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One of the prime purposes of an audit is to enable the auditor to express an opinion with respect to financial statements included in annual reports to stockholders. Certified public accountants were therefore very much interested this past year in the notice given by the Interstate Commerce Commission in docket 33581 of its intention to issue a rule providing that no carrier subject to the Commission's jurisdiction shall issue financial statements for public distribution that are inconsistent with the uniform system of accounts prescribed by the Commission and with reports filed with the Commission by the carrier.

Many certified public accountants because of their interest in the impact of the proposed rule on reports to stockholders wrote letters to the Commission in reply to its request for data, views, and comments with respect to the proposed rule. The president of the American Institute of Certified Public Accountants submitted a letter to the Commission on behalf of its members containing the view that managements of companies subject to the Commission's jurisdiction should have the responsibility and freedom to report to the investing public in conformity with generally accepted accounting principles.

The Commission has not yet issued a decision on this matter, but it is expected that a decision will be released before the end of the year.*

Before a CPA can express an opinion with reference to generally accepted accounting principles, he must determine whether the financial statements prepared in accordance with the uniform system of accounts include variances from generally accepted accounting principles and whether such variances are of sufficient materiality to be covered in his opinion.

I shall not go into any detail concerning these variances at this time inasmuch as a discussion of the differences between Interstate

* The Commission has since issued its rule that permits regulated carriers to prepare reports for stockholders and others in accordance with generally accepted accounting principles (with disclosure in footnotes of any variations from the Commission's prescribed accounting rules).

Commerce Commission regulations and generally accepted principles of accounting has just been presented to you by another member on this program.

SCOPE OF I.C.C. AUDITS

Some carriers believe that one audit is enough and as long as the I.C.C. makes an examination, why should the extra expense of an audit by a CPA be incurred if it is not required by lenders, stockholders, or by stock exchanges. It would appear that a sound decision on whether to have, or not to have, an audit by a CPA cannot be made without adequate knowledge and understanding of the differences between an examination by the I.C.C. and one by a CPA.

An examination by the I.C.C. generally is limited in scope. Its objective is to determine compliance with the uniform system of accounts and to obtain data in connection with special studies. The I.C.C., for example, usually does not confirm account balances with outside parties or verify cash and securities. Its examinations are made at irregular intervals and do not necessarily cover a stated period. The I.C.C. does not issue a report on its examination but communicates with the carrier with respect to any exceptions found in its examination. If no exceptions are called to the attention of the carrier, there is only negative assurance that the accounts are in order. The carrier has only a limited knowledge of what accounts have been examined and how extensive the examination was.

There may be a few occasions where I.C.C. examiners and independent auditors examine the same records and documents and to that extent there may be a measure of duplication. I do not believe that there is any material duplication at present, and if any should develop it could certainly be lessened by furnishing copies of the reports of independent auditors on general audits to the I.C.C. and also by having independent auditors include in their reports any specific data in which the I.C.C. had indicated a particular interest.

SCOPE OF CPA AUDITS

Audits by certified public accountants require sufficient examination of the statements and supporting records, and sufficient study of the carrier's accounting practices, including the inspection of physical assets and documents and the obtaining of written confirmations from outsiders with respect to bank balances and certain other accounts, to place the CPA in a position to express an informed opinion on the general fairness of the financial statements.

The soundness of accounting judgments and estimates depends on the integrity and competence of those who make them and on their adherence to generally accepted accounting principles. It is for an independent review of the reasonableness of both management's and employees' decisions regarding these questions, even more than for tests of the mathematical accuracy of the accounting data, that an unbiased, objective audit, as provided by CPAs, is desirable.

Many years ago the audit was considered to be primarily a protection for the owners against fraud and embezzlement. Today with an increasing number of companies being operated by professional managers the emphasis of an audit is more on arriving at an opinion on the fairness of the financial statements. Even in companies managed by the owners the emphasis in an audit is more on strengthening internal control than detecting fraud.

While the usual audit that is undertaken to enable the CPA to express an opinion on the financial statements may not be relied on to disclose minor defalcations or fraud, it is incumbent on the CPA to be alert to the possibilities of irregularities and to inform the management about weaknesses in internal control that come to his attention and that conceivably could permit such irregularities to remain undisclosed.

PURPOSE OF CPA AUDITS

Audits of financial statements may be prepared for the benefit of management, such as the executive officers and the board of directors, as an independent check on the accounting system or as the basis for certain managerial decisions. However, impartial audits of financial statements are generally prepared to supply information to the following outsiders:

Present stockholders or potential investors—Listed companies are required to furnish stockholders with an audited annual report which is also of interest to a prospective stockholder.

Present or prospective creditors—Many lenders today require a borrower to submit audited financial statements and even though such statements may not be required, the lender tends to have more confidence in the company that submits audited statements which, in turn, will improve the possibility of successfully negotiating a loan.

Trustees under bond indentures—Indentures frequently contain restrictions on working capital, payment of dividends, use of funds received from sale of assets, and other accounting matters. In order for the Trustee to determine whether the borrower has complied with the requirements of the indenture on such accounting matters there is usually the further requirement that the accounts be audited and that the auditor's report be filed with the Trustee. Occasionally the Indenture will also require that the CPA advise the Trustee of any events of default relating to accounting matters that came to his attention during the course of his examination.

Potential buyers—Buyers usually prefer to base decisions on audited financial statements.

Parties to merger agreements—Audited financial statements are more apt to be comparable and to disclose pertinent data of interest to parties trying to arrive at satisfactory terms of merger.

Stock exchanges—Audited financial statements are required when stock is listed on a securities exchange; after listing, audited reports must be filed annually.

Insurance companies—Insurance companies frequently require audited statements in support of claims for losses under blanket bonds, use and occupancy insurance, etc.

A growing number of motor carriers are issuing annual reports to stockholders containing opinions of certified public accountants. On the other hand a great number of the approximately one thousand Class I carriers are still owned and operated by individuals or their families with little, if any, outside equity capital. However, with the present-day trend in mergers and the continuing growth of individual carriers, more and more of the smaller carriers will require the services of certified public accountants.

I shall not go into the advantages of public financing or the requirement of independent audits in connection with public financing because that is a subject in itself. However, bankers and underwriters generally advise motor carriers that are not using independent accountants but are contemplating public financing in the next two or three years to engage such accountants at the time the matter is under discussion. A current audit will disclose whether any accounting then followed by the carrier need be changed to meet financing requirements and will also allow adequate time to make such changes. In any event, it will be necessary to have an audit of the three latest years' operations when they do *go public.*

OTHER SERVICES BY CPAs

Although this paper has only dealt with the scope and purpose of audits of motor carriers, it did seem appropriate to refer at least briefly to other important services to clients by CPAs, such as:

- Preparation of income tax returns and representation of client in reviews of returns by Federal and state taxing authorities
- Tax planning of business transactions
- Estate and gift-tax planning
- Review of system of accounting and system of internal control
- Preparation of special studies relating to costs, budgets, and cash projections
- Preparation of financial data for inclusion in applications to be filed with the I.C.C.

The CPA is becoming more of a *business doctor* and counselor to businessmen. One of the important areas of management is in financial planning and control of resources. Financial planning includes forecasting needs for capital expenditures and planning working capital requirements. Control of resources includes the maintenance of records and preparation of reports, budgeting, internal auditing, and systems and procedures. It is evident that these functions include the application of knowledge and skills that many CPAs possess.

More efficient management usually results in more profits and small carriers need financial planning and controls as much as large carriers. Services by CPAs in these areas are generally called *management services.* This concept of *management services* by CPAs has received much publicity in the last two or three years. For example, the American Institute of Certified Public Accountants has recently published a series of articles on management advisory services for small businesses relating to budgeting, financing, cost reduction and cost control, office management, and review of management controls.

There was a time, some years ago, when running a small business was not too complicated and the single owner-manager could handle all the details himself. But no longer. With complicated taxes, government and state regulations, high operating costs, and the question of budgeting, even the man with only a few employees is likely to need the assistance of a qualified CPA.