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Acceptability of commercial paper; Bulletin on. 1

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American Association of Public Accountants

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Acceptability of Commercial Paper

BULLETIN NO. 1

Edited by
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The American Association of
Public Accountants

55 Liberty Street

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The Federal Reserve Board uses commercial paper as a basis for issuance of currency. The acceptability of paper offered by member banks for rediscount depends upon the strength of the original maker and upon the evidence of validity presented by the rediscounting bank.

The Federal Reserve Board demands that the rediscounting bank have accurate information in support of statements submitted by borrowers. No banker can afford to offer commercial paper for rediscount unless he has employed every proper method of verifying the statements of borrowers. An unendorsed report of conditions should not be considered sufficient.

Circular No. 13, November 10th, 1914, provides as follows :

“ The required statement should be signed under oath and should contain a short general description of the character of the business, the balance sheet and the profit and loss account. Assets should be divided into permanent or fixed investments, slow assets and quick assets. On the liability side should be shown capital, long-term loans and short-term loans. Short-term loans should be in proper proportion to quick assets, and the statement should contain satisfactory evidence that short-term paper is not being sold against permanent or slow investments. The statement should, furthermore, show the maximum aggregate amount up to which the concern supplying this paper expects to

borrow on short credit or sale of its paper, and the concern giving the statement should obligate itself to obtain the member bank's consent before exceeding the agreed limit. The affixing of the stamp stating such paper to be eligible for rediscount will be considered a solemn and binding declaration by the member bank that the statement has been examined from this point of view and that the paper bought complies with all the requirements of the law and the regulations hereby imposed."

It is impossible to conceive of any method by which satisfactory evidence can be given that short term paper is not being sold against permanent or slow investments except the statement of one who has thoroughly investigated the financial conditions and general methods of the borrower.

Success of the Federal Reserve Bank Act depends upon the faithful co-operation of the bankers of the entire country. Tremendous possibilities of fiscal betterment lie in the administration of the new law—but the banking world must assist.

The banker cannot afford to take chances at any time. Especially is caution imperative when the whole financial fabric hangs upon the banker's conduct of affairs.

Justice to the Federal Reserve Board, the banking system as a whole, each bank in particular and the borrower himself demands the adoption of every precaution.

No man can speak impartially of his own property. No statement of condition can be accepted at its face

value unless it bears independent endorsement.

Senator Root has said that "the spirit of optimism in the absence of restraint leads men to take a rosy view of the future. The earning power of properties is (innocently) overstated; the success of enterprises seems absolutely sure, and failure impossible."

In all probability the Federal Reserve Board will soon issue explicit rulings on the subject of certification of borrowers' statements. The question has already been mentioned in circulars of the board. In the meantime it is essential that bankers themselves insist upon the verification of statements presented with applications for loans. The great bankers of the country favor the universal requirement of certification of borrowers' statements. The laws of thirty-nine states call for the licensing of men who after examination shall be found qualified to investigate and report upon such statements. The modern business man believes in examination of his affairs.

The American Bankers' Association has adopted resolutions in favor of making mandatory a certified public accountant's approval of every statement presented in support of application for credit. The only thing that has prevented the general adoption of the principle has been the competition among banks themselves.

The Federal Reserve Bank Act presents an opportunity to work effectively in unison for the improvement in credit relations which will follow insistence upon complete examination and unprejudiced report on financial conditions of borrowers.

It is essential that the reports of auditors should go into sufficient detail to give an exact and trustworthy presentation of the borrower's affairs. The scope of the auditor's work is often specifically limited by his instructions from the client, and the auditor is therefore obliged to give a qualified certificate, with the result that the banker is sometimes disposed to criticize the auditor for apparent omissions which are entirely beyond the auditor's control. This condition would be remedied if bankers would insist that the auditor be given full power.

The Certified Public Accountants Society of this state presents this important subject to your attention and requests your co-operation in bringing about a condition that will work to the advantage of both the banks and their borrowing customers.

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