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The Relationship of the Securities and Exchange Commission to the Accountant*

By Carman G. Blough

The Securities and Exchange Commission is, at the present time, primarily responsible for the administration of three acts of Congress. They are the securities act of 1933, the securities-exchange act of 1934 and the public-utility act of 1935.

Extensive provisions for the regulation of accounting matters are found in each of the several acts and each provides that the commission shall prescribe the methods to be followed in the presentation of financial statements. The public-utility act goes still further, authorizing the commission to prescribe the accounts to be kept and the methods to be followed in keeping them.

With such broad powers over the accounting statements of companies coming under the jurisdiction of the commission, its decisions with reference to accounting policies, principles and procedures will undoubtedly have a material effect upon general accounting practice. For this reason many accountants are interested in the work of the commission even though they do not expect to represent registrants.

Many prominent accountants have expressed the belief that the profession is looking to the Securities and Exchange Commission for material assistance in solving controversial questions; and the members of the profession have, for the most part, coöperated with the commission.

The presentation of accounting data in reports to stockholders has been improved noticeably in the last few years, and numerous accountants have stated that they have been able to improve their statements because they were supported by our rules and regulations. Undoubtedly, the acts have contributed toward more adequate disclosure and the adoption of sounder practices in the presentation of accounting statements.

The commission realizes that it has grave responsibilities in these matters. Accordingly, it has sought and, I am happy to say, has received the coöperation of the leading accounting associations and numerous individual authorities on the subject. We hope, by this coöperation, to make sure that the positions we

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take on accounting matters from time to time may be the result of the best thought in the profession with particular reference to the aims of the legislation being administered.

Reasons for the Acts

The reasons for the passage of the various acts are numerous and involved, having their roots in the history of American corporate policies and practices of the last fifty years, more particularly the 1920's. The securities act of 1933 and the securities-exchange act of 1934, in so far as they relate to accounting matters, are designed for the purpose of obtaining "the truth, the whole truth and nothing but the truth." They are intended to give investors and prospective investors information regarding a registrant's financial condition and operations adequate to make sound judgments as to the value of its securities.

In this country a great many corporate stockholders are in the investing rather than the controlling class. A controlling investor, an officer or a director is usually in possession of sufficient information about the company's affairs to make an intelligent judgment as to the desirability of buying, holding or selling the company's stock. This has not, in a large number of cases, been the situation of the investing stockholder. He also needs comprehensive information not only as to financial conditions and prevailing trends in the industry but as to the financial situation of the individual company. The 1933 and 1934 acts were designed to enable the investor to get this information.

The public-utility act of 1935 was enacted with the intent to curb many of the practices that developed during the past fifteen or twenty years as a result of the rapid expansion of public utilities and the tremendous increase in the use of holding companies to finance and control them. Such practices were anything but beneficial either to consumers of public-utility service or to the general investors in public-utility securities.

Large holding-company systems were built up in such a manner as to place the control of tremendous aggregations of property in the hands of persons having relatively small amounts of investments at stake.

Operating companies were subjected to excessive charges for services, construction, equipment and materials, and were required to enter into other transactions with controlling and other affiliated companies upon terms fixed with a view only to the

ultimate advantage of persons in control. Securities and properties were exchanged among members of the same system at exorbitant profits to the selling company. Fictitious and unsound asset values having no relation to the sums invested in, or the actual capacity of, the underlying properties were used as a basis for the issuance of securities. Paper profits from intercompany transactions, and property values inflated by the same means or by internal appraisals, induced the public to furnish the capital. Usually the public had no knowledge of the fair value of the underlying securities or property. Assumptions that the values placed on assets were the results of arms-length dealing were encouraged.

These abuses, among other reasons, brought about the passage of the 1935 act and placed upon the commission the responsibility of exercising extensive accounting control over the public-utility holding companies and their subsidiaries.

Accounting under the 1933 and 1934 Acts

Rules for registration under the 1933 and 1934 acts generally require the registrant to submit balance-sheets, profit-and-loss statements and various supporting schedules, certified by independent public or independent certified public accountants. Every company having securities registered upon a national securities exchange is required to file an annual report with the commission and with the exchange. Certified financial statements constitute the major portion of such reports.

The commission has depended a great deal upon the ability of the independent public accountants, and has not attempted to lay down hard and fast rules regarding the type of audit or the specific form of the financial statements required. Certain minimum requirements are specified in each form, but much is left to the judgment of the accountant.

Form 10 under the securities-exchange act and form A-2 under the securities act are used for most of the filings under those acts. As prescribed by the commission, both of these forms provide for a balance-sheet, a profit-and-loss statement and supporting schedules. While the information required in these statements is set forth in considerable detail, the following significant sentence is incorporated in the instructions to each form: "The registrant may file statements and schedules in such form, order and using such generally accepted terminology as will best in-

dicate their significance and character in the light of the instructions."

This sentence was inserted in the instructions because these forms were devised for the registration of innumerable types of business enterprise, extending from a one-horse gold mine in Colorado to the far-flung empire of the Standard Oil Company of New Jersey. Since the registration forms were prescribed for such a widely diversified group, it was obviously impossible to draw them so as to incorporate the details of procedure to be followed in preparing each statement. Accordingly, the sentence quoted was incorporated for the purpose of giving the accountant enough leeway to express adequately the information for varying types of businesses.

We have had strange reactions to the sentence. Some registrants and some firms of accountants have interpreted it to mean that a statement could be prepared in almost any manner, and have used it to justify the omission of most of the information called for by the form. Some have even interpreted it to mean that the registrant could judge as to which financial statements would best show its condition irrespective of specific requirements as to the necessity of filing certain statements. Others seem to have overlooked the significance of this sentence entirely and have attempted to make an obviously inapplicable situation fit into the exact form set forth in the instruction book.

The rules and regulations of the commission provide that the financial statements required shall be accompanied by a certificate of an independent public or independent certified public accountant, that such certificate shall be dated, shall be reasonably comprehensive as to the scope of the audit made and shall state clearly the opinion of the accountant in respect of the financial statements of, and the accounting principles and procedures followed by the registrant.

It should be noted in connection with the certification that the rule specifically provides that nothing in the instructions should be construed to imply authority for the omission of any procedure independent public accountants would ordinarily employ in the course of a regular annual audit. This provision answers the question many accountants have raised as to whether it is necessary to make certain analyses and checks in order to certify the statements to be filed. The responsibility for certification rests upon the accountant; it is his job and it is not the desire of the

commission to restrict the scope of his work; he is the judge of the type of examination necessary to make a reasonably unqualified certification.

The qualifications of accountants under the requirements of the acts has been the subject of considerable discussion. Criticisms arise for various reasons. In the first place, the auditors are often not independent. For instance, an accountant who is a director or officer or who owns a material interest in the registrant (either material as to the capitalization of the registrant or as to his own personal fortune) is not deemed to be independent, nor is one who is a regular employee of the registrant or has a continuing pecuniary interest in it. We have also taken the position that one who was an officer or director during the period under review can not qualify as being independent even though he held no such position at the date of the audit.

In determining the right of a person to certify an accounting statement, the question of the public nature of his activities also arises. Certainly, if one is recognized by the laws of the state as having the right to practise accounting, holds himself out as a general practitioner and actually does a variety of accounting work, there can be little question but that he is a "public" accountant. On the other hand, if he has the right to act as a "public" accountant but his only client is the registrant, the question may be seriously raised as to whether he can qualify.

A third weakness exists when the person certifying is not properly trained as an accountant. Unhappily, it has been necessary to inquire into the training and experience of a number of such persons.

Just what the commission will have to do, or will be able to do, in the way of determining who is qualified to certify the financial statements submitted for registration purposes is a question it is not prepared to answer at this time. While certifications have been rejected in a number of cases because the accountant could not qualify under the general rules and regulations, no attempt has been made, as yet, to name specific qualifications for accountants. Whether it will be expedient or even desirable to limit certifications to certified public accountants is a debatable point. Effective regulatory laws in the several states would go a long way toward solving our problem in that regard.

Another criticism arising out of the examination of financial statements is the failure of the accountant to indicate the scope

of his audit. I seriously doubt whether any concept of the word "audit" is sufficiently uniform among accountants that the investor may be reasonably expected to appreciate the significance of the term when an accountant certifies that he has "audited" the books of a corporation. There are a good many accountants who take the position that such a statement without qualification of any kind means a complete detailed audit. From this position, opinions vary all the way to the person who maintains that the sketchiest kind of an examination is sufficient to be dignified by the term "audit." For this reason, it is quite important that the auditor incorporate in his certificate an adequate explanation of the scope of the audit.

Another of the required provisions of the certification is that it shall state the opinion of the accountant with regard to the financial statements. Possibly, you may feel that if the auditor presents a statement it should be assumed that he believes it correctly reflects the financial condition of the registrant or the results of its operations, as the case may be. If the accountant always drew up the statements himself and if he were always completely indifferent to the wishes of his client, this might be a safe assumption. Unfortunately, that is not always the case. The statements are often drawn by the client for the accountant's examination, and he is seldom completely indifferent to the client's wishes.

It is not uncommon for an accountant to present financial statements and, in his certificate, point out certain facts of inclusion and exclusion without expressing any opinion as to whether the statements properly reflect the facts or not. Thus the accountant who would certify to a financial statement in which plant-and-equipment is carried at twice its cost and three times its present sale value on the basis of a 1928 appraisal, at which time the appreciation was carried to, and is now included in, the earned-surplus account, might very well attempt to protect himself by including in his certification a statement of such facts without expressing his opinion as to the propriety of such treatment. In our opinion, the protection of investors requires that the accountant who, by a narration of facts in his certificate, attempts to protect himself, should be required to express his opinion with regard to the propriety of showing the facts in the manner in which they have been shown. If all of the facts have been treated in the statement in a manner he considers to be in accord-

ance with accepted accounting practice, he should so state. If he is prevented from properly presenting the facts, he should qualify his statement with respect to such items and should express his disapproval of handling them in the manner in which they have been handled.

Another requirement of the certification is that it shall state the opinion of the accountant with respect to the accounting principles and procedures followed by the person whose statements he is certifying. Reason should, of course, govern the statement made in that respect. I do not believe the fact that the accountant is forced, at the time of his audit, to make routine adjustments correcting minor errors in accounting procedure, should prevent him from stating that the accounts of the client have been kept in accordance with accepted principles of accounting consistently maintained. On the other hand, if the client's customary procedure is deliberately to record important transactions in such a manner as to violate accepted accounting practice or if isolated items of major importance have been improperly handled, I think the accountant is duty-bound to indicate that his client's accounting procedure has not been all it should have been.

There is, of course, a dividing line between acceptable and unacceptable accounting practices; that line is a hairline, the location of which is a matter for the individual judgment of the accountant. The determination of how far he can go in approving the practices of his client and how far he must go in criticizing them is primarily his responsibility. Certainly from the standpoint of the investor, it is of significance to know the customary accounting policies of the registrant and its subsidiary companies. Such policies reflect the likelihood of integrity in the accounts during years prior to those under review and they also reflect the present attitude of the corporate officials.

Occasionally, an accountant seeks to protect himself by including in his certification numerous qualifications and exceptions. Sometimes these are probably due to a lack of courage on the part of the accountant to insist upon being permitted to make adequate examination of the accounts and to prepare correct statements so as to make qualifications unnecessary. In other cases, they may be due to the accountant's wish to hide his own inability as an auditor by citing in his certification numerous matters he has failed to cover. Occasionally, of course, the cir-

cumstances are such as to require extensive qualifications. In my opinion, good accountants will use them sparingly.

A certification covering two or three pages (to say nothing of ten or fifteen) filled with qualifications and exceptions makes proper interpretation of the accounting statement extremely difficult and leaves the reader with a feeling that there is more wrong than has been revealed. Usually, it should be possible to carry an audit to such an extent and to adjust the statements in sufficient detail to permit certification with relatively few qualifications or exceptions. Just how far the commission eventually will go in refusing to accept statements because the certifications are so extensively qualified, I do not know. The distinction between the comments a high-grade accountant considers necessary in connection with an audit that has involved peculiar difficulties and those of a less capable accountant trying to protect himself against his own incompetence may not be hard to make at the extremes, but the dividing line is often very difficult to detect. Some place between the two extremes there is a point where qualifying explanations cease to be acceptable and become a fit subject for refusal on our part.

Amendments to financial statements should be covered by new certifications from the accountant. In some instances, after deficiencies have been cited with respect to financial data, the accountants are reluctant to certify a new statement or schedule that is different from the one originally filed. Naturally, I am sympathetic with the accountant who does not wish to appear to vacillate in the things to which he certifies, but on the other hand, if the changes suggested are such as to bring the statements more nearly in accord with good accounting practice, he should have no hesitancy in certifying the amended statements.

Problems Involving Accounting Principles

In the administration of the rules of the commission relating to accounting matters, problems of wide variety are presented for consideration. To organize and discuss them in any comprehensive manner is out of the question at this time, but it seems appropriate to comment upon a few of the accounting principles that have been involved in our discussions with accountants and to relate a few specific cases.

Up to September 15, 1936, formal findings and opinions had been issued by the commission in twenty-seven of its stop-order

hearings under the 1933 act. (A stop order is an order issued by the commission suspending the effectiveness of a registration of a security. Until a stop order has been lifted, it is illegal to sell the security in question through the mails or in interstate commerce.) In nineteen of these cases, the financial data submitted or accounting practices followed, or both, were cited as being at least partly responsible for the issuance of the stop order.

All of these hearings involved registrations on form A-1 and, therefore, concerned new companies, many of a highly speculative nature. Of the nineteen mentioned as involving accounting matters, twelve were mining ventures, three were investment companies, two were distillers, one was a manufacturer of airplanes and one was an oil-royalty company. The accountants who certified the financial data contained in these statements were principally small firms. While the failure properly to disclose or reflect reprehensible accounting practices probably was not intentional, it certainly indicated a lack of recognition of the accountant's responsibility.

The commission's principal criticisms of the financial data presented in these nineteen cases may be summarized as follows:

(1) Fixed assets were stated on the balance-sheet at amounts equal to the par value of stock issued therefor; whereas, the value of such assets was found to be much less.

(2) Stock was issued for fixed assets and simultaneously donated back to the corporation. Although the nominal value of these shares was included in the figure at which the fixed assets were carried on the balance-sheet, an equal amount was also included under treasury stock, capital surplus being created to offset the charge to treasury stock. (In instances of this kind the commission has required the elimination of the amount of the donated stock from both the asset and the surplus accounts and has required the company to state on the face of the balance-sheet whether stock issued under such circumstances is fully paid and non-assessable.)

(3) Fixed assets were stated on the balance-sheet at appraised values that were found to be grossly overstated.

(4) Fixed assets, as carried in the balance-sheet, included an amount equal to the par value of stock issued to the seller of such assets in consideration for his agreement to reconstruct certain property included therein.

(5) Fixed assets, as stated, included amounts equal to the par value of stock issued to promoters for services as such.

(6) Fixed assets included lease and option agreements without

disclosing their nature or the fact that the obligations assumed thereunder were subject to cancellation.

(7) The amount at which promotional services were included on the balance-sheet was found to be greatly in excess of the value of the services rendered.

(8) The balance-sheet failed to indicate that certain assets were pledged as collateral to loans.

(9) Donations by stockholders were treated as income rather than as donated surplus.

(10) Pro-forma balance-sheets were used to reflect the receipt of proceeds from anticipated sales of securities for which no firm commitment for their sale existed.

In a number of cases the accountant was not directly subject to criticism. In some he had no access to facts that would have permitted him to give the proper treatment to the items in question. In others the scope of his duties did not include a judgment as to the propriety of the values fixed by the directors.

However, the commission did find justification for specifically criticizing the accountants for the following reasons:

(1) The nature of the deficiencies in financial data was such that it appeared that the accountant had not made a "proper examination."

(2) The accountant's statement that the registrant had consistently followed sound accounting practices was found to be erroneous.

(3) The accountants were found to be "not independent."

The twenty-seven cases in which formal findings and opinions were issued, however, do not constitute even a major percentage of the instances in which stop orders have been entered, and the cases taken to stop order constitute only a very small percentage of the registrations in which accounting problems arise. As a matter of fact, the most technical accounting questions have not arisen in stop-order cases but in registrations that were corrected and ultimately became effective.

A hasty review of a few examples will serve to illustrate the type of problem with which the commission is regularly faced.

Case I

A chemical company created a subsidiary corporation and subscribed for its entire capital stock, paying in cash approximately $1,500,000 in excess of par. The subsidiary credited this excess to paid-in surplus. In the course of several years the sub-

sidiary returned over $1,350,000 of this paid-in surplus to the parent in the form of dividends.

The financial statements of the parent company filed with the commission revealed that the company had credited the amount of the dividends received from the subsidiary to capital surplus, leaving the investment account unchanged. The commission advised the registrant that such dividends appeared to be in the nature of a return of consideration paid for the investment and that, unless they were credited to the investment account, such account would be overstated by the amount of the dividends. Following this criticism, the registrant reversed its entry, thereby eliminating the capital surplus and reducing the investment in its subsidiary.

Case II

A glass-sand corporation recorded depletion of its deposits by direct charges to surplus. The commission expressed the opinion that failure to include depletion charges in the profit-and-loss statements had the effect of inflating the net profits for each year by approximately 25%.

By amendment the registrant restated its profit-and-loss accounts so as to reflect therein proper depletion expense and attached the following note:

"On the registrant's books of account the amounts provided for depletion have been charged to earned-surplus-unappropriated account but have been treated in these financial statements as charges against profit-and-loss account."

Case III

An incorporated investment trust omitted from its statement of "income, expenses and earned surplus" the expenses representing management fees paid to its sponsor corporation. The charge for this expense, which in some periods amounted to over 65% of the gross dividend and interest income of the trust, was made to paid-in surplus.

Following the commission's objection to this practice, the income account was amended to reflect the management fee paid.

Case IV

An airplane company engaged in the development of a new type of airplane and other mechanical devices carried on its balance-sheet as an asset experimental expenses incurred in the

development of projects which had been abandoned prior to the balance-sheet date. In addition, the company included a substantial item of goodwill on its balance-sheet, despite the fact that the company had never marketed its product.

The commission suspended the effectiveness of the registration statement containing that balance-sheet on the grounds that, among other things, (1) "Sound accounting principles require that where the results of experimentation, such as has been carried on here, are unsuccessful, the respective development costs should be written off as a loss" and (2) that "In view of the fact that in this instance we are dealing with a new concern and a new contrivance, which had not been completed or proved to be a success or source of 'differential advantage,' goodwill based on actual profits can not be contended to exist. Neither has any reasonable demonstration of future possible or prospective 'superprofits' been made. Mere speculation as to the existence of intangible values is not sufficient."

Case V

A utility holding company having assets aggregating approximately $900,000,000 filed financial statements supplemented by numerous lengthy explanatory notes.

Upon examination of the financial statements, the commission was of the opinion that the data as furnished was not understandable because of the numerous qualifications appearing in the notes. The commission felt that many of the qualifications set forth in the notes, together with other adjustments recommended by the commission's staff, should be reflected in some manner in the body of the financial statements. The objections raised by the commission were removed by the registrant by filing financial statements in the following form:

	(1) Per company's books	(2) Footnote adjustments	(3) Amounts if adjusted as explained in footnotes
Items......................	————	————	————

The adjustments included in column (2) resulted in reducing the assets on the balance-sheet in column (3) to approximately $173,000,000 less than they were shown in column (1). Corresponding reductions were made in the surplus accounts. In the

profit-and-loss statements, column (3) showed a reduction in net profits from the amounts shown in column (1) by approximately $1,700,000, $1,400,000 and $300,000 for the years 1932, 1933 and 1934, respectively.

Case VI

This heavy manufacturing company created a reserve for plant retirements by charges to paid-in surplus and shortly thereafter, in 1931 and 1932, wrote off thereagainst properties retired in the amount of $1,744,213.61.

The facts in the case indicated that depreciation charges in previous years had been insufficient to provide for the normal retirement of the properties. The charge to the reserve created from paid-in surplus thus relieved the earned surplus of the charge.

The accountant had failed to express an opinion on this matter in his certificate. The commission took the position that the auditor had not met the requirement that he express an opinion of the accounting practices and procedures followed by the registrant. The accountant thereupon inserted the following in his certificate:

"We are of the opinion that it would have been preferable to have made such charges against earned surplus and in such event the earned surplus and paid-in surplus of the registrant, December 31, 1934, would have been $3,311,321.20 and $7,506,986.59, respectively . . ."

Case VII

A company charged paid-in surplus with $211,525.91, representing inadequate depreciation provision for periods prior to July 1, 1931.

Pursuant to a letter of deficiencies, the charge was transferred to earned surplus and the following note appeared in the certificate:

"Attention is also directed to the analysis of paid-in surplus included under instruction 22 accompanying the balance-sheet wherein it will be noted that a portion of depreciation provisions for the periods prior to July 1, 1931, amounting to $211,525.91, was charged to paid-in surplus as ordered by the board of directors. On March 5, 1935, the board of directors passed a resolution to transfer this charge to earned surplus, effective as of September 30, 1934, and effect has been given to such transfer in the exhibits referred to."

Case VIII

A public-utility company, prior to 1924, dealt with its unamortized debt discount and expense by making annual charges to

income to provide for amortization over the duration of the issues. Also, prior to 1924, the physical properties, intangibles and investments were written up approximately $15,000,000 as a result of appraisal of the property of the utility and its subsidiary by an affiliated engineering corporation. Approximately $7,000,000 was credited to a retirement reserve and $8,000,000 was credited to capital surplus.

In 1924 and 1925 substantially all of the then-unamortized debt discount (about $8,000,000) was charged against the $8,000,000 capital surplus thus created. The effect was to relieve the income account prior to August 31, 1934, of annual charges aggregating approximately $5,000,000. Had this method not been followed, the earned-surplus account as of August 31, 1934, instead of showing a credit balance of over $4,000,000, would have shown a deficit exceeding $1,000,000, and the capital-surplus, unamortized-debt-discount-and-expense and the interim income accounts would have shown correspondingly different figures.

The auditors' certificate, as finally amended, included among others, the following paragraphs:

"Substantially all ($8,402,791) of the then-unamortized debt discount and expense of the companies was charged off during 1924 and 1925 against the capital surplus arising from the appraisal. Premium and duplicate interest on refunded issues of the company were charged to unamortized debt discount and expense on refunding mortgage gold bonds, 4½% series due 1961, and are in process of amortization over the life of the refunding issue. Prior to the making of these charges to capital surplus the companies had followed the policy of making annual charges to income which, in general, were designed to provide for the amortization of debt discount and expense over the lives of the respective issues, but on the basis of carrying forward all unexpired discount, premium and expense applicable to refunded issues to be spread over the life of the refunding issue. Upon this basis, the charges against income for amortization of debt discount and expense would have been increased by approximately $337,000 for the year 1931, $314,000 for the year 1932, $315,000 for the year 1933 and $201,000 for the eight months ended August 31, 1934, the total additional charges against income for the period prior to August 31, 1934, would have aggregated approximately $5,426,000, approximately $2,977,000 of the $8,402,791 would have remained to be amortized over future years and the consolidated surplus accounts as of August 31, 1934, would have shown a debit balance of approximately $381,000 for earned surplus and a credit balance of $8,402,791 for the capital surplus arising from the revaluation of fixed assets and investments.

"Except for the matters discussed in the foregoing comments, in our opinion, the accompanying consolidated balance-sheet and statement of consolidated income and earned-surplus accounts fairly present the financial position of the companies at August 31, 1934, and the results of their operations for the three years and eight months ended that date."

The foregoing are only a few representative cases indicating the nature of the accounting problems of the commission. A complete recital of those occurring on the registration of securities would cover most of the accounting problems in the handbook.

Uniform System of Accounts for Public-Utility Holding Companies

Under the 1935 act, uniform systems of accounts are to be promulgated for the use of public-utility holding companies and their subsidiaries. The commission has, to date, issued two such systems, one to be used by service companies (required to operate on a non-profit basis) and the other to be used by public-utility holding companies deriving practically all of their income from interest and investments in other companies. Important accounting questions naturally had to be settled in the writing of these classifications. Some of them are, undoubtedly, of sufficient general interest to mention at this time, so I have selected a few for comment.

Investments acquired subsequent to the effective date of the systems are required to be entered at cost to the accounting company and to be retained in the accounts at cost until sold or otherwise disposed of or written down or off. No write-ups of investments are permitted.

If a company emerges from receivership, bankruptcy or reorganization proceedings as the owner of investments of undetermined value, and at the time of recording such investments on its books does not have a satisfactory valuation of some portion of the items, it may enter such investments at figures representing a reasonable estimate of their value. Each item of investment is to be recorded separately, and if the amount so recorded, plus other assets acquired, exceeds the aggregate par value of its capital stock plus its debts, an amount equal to such excess is required to be set up as "reserve for adjustment of assets acquired in reorganization." That reserve is to be available only for the adjustment of the investment figures. When values have been

determined and adjusted any excess in the reserve may be disposed of as the commission may approve or direct.

Three special classifications of surplus are provided, as follows: (1) paid-in surplus, (2) other capital surplus, (3) earned surplus. Paid-in surplus is to include amounts paid in for capital stock over the amount credited to the capital-stock account; surplus arising from donations of the company's stock by stockholders or from a reduction of the par or stated value of the company's stock; net gains from the acquisition or resale of the company's stock; and debt of the company forgiven by stockholders. It may be charged for losses arising from the reacquisition or resale of the company's own stock to the extent that such losses do not exceed the amount of accumulated net gains previously included in the paid-in surplus account arising from reacquisition or resale of the company's own stock. Any excess of such losses must be charged to earned surplus.

If any discounts, commissions or expenses on the issuance of capital stock attributable to shares reacquired are still carried in the accounts at the date of reacquisition, they must be written off.

Bond discount and expense attributable to reacquired long-term debt is required to be written off when the bonds have been reacquired, irrespective of whether they may be subsequently resold.

A holding company is not permitted to take up on its books the undistributed earnings of subsidiaries except to the extent that such undistributed earnings have been declared as dividends and may properly be included as dividends receivable.

A stock dividend may not be included in the accounts of the receiving company at more than the amount charged by the paying company to its income or earned-surplus account or the market value of the stock received, whichever is less. A dividend in stock of a paying company may not be included in income if the dividend is paid from sources other than income or surplus of the paying company earned subsequent to the receiving company's acquisition of the stock with respect to which the dividend was paid.

Conclusion

There have been inquiries as to what the commission expects in the various financial statements required to be filed with it. There have been some criticisms of the information required, as well as some protestations of inability to obtain the necessary

information without undue hardship. These questions and protests have been surprisingly few in view of the large number of statements filed. I have the feeling that those registrants and accountants who have made up their minds that they will carry out the spirit of the act have not been seriously troubled by the requirements.

We are striving to obtain the greatest amount of information that will be of real assistance to the investors with a minimum of effort on the part of the registrant. There are certain specified rules that have been laid down in the preparation of the forms. Necessity dictates that such should be the case. However, when specific situations present problems that do not fit into the requirements, an approach to the problem with an honest desire to present full disclosure of the facts involved has usually made it possible for the registrant or the accountant to comply substantially with the rules and regulations.

The Securities and Exchange Commission is anxious to develop accounting practice and procedures on a high level, to bring to the investor for whose protection it was created a more dependable body of information than he has ever had before. To do so will require the support of the accounting profession. The accountants and the commission working at cross-purposes will accomplish little and in my opinion the cause of accountancy will suffer. On the other hand, if the accountants and the commission coöperate, they can do much towards correcting undesirable accounting practices.