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Correspondence: Whose Balance-sheet Is It?; Surprise Audits; General Tax Formula

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CORRESPONDENCE

Whose Balance-sheet Is It?

Editor, THE JOURNAL OF ACCOUNTANCY:

DEAR SIR: I agree fully with those who say:

"Quite obviously, also, an accountant can and sometimes does prepare statements for a business that represent principally his own judgment, and not that of management."

I *would* like to find the man who invented the question: "Whose balance-sheet is it?" Expressed in that way, it takes on many imagined meanings never contemplated in the basic problem of primary responsibility for financial representations, so ably discussed in the editorial in *THE JOURNAL OF ACCOUNTANCY* for May, 1940.

I must demur, however, when Mr. Lee implies, in his letter to *THE JOURNAL*, that I selected the participants in the forum at San Francisco, or presumed to direct the presentation of their views. The statement made by Mr. McIntosh attests how futile that attempt would have been. The gentlemen were selected by the convention committee. I invited them all to present Mr. Lee's side of the question. I wonder whether Mr. Lee read Mr. Harmon's contribution to the subject, which appears in the *Papers on Auditing Procedure—1939*, published by the Institute.

Mr. Lee assumes, rather naïvely, that when one says the audit begins with the balance-sheet, it also means that it ends there. That misconception is too utterly fantastic to merit patient correction. The financial statements are merely the beginning.

To be enabled to express a competent opinion as to the fairness of the representations made by management, the independent certified public accountant must undertake an examination of the financial statements, underlying accounting records, and other supporting data. In some phases of his work he must obtain outside confirmations, and he should require and assay supplementary explanations and information from management and employees to the extent necessary

to reach a reasoned conclusion. (All in accordance with generally accepted auditing procedure as set forth in the Institute's pamphlets: *Examination of Financial Statements* and *Extensions of Auditing Procedure*.)

I disagree with Mr. Lee's conclusion that the certified public accountant's responsibility is fixed by the general public regardless of pronouncements those in the profession may make. The responsibilities of the certified public accountant are those determined by his own profession; whether or not he has done a competent job should be determined by what his peers would have done under like circumstances pursuant to standards set by the profession.

No one can rightly expect the auditor to assume a legal responsibility which goes beyond the function which he has declared himself competent to serve. That normal function clearly imposes upon the certified public accountant the responsibility to satisfy himself by generally accepted auditing procedure that the representations of management set forth in related financial statements are fair and in conformity with generally accepted accounting principles consistently applied.

Yours truly,

VICTOR H. STEMPF

New York, N. Y.

Surprise Audits

Editor, THE JOURNAL OF ACCOUNTANCY:

DEAR SIR: Having noted a comment under "Surprise Audits" appearing on page 294 of the April issue, I have assumed that you would be interested in receiving the detailed bulletin mentioned therein as announced by my preliminary letter under date of March 6th.

As you will note from the enclosed bulletin, registrants are now afforded the opportunity of electing any annual audit date within the calendar year. Registrants may choose to

continue use of a fixed annual audit date heretofore established or may now elect in lieu thereof an annual audit date more suitable or advantageous for fiscal or other purposes. The variable dates which result from the surprise audits now proposed by the rules and regulations of the New York Stock Exchange are also provided for in the revised rules of this department.

While in this initial transition period, the department will necessarily accept audit reports of dates as remote as December 31, 1939, the plan when fully established will require the submission of reports of any audit within thirty days following the audit date involved.

I believe this program will be approved by both registrants and accountants, particularly by the latter group because of the convenience of planning examinations in advance and perhaps initiating the actual work a few days prior to the audit date chosen.

Yours truly,

EDWARD J. HUGHES

Secretary of State for Illinois
Springfield, Ill.

General Tax Formula

Editor, THE JOURNAL OF ACCOUNTANCY:

DEAR SIR: Reference is made to the general tax formula submitted by Mr. Fraser in the May JOURNAL for the obtaining of the federal income tax, state income tax, and bonus, where each is arrived at after deducting the other two and in each case there is but one rate. For this type of a problem, the following approach is suggested, in which the term "effective rate" means the rate applicable to the profit before deducting any of the three taxes:

Symbols:

f = Federal statutory rate

F = Federal effective rate

s = State statutory rate

S = State effective rate

b = Bonus rate

B = Bonus effective rate

$k = \frac{1}{1 + 2bsf - bf - sf - bs}$, a common factor

Formulae:

$B = k(b + bsf - bf - bs)$

$S = k(s + bsf - bs - sf)$

$F = k(f + bsf - bf - sf)$

Yours truly,

EDWIN S. RENO

Pittsburgh, Pa.