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Speeches - SEC Staff.

FINANCIAL DATA AVAILABLE TO
INVESTORS IN UNREGISTERED SECURITIES

Address

of

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Before the

Philadelphia Chapter

Pennsylvania Institute of Certified Public Accountants

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and

Sigma Kappa Phi

University of Pennsylvania

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Your program director has invited me to discuss generally the subject of "Financial Information Available as to Unregistered Companies." I am pretty sure that what prompted his suggestion as to our subject matter this evening was a recent report to Congress by our Commission entitled "A Proposal to Safeguard Investors in Unregistered Securities." More specifically, there was included therein a "Study of Stockholders Reports of Unregistered Companies" which was prepared under my supervision and which has been the object of some criticism by accountants because of certain of its conclusions, and of one at least of its suggestions as to the social responsibilities of public accountants who undertake to certify financial reports to stockholders.

I may as well quote at the outset that part of the study which I believe has been considered most provocative of comment:

> "It seems highly significant that notwithstanding that 90% of the financial statements were certified, practically every one failed to disclose information that was of considerable significance to investors. Yet not a single accountant registered an exception in his certificate because of improper or inadequate disclosures in the financial statements.
>
> "The principal guiding force that might lead accountants to insist on adequate disclosure in financial statements of these companies is their professional conscience as expressed in their rules of ethics. The ethical standards established by the American Institute of Accountants and followed in various State jurisdictions provides in Rule 5 that
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> > "'In expressing an opinion on representations in financial statements which he has examined, a member or an associate shall be held guilty of an act discreditable to the profession if:
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> > "'(a) He fails to disclose a material fact known to him which is not disclosed in the financial statements but disclosure of which is necessary to make the financial statements not misleading; or
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> > "'(b) He fails to report any material misstatement known to him to appear in the financial statements; or
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> > * * * *
> >
> > "'(e) He fails to direct attention to any material departure from generally accepted accounting principles or to disclose any material omission of generally accepted auditing procedure applicable in the circumstances.'
>
> The by-laws of the American Institute of Accountants provide that a member is liable to expulsion or suspension from the Institute if he is found to have been guilty of 'an act discreditable to the profession.'

"Presumably these rules do not make it an 'act discreditable to the profession' to certify the balance sheet of a company when no income statement is presented. This can perhaps be accepted on the ground that the certificate merely states that the particular financial statement certified 'presents fairly.' It is more difficult to understand how an accountant can justify, under these rules, certification of highly condensed balance sheets or income statements in which the facts that are basic for analytical purposes are not disclosed.

"The fact that the financial statements examined in the course of this study were generally grossly inadequate, notwithstanding that 90% had been subjected to the expert review of a certifying accountant, makes it quite clear that the procedure of certification does little to assure adequate information for investors. Excessive condensation and insufficient supplemental disclosure apparently do not prevent certification. Nor do they always give sufficient attention to the propriety of the accounting principles followed. Examples of improper or unsound accounting principles, referred to above, were found, almost without exception, in financial statements that had been certified."

These paragraphs it may be noted appear as part of a two-page section of a 56-page report. That section constitutes the only reference in the report to the work of the certifying accountants — the remainder consists of an analysis of the nature and inadequacies of the reports which these unregistered companies prepared.

I want tonight to describe rather briefly the factual results of our study and to leave it to you as responsible members of the public accounting profession to judge whether the fact of certification did in these reports assure the presentation of financial information which was reasonably adequate for the purposes of members of the general investing public.

Possibly the best way to begin is to outline the purpose of the study and how it came to be undertaken. Under the Securities Exchange Act of 1934, companies having securities listed and registered on a national securities exchange must file annual reports with the Commission. There are, however, many companies which enjoyed an "unlisted trading" status prior to the 1934 Act and which even now file no reports with us. Companies which since 1936 have sold large blocks of securities also have to file annual reports with us even though they have no securities listed on an exchange. So also do companies subject to the Trust Indenture Act of 1939. And, of course, most Investment Companies and most Public Utility Holding companies and their subsidiaries have to file under the 1940 and 1935 Acts. As a result of this historical development, there are important gaps for which there can be no logical justification. Some companies whose securities are traded over exchanges are not subject to our reporting requirements or those of other public bodies such as utilities commissions. Many traded only over-the-counter are so subject. Whether a particular company is or is not subject to such reporting requirements depends on such fortuitous factors as the nature of the business, the fact that it has or has not sold securities since 1936, or the fact that it happened to be in a particular status in 1934.

To close these gaps the Commission has proposed the application of the reporting, proxy, and insider trading provisions of the 1934 Act to most companies of substantial size in which there is a public investment interest. In the proposal, the test is set at $3,000,000 in assets and 300 or more security holders. Specifically excluded are banks, and charitable, non-profit companies.

At an early stage of the Commission's study of this uncovered area, my office was asked to undertake for the Commission a study of the financial data generally and readily available as to these companies and to form a judgment as to adequacy and informativeness in comparison to that available as to companies subject to our reporting requirements. The "Study of Stockholders Reports" appended to the report to Congress is the result. Briefly, we first excluded banks, insurance companies and utilities since ordinarily such companies are required to file reports with state or federal agencies. We next concluded that as to other companies the annual reports to stockholders would ordinarily be the principal or only source of financial data readily available to public investors. Then, we consulted the files of such reports maintained by the library of a large university on the ground that if they appeared there we should conclude that they were generally available. To check this the library at our request wrote for data on a new group of 90 companies — and got some in about 57% of the cases. 1/

Next, we concluded to compare these data, not with the stockholders reports of listed companies as some have suggested we should have done, but with our financial requirements as to the 10-K or 1-MD reports filed with us by listed companies. It was not our purpose to determine whether listed or unlisted companies furnished better reports to stockholders, but to determine <u>whether</u> adequate and informative financial data <u>was available</u> as to these non-reporting companies. For that purpose it seems obvious that comparisons with the 10-K and 1-MD reports is a wholly, if not the only, proper standard of comparison, for even if a listed company furnishes no financial data in the form of a published annual report to stockholders, the fact remains that a full 10-K report is publicly on file with this Commission and the exchange. Moreover, the financial data so filed is picked up by several financial services and thus is widely disseminated. In addition during the year ended June 30, 1945, for example, 14,487 persons visited the public reference rooms of the Commission; also, 2,312 orders for copies of public registered information were filled, involving 181,753 pages of material.

1/ In all, 119 reports were included in the study. This is about 12% of the estimated number of companies believed to be affected by the proposal, which do not already make public reports to Federal or State agencies.

As a matter of fact, however, we have made several studies of the annual reports to stockholders issued by listed corporations. Studies in 1936 and again in 1941 showed a definite course of improvement. I shall not speculate on the reasons for that trend. More important, in the 1941 study, balance sheets in the annual reports were substantially different from those included in reports to this Commission in only 20% of the cases. In the study of unregistered companies, 52% of the balance sheets failed in material respects to meet our minimum requirements. In the 1941 study, 61% of the profit and loss statements were materially different while in the 1946 study of unregistered companies 63% were materially different. In both instances the major difference was in the failure to show sales and cost of sales. In the 1941 study 99% of the companies furnished a full set of statements -- i.e., balance sheet, income account, and surplus statement. In the 1946 study only 66% of the companies gave all three of these primary statements.

And now to what the study disclosed. As mentioned earlier, the criteria adopted as a satisfactory standard of performance were the Commission's reporting requirements under the 1934 Act for commercial and industrial companies as prescribed by Regulation S-X, which regulation governs the form and content of financial statements for most companies. As you will doubtless recall, the provisions of Regulation S-X were adopted after detailed and lengthy discussions with a great body of public accountants, corporate officials, financial analysts and others interested in the welfare of investors. As a result they represent a distilled consensus of all these groups and ourselves as to the proper form and content of financial statements to be offered to investors. However, for the purposes of this study, in appraising the annual reports examined, only serious departures from these requirements were noted. Deficiences relating to items that were small in amount, or improprieties that did not seriously affect the utility of the financial statements were disregarded. Failure to furnish information called for only in the Regulation S-X schedules was not deemed a material discrepancy. And a statement was not deemed to be "materially different" or "deficient" unless it contained several important faults involving items of significant amount. On the other hand, our tabulations reflect only patent omissions or inadequacies. There was ordinarily no way of telling whether other deficiencies existed, were all the facts known. For illustration, one could not tell whether the caption "accounts receivable" included large and undisclosed sums due from officers, or whether an item "fixed property andintangibles" in fact consisted largely of "intangibles." This difficulty was particularly inportant so far as appraisal of the accounting principles followed is concerned. In most instances, the statements were so abbreviated and so lacking in the detail found in our supplementary schedules as to preclude the possibility of forming any judgment as to whether generally recognized accounting principles were being followed. We assumed, however, in the absence of clear evidence to the contrary that no departures from recognized principles of accounting were present.

The deficiencies found may be classified into the following major groups which I shall discuss in turn:

1. Failure to furnish a full set of financial statements.

2. Deficiencies in the form and content of the balance sheet.

3. Deficiencies in the form and content of the income statement.

4. Deficiencies in footnote disclosures.

5. Deficiencies relating to the use of improper or unsound accounting principles.

6. Deficiencies in the certification of the financial statements by independent public accountants.

1. Failure to Furnish a Full Set of Financial Statements

The three financial statements almost universally recognized as fundamental are the balance sheet, the statement of income, and the statement of surplus. To me it seems clear that these statements are absolutely essential to any fair disclosure of the financial affairs of a company. The absence of any one of them deprives the investor of material information to which he is entitled.

The studies disclosed that 16 of the 119 reports reviewed did not include any statement of income at all, and that 24 of the 119 reports reviewed did not include a statement of surplus. Failure to furnish investors with a statement of income for the fiscal year is to me a grave omission. Earning power is the very core of investment values in competitive fields and suppression of all information on the subject is prejudicial to the interest of everyone concerned except those favored "insiders" to whom the information is available. Failure to furnish a reconciliation of surplus is also a serious omission. Items of income, expense or loss that are carried to surplus represent an important qualification of a company's earnings history. Yet if a reconciliation of the balance of earned surplus at the begining and end of the fiscal year is not furnished, the investor ordinarily has no way of determining the significance of such items. Further, if a reconciliation of capital surplus and other surplus accounts is not available, the investor is likewise left in the dark as to the nature and significance of any increases in or utilizations of those surplus accounts. I suggest in all seriousness that it will not be long before it will be recognized as improper for an accountant, who knows statements are to be sent to investors to permit the use of his opinions except in connection with a full set of the three fundamental statements.

2. Deficiencies in the Form and Content of the Balance Sheet.

We concluded that of the 119 balance sheets examined, 13 substantially complied with our requirements, 44 were partially different, and 62 were materially different.

The deficiencies most frequently noted related to the presentation of reserves, inventories, fixed assets, investments and capital stock.

a. Reserves

With respect to reserves, inadequate disclosures were quite common. Nearly all companies indicated that they had established reserves of one kind or another (in addition to depreciation reserves), and more than half the companies had reserves that were very material in amount.

In thirty-two cases valuation reserves were deducted from assets without disclosure of the amount so deducted. Regulation S-X provides that valuation reserves shall be shown separately as a deduction from the asset to which they apply and so precludes the practice of netting reserves against assets without disclosure.

It is possible through improper use of reserves to tailor the income account to show a preconceived result rather than the "actual" results of operations. One effective protection against such abuse is to insist that reserves indicate as specifically as possible, under the circumstances, the purpose for which they are created. Such disclosures are required in financial statements filed with the Commission. Forty-five companies, however, had reserves of a substantial amount, the purpose of which was not adequately disclosed. A number of these companies merely described the reserves as "reserves for contingencies" or "sundry reserves" with no mention of the purpose they were intended to serve except possibly a vague reference to "war and post-war conditions." The most extreme example of this practice was found in the case of a company with total assets of about $6,500,000 which had set up a reserve for contingencies of $2,200,000 without mentioning any specific contingency that was being provided for. A few companies indicated that contingency reserves were intended to provide for "renegotiation and other contingencies" but the amount of the renegotiation provision was ordinarily not disclosed and the "other contingencies" were not identified.

The use of "blanket" reserves that are represented as having been set up to provide for a variety of losses or contingencies is equally uninformative. One company had a reserve "For Preferred Dividends, Additional Income Tax 1939-42 Pension, Etc., "; how much was provided for each of these purposes and the amounts attributable to the "Etc."; were imponderables for the investor. Two companies set up reserves for "contingencies and income taxes," the latter a current liability while the former was possibly the equivalent of appropriated surplus. The amount attributable to each purpose was not disclosed. Other blanket reserves whose titles served more to conceal than reveal were "Reserve for post-war conversion, contingencies, adjusted compensation, etc.," "reserve for workmen's compensation, contingencies and repairs, etc.," and "reserve for insurance, etc."

While the reports examined were not criticized in our study for omitting a description of the principal changes in important reserves, yet there were several instances in which it was felt that if such information were available a question might be raised as to the propriety of the company's accounting treatment. One extreme instance was that of a company that had

established a sizeable reserve to cover both war and post-war losses. An additional amount of about $500,000 was provided for this reserve during the year 1944 out of income. Despite this, the balance in the reserve declined by $500,000 during the year, so that charges of an undisclosed nature amounting to about $1,000,000 were made against the reserve. The company's net profit after income taxes was about $750,000.

b. Inventories

In 84 of the 119 reports we felt the disclosures as to inventories were inadequate. In 67 cases there was a failure to make a clear statement as to the basis used in determining the amount at which the inventories were carried. In 55 cases only a single total for inventories was given instead of the subclassifications usually required by our regulations. In 38 cases both deficiencies existed. While the failure to subclassify inventories is not considered a serious failing by some, this is not true of the failure to state clearly and fully the basis of valuation. That information is uniformly considered essential where inventories are a major factor. Our rules call for a clear statement of the general basis such as cost or market, whichever is lower, and also, what is just as important, of the kind of cost -- first in-first out, average, and so on.

c. Fixed Assets

While balance sheets examined were not deemed deficient because of a failure to classify fixed assets or to state the basis of valuation used, it is to be noted that 66 of the 119 reports stated the fixed assets in one amount and in 37 reports no indication was given of the basis on which they were carried. 2/

However, in 17 reports, the reserve for depreciation was not shown separately but was deducted from fixed assets without indicating the amount so deducted. Two companies, neither a public utility, presented their reserves for depreciation on the liability side of the balance sheet rather than as a contra to fixed assets. One of them went so far as to present the reserve among the net worth accounts between capital stock and surplus.

In another case 95% of a company's total assets of nine and one-half million dollars appeared under the caption "Property, plant and equipment, including intangibles." No indication was given as to the respective amounts of fixed assets and intangibles included under this caption.

2/ Such practices were not in this study considered "discrepancies" because under Commission requirements the pertinent information is obtained in schedules or in the historical financial data. Actually a majority of the reports give an appropriate indication of the basis in the balance sheet or in a footnote. A considerable percentage of the smaller companies, moreover, show some breakdown of fixed assets on the face of the balance sheet.

One company had written down its fixed assets by a substantial amount during the fiscal year covered by its report. The write-down was equal to about 25% of the net carrying value of the fixed assets prior to the write-down, and, according to the president's letter, was based on an appraisal. The need for the write-down was not clear, yet, assuming the write-down to be justified it appeard to have been handled in a most improper manner. In the first place there was no disclosure of the effect of the write-down on income, although presumably depreciation charges were materially reduced by this adjustment and so a full explanation of the effect on income should be given. Moreover, the write-down was described in the president's letter as being charged to "capital surplus." It would seem that such losses should be reflected in earned surplus, by way of the income account. In addition, the president's letter apparently left something unsaid because the company reported no "capital surplus" account on its balance sheet. There was only the single caption, "Surplus."

d. Investments in Securities

Twenty-four reports did not indicate the market or fair value of the investments in securities.

e. Capital Stock

The description accorded this item was considered inadequate in 32 cases. In most of these instances there was a failure to indicate such information as the number of shares authorized or the number of shares outstanding. In a few cases, the balance sheet merely set forth "Capital stock" with no indication as to the number of shares authorized, issued, and outstanding, the par or stated value, or whether more than one clas of stock had been issued. One company used the caption "Capital" with no additional disclosure as to the classes of stock involved, their stated amounts, the number of shares issued, or whether any capital surplus was included. In another instance, two classes of capital stock while separately described were lumped with surplus and shown in a single amount. It is obviously essential for investors to know the number of shares issued and outstanding. The lack of such information aids in schemes by which insiders have defrauded investors by buying in their shares at amounts far below their intrinsic value. A number of such fraud cases have come before the Commission for action and one at least is described in another appendix to the report.

3. Deficiencies in the Form and Content of the Income Statement.

The income statements in the one hundred and nineteen reports examined reflected a standard of reporting practice that was seriously inadequate on major matters as compared with the requirements of Regulation S-X. On the basis of such requirements, the study indicated that 17 reports were substantially in agreement with such standards; that 27 were partially different; that 59 were materially different; and that 16 companies did not even furnish income statements. Here again, a statement was not judged to be "materially different" unless the deficiencies were major faults relating to significant items of the income statement.

Virtually all the deficiencies noted related to the adequacy of disclosure, since the information available was so scanty as not to permit any appraisal of the propriety of the accounting principles followed by the companies in determining net income. The most frequent departure from Commission standards lay in the failure to disclose the amount of sales or cost of goods sold.

Of the 103 companies that furnished income statements, 36, or over one-third, did not disclose their volume of sales or the amount of cost of goods sold. Some of these companies began their income statement with a figure such as "gross profit after sales and cost of goods sold;" fifteen companies began with a "net income figure" after all deductions save one or two. These deductions (ordinarily, depreciation and income taxes, and sometimes a provision for contingencies) were then set out and the residual balance shown as the final net income figure. Disclosure of these basic volume figures as information essential for investors has been a policy of the Commission since 1934. Only a handful of many hundreds of listed companies have been granted confidential treatment of these items as a result of circumstances indicating disclosure to be a definite and clear-cut hardship. The Commission's policy was, it may be noted, upheld by the courts in the American Sumatra Tobacco case.

About fifty-five of the reports examined either contained no income statement or contained only a highly condensed statement of very limited value to an investor. In several cases, income taxes and depreciation were left to the last and deducted from a figure captioned "Net income before income taxes and depreciation." This method of presentation of depreciation expense is apt to be very misleading since it tends to suggest that depreciation is an indefinite cost that need be recognized only in amounts that profits can comfortably bear. Coupling depreciation with income taxes at the bottom of the income statement likewise tends to foster the mistaken notion that depreciation, like income taxes, is a special type of charge that need be borne only to the extent that income exists.

One of the most important undertainties attending the presentation of income figures during the recent war years is the effect of renegotiation of war contracts. Most of the companies whose reports were examined were apparently subject to renegotiation and many of these gave information on the subject that appeared to be reasonably adequate. However, about twenty-six of the companies either made no mention of this matter or gave so little information that it was not possible to form a clear opinion of the renegotiation status of the company.

The disclosure given to provisions charged to income for reserves covering war or post-war contingencies or losses was also frequently inadequate. Many of the companies making such provisions failed to describe sufficiently the purpose of the reserve provision or the amount thereof. These reserves are part of the general question of reserve accounting that was discussed previously.

4. Deficiencies in Footnote Disclosures.

The one hundred and nineteen financial statements examined were characterized by a lack of footnotes. A large number contained none whatsoever, while many others merely presented one or two brief notes. For purposes of this study it was not deemed essential that footnotes to the financial statements be formally set out and separately captioned. Disclosures made in an accompanying letter of the president of the company were also accepted as the equivalent of formal footnotes.

The footnotes that should be presented with respect to a particular balance sheet or income statement cannot usually be determined from an examination of the face of the statement itself. However, there are certain types of footnotes that are necessary under most circumstances. These include the disclosure, by footnote or otherwise of the basis of determining the amount at which certain assets are carried in the balance sheet, the accounting principles followed in determining the inclusion or exclusion of subsidiaries for consolidation purposes, the accounting policy followed for depreciation of fixed assets, and similar matters relating to accounting principles or practices observed by the corporation.

Footnotes are also frequently needed to indicate more clearly the full significance of amounts shown in the financial statements. Unusual types of assets, dividend arrearages on preferred stock or other surplus restrictions, contingent liabilities, defaults on outstanding securities, and a variety of other special situations call for detailed disclosure, presumably by footnote.

In view of the great variety of situations that may necessitate footnote disclosure, and the fact that the existence of such situations could not always be determined, it was seldom possible to say that the footnotes in a given report were adequate. However, with respect to each financial statement we asked ourselves whether the footnotes, having in mind the other data available, appeared to meet the minimum standards of Regulation S-X. The balance sheet footnotes of 92 companies did not come up to this standard. In the case of 26 reports there were no observable inadequacies in the footnotes furnished. About 100 companies presented formal income statements. Of these only 5 seemed to have reasonably adequate footnotes while the remaining 95 companies did not appear to meet the minimum requirements of Regulation S-X.

The most common omission noted was an almost complete failure to disclose important accounting policies of the reporting company. Without such information, an investor is obviously left largely in the dark particularly should he wish to compare his company with others in which he may be interested. As an example, only three companies out of the entire group gave any clear description of their depreciation, maintenance or replacement policies.

Footnote deficiencies extended to a number of other matters. There was a failure to note preferred stock dividend arrearages or other surplus restrictions; the amount of the involuntary liquidating preference of preferred stock was not shown although that preference exceeded the amount at which preferred stock was carried in the balance sheet; and the pertinent facts were not given as to a recapitalization that apparently was to be carried out shortly after the date of the balance sheet.

It seemed clear that little attention was given to the need for footnote disclosures in the financial statements examined. The lack of information in the body of the financial statements could have been overcome in some instances by appropriate footnotes. However, as a general rule, the financial statements that were most in need of clarification were the ones that failed to give any footnotes at all.

5. Deficiencies Relating to the Use of Improper or Unsound Accounting Principles.

The deficiencies that have been discussed so far are almost entirely deficiencies relating to the adequacy of disclosure rather than deficiencies attributable to the use of unsound or improper accounting principles. However, the studies disclosed quite a number of instances in which it was evident that the accounting principles followed were improper. Several instances may be cited, such as treating treasury stock as an asset and including dividends on such stock in income, and charging write-downs of fixed assets to capital surplus.

Two companies resorted to appraisals during 1942 and 1943 resulting in the write-up of their fixed assets. No recapitalization or major readjustment seemed to have occurred, and nothing in the nature of discovery value existed since one of the companies was a textile mill while the other was a manufacturer of aeronautical and marine appliances.

One company that had written up its assets continued to charge depreciation to income on the basis of the old cost figures. This practice is very generally regarded by accountants as misleading, and has, I believe, no substantial authoritative support. Another company made no disclosure in its balance sheet of any write-ups in its assets but a surplus adjustment labelled "Amortization of building appreciation -- $36,909" made it apparent that a write-up had in fact been recorded at some time.

A company which had recently undergone a reorganization, announced in its financial statements that it was following the practice of charging or crediting to capital surplus all losses or gains realized on the sale or other disposition of fixed assets that had been acquired prior to the reorganization. The reorganization in question was a formal proceeding under Chapter X of the National Bankruptcy Act and operated to give the company a "fresh start." However, this reorganization could scarcely operate to absolve the company from recording any subsequent losses or gains on fixed assets. Losses or gains that appeared to be attributable to the period subsequent to the reorganization should be reflected in earned surplus, through the income account.

Another company that reported a substantial earned surplus failed to disclose the questionable nature of the account. This company had undergone a major capital readjustment three years earlier. The amount of stated capital was reduced from about $17,000,000 to $7,000,000 with a concurrent elimination of $9,000,000 of preferred stock dividend arrearages. In addition, about $10,000,000 of "goodwill" which had been on the books since the organization of the company in 1899 was written off. Earned surplus which was about $2,100,000 before this recapitalization was reduced to about $800,000 by charging a portion of the goodwill write-off thereagainst. This balance of earned surplus was not dated or explained in the financial statements but was presented as unqualified "earned Surplus," notwithstanding the write-off of goodwill to capital surplus and the settlement of $9,000,000 of preferred stock dividend arrearages.

6. Deficiencies in Certification of the Financial Statements.

The financial statements included in reports to stockholders of 100 of the 119 companies reviewed had been certified by certified public accountants or public accountants, leaving 19 companies whose financial statements were not certified.

The certificates furnished in eighty-two of the 119 reports were in substantial conformity with the requirements of the Commission. These certificates represented that the audit was made in accordance with normal auditing standards applicable in the circumstances and included all procedures that the accountants deemed necessary. Also the accountants clearly expressed their opinion that the financial statements were prepared in accordance with generally accepted accounting principles and fairly presented the financial condition and results of operation of the particular companies. The certificates furnished in eighteen of the reports were adjudged unsatisfactory; and the reports of nineteen companies were not certified.

Nearly all the deficiencies in the eighteen reports which were adjudged unsatisfactory were attributable to the fact that the scope of the audit was not clearly indicated. No representation was made that the audit conformed to normal auditing standards applicable in the circumstances, or that the accountants employed all procedures they deemed necessary. A few certificates described the scope of the audit by listing specific auditing procedures that had been employed, but in all such cases the described procedures seemed to fall short of a satisfactory audit. The financial statements of one company were presented over the printed name of a certified public accountant but without any formal opinion being expressed by the accountant.

What I have outlined so far are, I think, the salient findings of the study. On the basis of these findings and with the benefit of its direct experience with individual cases the Commission in the body of its report drew the conclusion that whatever an accountant's personal views may be about the necessity or desirability of disclosure, it is apparent that management policy is the factor which determines the nature of the annual report. It went on to conclude that it felt that unless accountants can point to legal requirements as to the extent of disclosure, they are often unable to insist on a position contrary to that of the management as to the extent of the disclosure which is desirable.

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The Commission is by no means unaware of the valuable services which public accountants are equipped to render to investors. Our nearly universal requirement for certification of financial statements by independent public accountants is perhaps the most striking evidence of this fact. Unfortunately, opportunity is seldom offered for commendatory publicity in the multitude of cases in which the certifying accountant has done a good job. On the other hand, it is one of our major statutory functions to uncover and seek to remedy instances in which those participating in the preparation of statements and reports have in our opinion failed to meet their responsibilities and those of course are the cases that get published.

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