers of IHM hardly read Marien's reports, let alone made any comparisons with internally generated figures; yet, they were responsible for the ultimate content.[17] In a lengthy explanation of its judgment, the SEC [1939, p. 721] concluded that:

> …the fundamental and primary responsibility for the accuracy of the information filed with the Commission and disseminated among investors rests upon management. Management does not discharge its obligations in this respect by the employment of independent public accountants, however reputable.[18] …In our opinion the conduct of Interstate's Management in respect of information which was to be the basis of reports submitted to the New York Curb Market, stockholders and the Commission indicated a complete abdication of responsibility.…We conclude that the officers of Interstate were at fault in failing to discover the falsification of the financial statements filed with the Commission.[19]

---

[17] The ruling did not change auditors' relationships to third-party liability developed in *Ultramares Corp v. Touche*. According to the *NYT* [1939a, p. 30], the only reported lawsuit stemming from Marien's fraud came from Aaron J.Funk, whose suit was over the excess bonuses that the officers eventually paid back.

[18] In June 1947, the SEC's ASR #62 used this verbiage to explain that independent CPAs should be careful in certifying "summary earnings tables" and other condensed financial-reporting devices.

[19] Montgomery [1949 p. 7] used the same quote to highlight management's responsibility for financial reporting. The quote showed the importance of the IHM case after its adjudication. However, by the next edition [Montgomery, 1957,

The responsibility of the accounting reports would be a point of contention for many years. In 1947, the SEC [ASR #62, p. 3] comments that the corollary to the IHM rulings is that, "the accountant's certificates are required not as a substitute for management's accounting of its stewardship but as a check of that accounting." In the mid-1980s, the AICPA, in an effort to limit its members' liability, included verbiage to this effect in its model audit report presented in SAS #58, *Reports on Audited Financial Statements*. In a more definitive manner, Title III of Sarbanes-Oxley reiterated the findings of this long-forgotten panel and made certain that corporate officials were formally responsible for the financial reports of the company under the threat of jail and fines.

The SEC Ruling: The general purpose of the SEC hearings originally was to determine if the suspension of IHM from trading on the Curb Exchange should be made permanent, resulting in formal de-listing and rescission of its right to trade shares of stock. In this part of the ruling, the SEC found that the officers of the corporation were negligent in their duties but not the CPA firm. The SEC, however, also found that in the year since the company had revealed its problems to the Curb Market, the company had made a number of changes to mitigate any future problems. For example, IHM's prompt notification of the Curb Exchange and the SEC allowed for a re-audit of the company's books with amendments filed on a timely basis. This seemed to convince the SEC that there was no intent of wrongdoing on the part of the officers of the corporation. Second, there was the prompt return of excess bonuses paid to the corporate officers. This showed that they were concerned with the institutional integrity of the company. Next, the company employed a corporate controller with responsibility over all three mills, allaying any SEC fears that this type of manipulation would happen again. Finally, the company made employment contracts more flexible as to bonuses as well as the removal of officers for cause. In the end, the SEC [1939, p. 721] ordered that the "registration of the common stock of Interstate Hosiery Mills on the New York Curb Exchange shall not be suspended or withdrawn."

An editorial by John L. Carey [1939, pp. 257-258] in the *Journal of Accountancy* highlighted the importance of the SEC's

---

p. 60], the reference had been dropped and relegated to a paraphrase that read: "…in a well publicized decision…management has the fundamental and primary responsibility for the accuracy of the financial statements."

finding in this matter. Carey emphasized the SEC's supervision position, but warned that the ruling does not "relieve the independent auditor of full responsibility for the exercise of reasonable care and diligence in making his check upon management's accounting." He goes on to write that the volume of material is too great for one person to scrutinize, and that the acts of subordinates are their responsibility, leading to a duty of "reviewing adequately the work of staff assistance as to satisfy themselves of its sufficiency." Carey finished by indicating that the IHM case may be a "freak one," but it is the partner's duty "to satisfy his own mind as to the representations of his assistants are sound and reasonable, and that they are based on sufficiently extensive inquiry and investigation." These comments were published before the American Institute of Accountants (AIA) issued standards of fieldwork, supervision, and evidential matter in the late 1940s.

AFTERMATH AND CONCLUSIONS

The issuance of the *SEC Report* recommending the reinstatement of IHM's trading privileges on the Curb Exchange effectively ended the Raymond Marien fiasco. The *WSJ* [1939, p. 2] reported that the Exchange allowed the trading of IHM's stock at 1:00 p.m. on March 24, 1939. For their part, IHM's officials were required to return the remaining $90,000 in bonuses paid to them from 1934-1936 even though this represented earnings from corrected financial statements [*NYT*, 1939a, p. 30]. Despite all the evidence from the hearings, this article alluded to the continuing suspicion in public circles and that IHM's managers would be dogged by rumors that they had put Marien up to the task of "juggling" the books. In fact, the issues surrounding IHM's difficulties would surface again as the McKesson & Robbins fraud unfolded in late 1938. At that time, the president of the New York Society of CPAs wrote a letter to the McKesson inquiry committee stating that "recent investigations into such [accounting problems] like Interstate Hosiery Company, have revealed certain fundamental weaknesses into the preparation of financial statements of large corporations" [*NYT*, 1938j, p. 4].

Within a few years, the Marien affair faded from the public eye, and the future of IHM began to brighten. For example, the 1939 financials showed profits of $2.27 per share compared with $2.15 in 1938 [*NYT,* 1940, p. 31]. Assets, however, were just $1.9 million after the reduction forced by the revelation that nearly five million dollars in inflated assets were reported in 1937.

IHM, however, would soon face some unusual problems as the relations between Japan and the U.S. deteriorated. In July 1941, President Roosevelt declared a *de facto* embargo on purchases from Japan which produced 85% of the world's silk at the time. The ban, however, was not on the importation of Japanese products directly, but rather on the transfers of U.S. hard currency to that country. This forced all silk hosiery manufactures to begin using more synthetic fibers like nylon.

Even with this problem, the company successfully survived the transition to the war years, posting $4.723 per share earnings in 1941 that allowed a restructuring and a repurchase of $500,000 of outstanding shares from the market [*NYT*, 1942, p. 29]. By 1943, however, the fortunes had turned as the *NYT* [1943, p. 26] reported the sale of the Bloomfield, New Jersey plant in January of that year. This event, along with a reported 65% drop in earnings per share in 1942 due to a limited production of women's fine hosiery because of wartime silk shortages, began the slow decline of IHM.

In 1945, the company voluntarily ceased trading on the Curb Exchange [*NYT*, 1945, p. 28], and by the early 1950s, nylon shortages in the industry due to the Korean conflict left the company financially weak. In November 1953, IHM accepted a contract to sell all of its operating assets to Green Cove Hosiery Corporation, a subsidiary of Burlington Mills. According to *Greenwald v. Commissioner*, Green Cove agreed to purchase "all of Interstate's operating assets, real property, inventories, accounts receivable, leases, name, customer lists, goodwill." In the end, IHM's name was changed to I.L.H. Corporation, and the textile company was converted to an investment company.

What happened to Raymond Marien during this period? The *NYT* [1939b, p. 37] reported on October 26, 1938 that Raymond Marien reversed his plea and admitted guilt to the charge of "attempted forgery." The court sentenced Marien to two and one-half years in prison at the Ossining Correctional Institute (Sing Sing) on November 4, 1938. The *NYT* further reported that he received this rather harsh sentence because it was his second offense for the same crime. This time he could not claim it was to help his family. The article went on to mention that Marien's sentence for attempted forgery grew "out of his mysterious falsification of accounts and inventories of the hosiery concern."

Other than a brief mention in the litigation entitled *Interstate Hosiery Mills v The First National Bank of Lansdale*, Marien's trail stops with the 1939 McCarten article. In this case, IHM sued the bank to recover the losses incurred by the company from the forged checks passed by "Ray Marien" and paid by the bank. The 1940 case suggested that Marien was still in prison for passing the checks at a New York bank.[20] McCarten [1962, p. 447] wrote that to the end, Marien maintained his defense that he was overworked and that stress made him falsify the records. However, the author mused that "overwork might more reasonably be accepted as the result rather than the cause of Marien's hocus-pocus," because "the work involved was just about five times what it would have been had he been keeping honest records." Did the long "commute" to the job and days away from an apparently normal and loving family life exasperate this situation? The answer is unknown; however, McCarten [1962, p. 447] felt he could easily identify Marien's motivation for the check forgeries as "a string of bad luck at the horse track."

Though the name of Raymond Marien is probably unknown to most accountants, and his motivations for the fraud may never be known, its result would have far-reaching effects on the conduct of audits that have lasted into the 21st century. The auditing profession fundamentally changed its philosophy for the planning and control of audits. The related principles of auditor independence, supervision, and management responsibility for the accounting records can be traced to Marien's actions in much the same way as the more famous 1938 McKesson & Robbins case changed the procedural conduct of audits to confirm inventories and accounts receivable. To reiterate Felker [2003, p. 45], this research pointed out that the actions of the people in the IHM case "reflect the origins [of the SEC's] long-standing views on the role of and responsibilities of executives and auditors."

REFERENCES

American Institute of Certified Public Accountants (1988), *Statement on Auditing Standards No. 58, Reports on Audited Financial Statements* (New York: AICPA).

American Institute of Certified Public Accountants (2009), "2009 Disciplinary Actions." Accessed August 20, 2010 at http://www.aicpa.org/ForThePublic/DisciplinaryActions/.

Arens, A., Elder, R., and Beasley, M. (2003), *Auditing and Assurance Services – an Integrated Approach*, 9th edn. (Upper Saddle River, NJ: Prentice Hall and Company).

Brink, V.Z. (1939), "Some Comments on the Inter-State Hosiery Case, *Accounting Ledger* (October): 18-22, 38.

[20] Attempts to find out more about Marien's later life through contacting the prison and using websites like Ancestry.com proved fruitless.

Carey, J.L. (1939), "Editorial," *Journal of Accountancy,* Vol. 67, No. 5: 257-258.

Felker, N. (2003), "Origins of the SEC's Position on Auditor Independence and Management Responsibility for Financial Reports," *Research in Accounting Regulation,* Vol. 16: 45-60.

Greenwald v. Commissioner [44 T.C. 137; 1965 U.S. Tax Ct. LEXIS 93].

Holmes, A.W. (1951), *Auditing: Principles and Procedures*, 3rd edn. (Chicago: Richard D. Irwin & Co).

Interstate Hosiery Mills v First National Bank of Lansdale [139 Pa. Super. 181; 11 A.2d 537; 1940 Pa. Super. LEXIS 31].

McCarten, J. (1962), "The Greatest Accountant in the World," in Baxter, W.T. and Davidson, S. (eds.), *Studies in Accounting Theory* (London: Sweet and Maxwell, Ltd.): 443-451. Reprint of 1939 *New Yorker* article.

Montgomery, R.H., Lenhart, N.J., and Jennings, A.R. (1949), *Montgomery's Auditing*, 7th edn. (New York: Ronald Press).

Montgomery, R.H, Lenhart, N.J., and Defliese, P.L. (1957), *Montgomery's Auditing*, 8th edn. (New York: Ronald Press).

New York Times (1923), "Caution Not to Over Buy," December 23: E10.

New York Times (1924), "Classified Ads," September 3: 40.

New York Times (1925), "Returned from Paris in $16,000 Theft Case," January 25: 23.

New York Times (1929a), "Hosiery Makers to Unite," February 24: 47.

New York Times (1929b), "New Stock Issued," February 28: 40.

New York Times (1929c), "Interstate Hosiery Mills," March 4: 42.

New York Times (1929d), "Prospectus Interstate Hosiery Mills," March 4: 42.

New York Times (1930a), "Dividends Omitted," March 19: 47.

New York Times (1930b), "Bankruptcies," September 4: 39.

New York Times (1930c), "Hosiery Men Form Credit Group," October 28: 49.

New York Times (1933), "Hosiery Prices Advance Sharply," August 4: 20.

New York Times (1934a), "Profits Reported By Corporations," February 9: 20.

New York Times (1934b), "23 Exchanges Ask U.S. Registrations," September 13: 33.

New York Times (1938a), "Whimsical Finance Bars a Curb's Stock," February 16: 42.

New York Times (1938b), "Accountant Held in Stock Inflation," February 17: 8.

New York Times (1938c), "Financial Writer Misled," February 25: 29.

New York Times (1938d), "Stock Inquiry Pushed," March 27: 2.

New York Times (1938e), "Profit Explained for Hosiery Mills," May 25: 33.

New York Times (1938f), "Accountant Pleaded Not Guilty," June 4: 30.

New York Times (1938g), "Falsified Records Explored by SEC," July 6: 36.

New York Times (1938h), "Accountant Defends Firm at SEC Hearing," October 1: 23.

New York Times (1938i), "Accountant Admits Guilt," October 26: 13

New York Times (1938j), "Coster Blackmail Laid to Ex-Lawyer," December 24: 4.

New York Times (1939a), "Repay Excess Bonuses," August 8: 30.

New York Times (1939b), "SEC Puts Audits on Management," October 26: 37.

New York Times (1940), "Other Corporate Reports," February 14: 31.

New York Times (1942), "To Reacquire Shares; Interstate Hosiery Provides $500,000 for Purchases," June 30: 29.

New York Times (1943), "Investors Acquire New Jersey Plant," January 30: 26.

New York Times (1945), "Investment Company Registers New Issue," January 23: 28.

Sarbanes-Oxley (2002). Accessed from fl1.findlaw.com/news.findlaw.com/hdocs/docs/gwbush/sarbanesoxley072302.pdf.

Securities and Exchange Commission (1939), *Decisions and Reports Volume 4 [No. 705] In the Matter of Interstate Hosiery Mills Inc.* (Washington, DC: Government Printing Office).

Securities and Exchange Commission (1947), *Accounting Series Release No. 62* (Philadelphia: Government Printing Office).

Securities and Exchange Commission (1949), *Accounting Series Release No. 67* (Philadelphia: Government Printing Office).

Securities and Exchange Commission (1972), *Independence of Accountants: Guidelines and Examples of Situations Involving the Independence of Accountants* (Washington, DC: Government Printing Office).

Securities and Exchange Commission (1976), *Accounting Series Releases to 195* (Washington, DC: Government Printing Office).

Texas Accountant (1939), "Interstate Hosiery Case," Vol. 11, No. 5: 1-3, 8.

Ultramares Corp v. Touche [Court of Appeals of New York, 1931, 255 N.Y. 170, 174 N.E. 441].

Wall Street Journal (1938a), "Interstate Hosiery Mills Notifies Curb of Finding Annual Reports Wrong," February 16: 11.

Wall Street Journal (1938b), "Interstate Hosiery Mills Head Testifies on Assets Difference," February 17: 12.

Wall Street Journal (1938c), "Partner Testifies in Interstate Hosiery Case," February 18: 17.

Wall Street Journal (1938d), "Interstate Hosiery Mills is Completely Solvent," May 25: 13.

Wall Street Journal (1938e), "Legal Moves Made at Hearing by SEC," September 30: 36.

Wall Street Journal (1939), "Interstate Hosiery Mills," March 23: 2.

Werntz, William, W. (1939), "Financial Statements for Investors: A Speech before the Ohio Society of CPAs" (Philadelphia: Securities and Exchange Commission).