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Correspondence: Accounting Procedure and the Stock Exchange

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Correspondence

ACCOUNTING PROCEDURE AND THE STOCK EXCHANGE

Editor, THE JOURNAL OF ACCOUNTANCY:

DEAR SIR: I think it would add greatly to the usefulness of papers which members contribute to meetings of the Institute and to your columns if readers would initiate discussions of points on which they find themselves not to be in complete agreement with the writers. In this spirit I would ask the opportunity to offer one or two comments on the very interesting paper of Mr. Stempf which appeared in your issue of November, 1936.

In that article, after quoting listing agreements of the New York Stock Exchange, Mr. Stempf offers the comment:

> "It should be noted that both (b) and (c) above relate to unconsolidated subsidiaries and, inferentially, recognize the practice of recording appreciation or depreciation of investments in subsidiaries by a direct credit or debit to the parents' earned surplus, concerning which more will be said later in this discussion."

Passing by the question whether the inference drawn is warranted, may I express the conviction based on long and intimate relationship with the New York Stock Exchange that no such inference was intended to be drawn and that the exchange does not approve the practice of recording appreciation of investments in subsidiaries by a direct credit to the parents' earned surplus. May I add, also, that I think the exchange would be going counter to the weight of accounting opinion if it should approve that practice. The better view, I believe, is that, while in some cases the adoption of the practice has no undesirable results, it is open to abuses and has been abused, and that it offers no advantages sufficient to warrant the risk of such misuse.

Another reference to the New York Stock Exchange in Mr. Stempf's paper is, I think, open to misunderstanding. He says, at page 376: "It is noteworthy that the New York Stock Exchange has issued letters to listed companies requesting the publication of financial statements in the form accepted by the Securities and Exchange Commission." This statement is correct to the extent that the exchange has requested listed companies to give certain information (notably in relation to costs and sales) in the form accepted by the commission. It has not, however, urged or favored the issuance of annual reports in the precise form required by the commission to be used in registrations; indeed, it will be recalled that Commissioner Landis, in one of his first speeches after his appointment to the commission, expressed the hope that annual reports to stockholders would be wisely condensed and be less voluminous than those which the commission would require for registration.

Mr. Stempf discusses on pages 365–6 the question whether depreciation should be based on cost to the subsidiary or effective cost to the controlling corporation which has acquired the entire stock of the subsidiary. May I say that I agree, and believe most accountants would agree, with the view which he expresses in favor of the principle of effective cost, though the facts are often less simple and clear than in his illustrative case. I suggest that the divergent views to which he refers are largely due to the influence of tax regulations.

The problems arising out of the system of controlled companies are many and difficult, and all accountants should use their best efforts to insure that these difficulties are solved in the way that is fairest and most helpful to the investor. I am sure Mr. Stempf would agree with me that while explanatory footnotes are sometimes necessary, an accountant has not lived up to his full professional obligation if he accepts an unsatisfactory method, explained in a footnote, in any case in which by the exercise of courage and persuasion he might have brought about the adoption of a more satisfactory method which would have rendered the footnote unnecessary.

Yours truly,

George O. May.