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Accounting Methods and Standards

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Presented at a conference under the auspices of the International Cooperation Administration at New York University—November 1957

This subject is so broad, encompassing as it apparently does the entire field of bookkeeping and accounting, that of necessity it must be materially narrowed down even to touch upon a few highlights during the time allotted this morning. One of the most important things dealt with by accountants is the form and content of financial statements, which no doubt will be included in the subject you will hear discussed this afternoon; this matter, therefore, will not be touched upon now. Neither will the method of keeping accounts. Our discussion then will be narrowed down to accounting standards, or in the language more commonly used in the ranks of accountants in America today – accounting principles. We will also touch upon some related problems.

ACCOUNTING PRINCIPLES AND UNIFORMITY

What is meant by an accounting principle? An accounting principle is nothing more than a recognized concept of the most appropriate way of presenting a financial transaction in the accounts and in financial statements. Accounting principles have been established in the United States out of the needs of business, both management and owners, and according to the time and circumstances under which business operates. Accounting principles are not inflexible and they are not unchangeable.

The following simple illustration may be cited as a presently accepted accounting principle in the United States. The purchase of a machine by a manufacturer is recorded in the accounts at cost, and the cost of the machine is amortized by charges to operations over its useful life, such amortization being commonly referred to as "depreciation." The annual amortization charge must also take into consideration the possibility of obsolescence of the machine. No change is made in the accounts or in the financial statement if the replacement cost of this machine increases or decreases in future years. You will note that I said "presently accepted accounting principle." There have been many and forceful arguments put forward in the past few years of our creeping inflation that replacement costs should be reflected in the accounts and that the annual charge for

depreciation should be based upon such replacement cost rather than upon the original cost. This concept has not been accepted up to the present time.

Record-keeping and accounting in the United States up to the twentieth century – and I feel sure this was true elsewhere in the world – were primarily for the benefit of the management of the business, who in the vast majority of the cases up to that time was also the owner. The accounting principles employed were those adopted by the owner to produce the results most helpful in the day-to-day conduct of the business, and whether his method agreed or disagreed with his competitors was of no concern to him whatever.

According to the best information I have, public or widespread ownership of stock in companies did not become important in the American business scheme until the turn of the present century. In fact, it probably was not too important until after World War I. And it was not until widespread ownership in corporations became important that attention was given to formulating a body of accounting principles or accounting standards. Before the turn of the century, there certainly was little or no accounting literature on the subject.

WORK OF COMMITTEE ON ACCOUNTING PROCEDURE

At the request of the Federal Trade Commission, the American Institute of Certified Public Accountants (which I shall refer to hereinafter as the American Institute) in 1917 prepared a booklet, rather condensed in form, dealing with uniformity in balance sheets, and the Federal Reserve Board published this booklet under the title "Uniform Accounting – A Tentative Proposal Submitted by the Federal Reserve Board." This was widely disseminated and was, I believe, the first material published on the subject. It was followed in 1929 by another publication, also by the Federal Reserve Board, called "Verification of Financial Statements." By this time it was recognized by many accountants, by the New York Stock Exchange, and by business men themselves, that if financial statements were to be meaningful to stockholders, there should be some uniformity in the underlying accounting principles. Accordingly, a special committee was set up by the American Institute of Accountants in 1932 to work with the New York Stock Exchange on the matter, and shortly thereafter the Exchange promulgated certain principles of accounting, which are now regarded as an important first step in establishing a body of generally accepted accounting principles. The American Institute formally approved the principles put forward by the Stock Exchange and in 1934 so advised its members. This was the first formal pronouncement on this subject by the American Insti-

tute and is also regarded as a very important step in establishing uniform accounting principles. There were six accounting principles concerned which it might be of interest to briefly summarize:

- Unrealized profits should not be credited to income.
- Capital surplus, however created, should not be used to relieve the income account of proper charges thereagainst in future years.
- Earned surplus of a subsidiary earned prior to its acquisition does not form a part of consolidated earned surplus.
- Dividends on its own stock held in the Treasury should not be entered as income of a corporation.
- Receivables from officers, employees, or affiliated companies should be shown separately in the balance sheet.
- In the case of capital stock issued for property, some of which is immediately donated back to the corporation, the par or stated value of the shares so donated should not be considered as cost of the property.

INFLUENCE OF SEC

The foregoing study was made in the depression days following the market crash of 1929. As might be expected when people suffer from their own folly, they try to find someone to blame. Investors who were hurt by the stock market crash raised a great hue and cry about the inadequacy in general of stockholder reports, and in particular, about the lack of proper financial data. What influence this had on our Congress, I do not know, but in any event, two securities regulatory bills were enacted, the first being called the Securities Act of 1933 and the second being called the Securities Exchange Act of 1934. Other parts of your program will supply you with information about these laws, and about the agency created for their administration, namely, the Securities and Exchange Commission. In fact, I see from the program and itinerary that you will be visiting the Securities and Exchange Commission in Washington.

Therefore, I shall merely mention at this time that these laws and the Securities and Exchange Commission (commonly referred to as the SEC) have had a profound impact upon the formation of an acceptable body of accounting principles and standards. The laws themselves require "full and adequate disclosure" of financial data included in reports required to be filed with the Commission, the definition of "full and adequate disclosure" being left to the discretion of that agency. Wisely, the SEC sought the advice and assistance of the accounting profession – that is, the practicing certified public accountants, the accounting teachers, and accountants in

the employment of industry – in formulating rules and regulations governing financial statements. The SEC refrained from attempting to lay down ironbound and inflexible rules with respect to accounting principles, but left the determination of a system of rules to the accountants themselves, and again I think this was wise. It is true that the staff of the SEC has issued opinions from time to time on accounting matters, but these have been merely opinions, and while the influence of such opinions on accounting procedures has of course been material, they were not in the nature of an edict.

WORK OF ACCOUNTING RESEARCH COMMITTEE

I mentioned earlier the work of a special committee of the American Institute cooperating with the New York Stock Exchange culminating in the statement of six broad principles of accounting. This committee was the forerunner of a standing committee created by the American Institute in 1938 to develop a program of research on accounting matters and to issue suggestions for the proper treatment in financial statements of any matter on which there did not appear to be uniformity of opinion in the accounting profession.

This committee was called the Committee on Accounting Procedure and is still in existence and, I might add, is still doing an excellent job in establishing standards and in bringing uniformity in financial reporting. Commencing in 1939, the committee from time to time has issued its views on accounting matters, the documents being called Accounting Research Bulletins. To date, 48 such Bulletins have been issued, the first 42 of which were revised, codified, and reissued as Accounting Research Bulletin No. 43. I understand that the committee has several controversial subjects under study at the present time and that we can expect additional Bulletins in the near future.

I believe everyone will agree that the work of this Accounting Research Committee and the Accounting Research Bulletins issued by it have done more to establish the body of generally accepted accounting principles in the United States than anything else. The interesting thing about this accomplishment is that the American Institute of Certified Public Accountants is of course a voluntary association of professional accountants without authority to pass or enforce laws. This also applies to its committees. However, it would be difficult for anyone to dismiss lightly the views of the committee on accounting procedure. This committee consists of twenty-one members drawn from the public accounting profession and from the accounting teaching profession, all of whom are considered to be outstand-

ing men. In addition to having passed the scrutiny of the committee, before an Accounting Research Bulletin is issued it is submitted in draft form to the staff of the SEC and to the New York Stock Exchange, to the state societies of Certified Public Accountants, the Controllers Institute of America, the American Accounting Association, the National Association of Accountants, The Edison Electric Institute, the Robert Morris Associates, and others. Furthermore, it is usual for the members of the committee to submit copies of the drafts to the partners of their own firms for discussion and suggestions. Thus it can be seen that when an Accounting Research Bulletin is finally issued, it carries great weight. As a footnote to each Bulletin, the committee has this to say:

> "Accounting Research Bulletins represent the considered opinion of at least two-thirds of the members of the committee on accounting procedure, reached on a formal vote after examination of the subject matter by the committee and the research department. Except in cases in which formal adoption by the Institute membership has been asked and secured, the authority of the bulletins rests upon the general acceptability of opinions so reached.
>
> "Opinions of the committee are not intended to be retroactive unless they contain a statement of such intention. They should not be considered applicable to the accounting for transactions arising prior to the publication of the opinions. However, the committee does not wish to discourage the revision of past accounts in an individual case if the accountant thinks it desirable in the circumstances. Opinions of the committee should be considered as applicable only to items which are material and significant in the relative circumstances.
>
> "It is recognized also that any general rules may be subject to exception; it is felt, however that the burden of justifying departure from accepted procedures must be assumed by those who adopt other treatment. Except where there is a specific statement of a different intent by the committee, its opinions and recommendations are directed primarily to business enterprises organized for profit."

BUILDING THE PRINCIPLES

In summary, then, the body of generally accepted accounting principles, or standards if you prefer, have been built up over the past twenty-five years by (1) the impact of the thinking and pronouncements of the American Institute's committee on accounting procedure, (2) the influence of the Securities and Exchange Commission, and (3) the practices and

procedures adopted by business itself and in use long before the Securities and Exchange Commission was created. It might be mentioned also that during these twenty-five years a considerable volume of literature on the subject has been published.

SOME GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

Merely as an illustration rather than as an attempt at detailed discussion of technical aspects thereof, perhaps at this point a few so-called generally accepted accounting principles might be mentioned and briefly discussed. I have already mentioned the accepted practice of recording property at cost and of depreciating such cost by systematic charges to income over the useful life of the property. I have also mentioned six broad general principles of accounting promulgated by the New York Stock Exchange and the American Institute in the early 1930's. Others which I should like to mention briefly are:

INVENTORIES

The term "inventories" in United States accounting terminology means stocks of goods owned, whether finished products ready for resale or raw materials and goods in process. Acceptable accounting requires that inventories must be compiled periodically and recorded in the accounts. In compiling the inventories, the basic pricing procedure is to price the inventory at cost, although the goods should be valued at market when there is evidence that amounts to be realized upon sale or other disposition of such goods will be less than cost.

Cost generally is defined as the price paid or consideration given to acquire an asset. As applied to inventories, cost means the sum of expenditures and charges in bringing an article into proper condition and location for sale or use. Market value is defined as the net realizable value of the goods. The problems met in determining cost for most industries are many and quite complicated, but time will not permit discussion of them this morning.

Rarely is it permissible to value inventories above cost, and it is never permissible to value them below market when market is lower than cost. Gold and silver, when there is an effective government-controlled market at a fixed monetary value, is an illustration of an inventory item that may properly be valued above cost.

It is also generally accepted accounting that the basis of valuation of inventories should be shown in the balance sheet.

INTANGIBLE ASSETS

By intangible assets we mean generally such items as patents, copy rights, leases, licenses, subscription lists, franchises, trade names, goodwill etc. In the early days of accounting in America, it was regarded as proper in fact good accounting, to eliminate intangible assets from the financia statements completely or to reduce them to a nominal value, usually one dollar. However, this concept has changed in the past few years, and it is generally accepted procedure now to show such assets in the accounts at cost, and to amortize such cost or otherwise dispose of such cost in accordance with the particular circumstances in each case. The change in thinking is the result of the conclusion of most accountants that an income-producing intangible asset of limited existence should be amortized, and its cost ratably charged against the income it produces.

For accounting purposes, therefore, intangible assets are divided into two classes: (a) those having a limited existence under law or regulations or by their nature and (b) those having no such limited existence. As already indicated, those having limited existence are amortized by systematic charges in the income account over the income-producing period. As to those intangibles not having a limited period of income production, they should be carried in the accounts at cost. Should some event occur which would change the situation with respect to an intangible that originally had no limited existence so that its existence and usefulness did in fact become limited, then this intangible should either be amortized over its remaining useful life or be charged to earned surplus as the circumstances require.

CONTINGENCY RESERVES

Generally the two types of contingency reserves with respect to which pronouncements on generally accepted accounting principles have been made are (a) general contingency reserves whose purposes are not specific and (b) reserves designed to set aside a part of current profits to absorb losses feared or expected in connection with inventories on hand or future purchases of inventory.

It is now generally regarded as improper accounting to provide reserves for general undetermined contingencies by charges to income. Also, generally accepted accounting would regard as improper the creation of a reserve for indefinite possible future losses such as, for example, losses on inventory not on hand or contracted for. In the same category would be reserves provided for the purpose of reducing inventories to a basis which is not in accordance with generally accepted accounting principles, or to provide for any specific loss not reasonably related to the current operations

of the period or in amounts not determined on the basis of any reasonable estimate of costs or losses.

It is also now generally accepted accounting practice that should any reserve of the type just mentioned be created, it should be shown in the balance sheet as a segregation or appropriation of earned surplus. Also, no cost or loss should be charged to such reserves and no part of such reserves should be transferred to income or be used in any way in determining income for any year. Such reserves should be restored to earned surplus when they are considered no longer necessary.

The essence of the foregoing discussion is that under generally accepted accounting principles in the United States today, it is deemed improper to use so called "hidden or secret reserves." The consensus is that the stockholders and other interested readers of financial statements should be informed of the true facts regarding the operations of the company, so that such reader knows when the company has good years, bad years, or average years. We strongly believe that hidden reserves should not be provided in a good year and used to bolster up the income in a lean year. In other words, any reserve that has solely as its purpose the leveling of income as between years is no longer regarded as acceptable accounting in the United States.

STOCK DIVIDENDS

A discussion of stock dividends falls naturally into two parts, namely, (1) the recipient of the dividend and (2) the issuer of the dividend. The problems of the recipient of the dividend will be considered first.

The question of whether a stock dividend constitutes income to the recipient is a matter that was extensively debated a few years ago. However, it is now generally recognized as improper to regard a stock dividend as income. This was recognized for federal income tax purposes in a famous decision of the United States Supreme Court in Eisner vs. Macomber. I am sure the reasoning of the Supreme Court in this decision helped to decide this matter for the accounting profession. Mr. Justice Pitney in the Court's decision had the following to say:

> "A stock dividend really takes nothing from the property of the corporation and adds nothing to the interests of the stockholders. Its property is not diminished and their interests are not increased . . . the proportional interest of each shareholder remains the same. The only change is in the evidence which represents that interest, the new shares and the original shares together representing the same

proportional interests that the original shares represented before the issue of the new ones."

Accounting problems for the issuer of a stock dividend are rather technical and therefore will be merely mentioned as a matter of interest. First it must be determined whether a true stock dividend is concerned or whether in fact there has been a stock split-up. If it is a stock dividend, it is accepted accounting practice to transfer from the earned surplus of the corporation to its permanent capital an amount approximately equivalent to the market value of the shares issued. There is no such requirement for a stock split-up.

INCOME TAXES

It might seem strange that there would be any difficulty in accounting for income taxes, but believe it or not, there have been few matters that have been the subject of more debate. Again, this is a rather complicated matter and I shall not attempt to go into all of the related technical accounting details. The problem arises from the belief that the income statement of a corporation should be drawn up in such a way as to give the reader the best information possible on the normal operating results for any particular year, and year by year; it also arises partly from the fact that there are expenses and losses properly deductible in determining income taxes, but not properly chargeable to income in determining normal operating results for a year. As a simple illustration, assume a corporation has normal net income for a year of $1,000,000 before taxes and $500,000 after taxes. It decides to sell one of its plants, and sustains a loss on such sale of $1,000,000. Under present accounting practice, this $1,000,000 loss would be charged directly to earned surplus. The loss, however, would be properly deductible in determining taxable income, so under the assumed circumstances, there would be no taxes payable. One school of thought contends that the corporation would show net income of $1,000,000 since there is no income tax, whereas the other school of thought contends that such a presentation might deceive the reader and that the net income to be shown would be $500,000, with a tax charge in the income account of $500,000 and the offsetting to earned surplus. In this way, the normal operating results will be shown and a proper comparison can be made with other years. This is known as income tax allocation and as long ago as 1944, the committee on accounting procedures of the American Institute issued an Accounting Research Bulletin on this matter recommending that allocation of income taxes under appropriate circumstances be recognized as proper accounting.

While the aforementioned Bulletin did not receive whole-hearted support, it nevertheless has been followed. However, in the past two or three years certain segments of industry — among them the utilities industry — have raised serious objections to the Bulletin, especially with regard to its application where there are differences in the methods of depreciation permitted under the Internal Revenue Code of 1952 and the methods used for ordinary accounting purposes. The committee on accounting procedure of the American Institute has been giving this problem consideration for the past several months, and recently has circulated to interested parties a draft of a proposed revision of the previous Bulletin.

* * * *

I selected the foregoing subject for brief discussion with a specific purpose in mind, which I shall come back to in a few moments. If time permitted, we could discuss many other important accounting principles, for example, account classification, which means that revenues and expenses should be recorded consistently in proper accounts so that captions in financial statements are accurate and meaningful; the general rule that all assets and all liabilities should be shown in the balance sheet; the broad principles underlying the determination of current assets and current liabilities; the principle that reserves should be provided for any assets, such as accounts receivable, the value of which is in doubt; and the principle that surplus funds should be segregated as earned surplus and capital surplus. I might mention one more that is very important, namely, the consistent application of accounting methods and procedures. The purpose of this, of course, is to provide the stockholder and other interested readers each year with financial statements that have been compiled on a uniform basis, so that results year by year can be appropriately compared. Should there be any change in an accounting procedure, such as a change in the method of providing for depreciation, the financial statements should disclose this change and should show the effect on the operating results for the year in which the change was made.

ACCOUNTING PRINCIPLES OBSERVED IN THE UNITED STATES CONTRASTED WITH THOSE OF FOREIGN COUNTRIES

Perhaps it would be of interest now to compare some of the accounting principles observed in the United States with those of other countries of the world. Obviously, time will not permit such a comparison country by country, even if I had detailed information about every country in the

world, which I do not have. The six broad principles that have been briefly discussed, namely, property and related depreciation provisions, inventories, intangible assets, contingency reserves, stock dividends, and income taxes, were selected because it is in these areas that we find the main differences between accounting principles followed in the United States and those practiced in other countries.

I should like to point out a few of the differences:

PROPERTY AND DEPRECIATION

The first item I mentioned was property and related depreciation. You will recall that I stated that the generally accepted procedure in use in the United States today is to record the property at cost and to amortize such cost over the useful life. This treatment is also followed in most countries of the world but in practically all of these countries it is not at all unusual for property to be adjusted to appraised values with the offsetting credit to capital surplus or to capital stock. There are also material variations in many parts of the world in methods of providing for depreciation, amortization, and obsolescence. In many countries such methods do not conform with those generally accepted as being proper in the United States.

A simple illustration is KLM Royal Dutch Airlines, one of the relatively few foreign companies in the past several years to file a Registration Statement with the SEC and to sell securities to American investors. The Prospectus discloses that aircraft and engines are depreciated on a straight-line basis to a residual value of 10 per cent and that during each of the three years following such five-year period, an additional amount of 7.5 per cent of the cost of aircraft and engines is provided. Two things are at variance with United States standards: (1) the indicated life is eight years and in the United States the cost would be amortized to residual value over such eight years of useful life, and (2) in the United States no depreciation would be provided after the asset was depreciated to its residual value.

INVENTORIES

The second item I mentioned was inventories, and I stated that under generally accepted accounting principles, inventories are valued at the lower of cost or market.

There is some variation in the elements of cost as determined in the United States compared with other countries but the major difference in inventory valuation arises from the practice prevalent in many countries of establishing secret reserves through a write-down of inventories. As a

matter of fact, profits are controlled year by year in many countries through the inventory valuation.

INTANGIBLES

The third item I mentioned was intangible assets. I believe the accounting procedures followed in the United States with respect to intangible assets is unique, as I know of no other countries that use the same procedures. Intangible assets generally are written off in other countries, as was done in this country twenty-five years ago, and if they are not written off they are kept in the accounts as an asset without any systematic amortization.

CONTINGENCY RESERVES

Another item I discussed briefly was contingency reserves, and so called "hidden or secret reserves" were included under this caption. With few exceptions, it is considered not only good accounting but good business by accountants in other countries to use reserves to equalize income year by year. I attended the Seventh International Accounting Congress in Amsterdam in early September of this year where some 45 countries were represented. One of the technical sessions was devoted to "Ascertainment of Profit in Business" and we heard some interesting arguments on the propriety of reserves as they related to determination of profit. Most of the countries participating in this particular panel discussion disagreed with the position of the United States.

STOCK DIVIDENDS

Another item I mentioned was stock dividends. It is quite common in many countries to credit stock-dividends received to income, but as I have mentioned, this treatment is not acceptable in this country.

INCOME TAX

Finally, I mentioned income taxes. I believe that in many countries no attempt is made to allocate income taxes. In such cases, the income statements reflect the income taxes to be paid regardless of whether such taxes are normal or abnormal, measured against the normal operating results for the year.

SEC REQUIREMENTS

Before discussing with you some of the problems in the accounting and financial fields of international finance, I should like to mention briefly some requirements of the SEC as to certification of financial state-

ments by accountants and requirements with respect to such certifying accountants.

When the Securities and Exchange Commission was created, one of its first tasks was to establish regulations regarding financial statements. There have been changes, of course, from time to time since the first regulations were promulgated. At the present time the Commission's Regulation S-X governs the form and contents of financial statements. I assume that the form and content of financial statements will be discussed in your conference this afternoon but I would like to point out one or two things in Regulation S-X that are directly related to the subject we are discussing this morning. The Securities Act of 1933 and the Securities Exchange Act of 1934 both require that financial statements included in reports to be filed with the SEC must be accompanied by the opinion of an independent certified public accountant, or public accountant. Regulation S-X provides that the accountants' opinion shall state clearly:

> "(1) the opinion of the accountant in respect to the financial statements covered by the certificate and the accounting principles and practices reflected therein; (2) the opinion of the accountant as to any material changes in accounting principles or practices or method of applying the accounting principles or practices, or adjustments of the accounts, required to be set forth by rule 3.07; and (3) the nature of, and the opinion of the accountant as to, any material differences between the accounting principles and practices reflected in the financial statements and those reflected in the accounts after the entry of adjustments for the period under review."

You will observe that the accountant is required to give his opinion not only as to the financial statements but as to the accounting principles and practices reflected therein and he must also state that such accounting principles and practices have been consistently applied.

Rule 2.01 of Regulation S-X relates to the qualifications of accountants. It reads as follows:

> "The Commission will not recognize any person as a certified public accountant who is not duly registered and in good standing as such under the laws of the place of his residence or principal office. The Commission will not recognize any person as a public accountant who is not in good standing and entitled to practice as such under the laws of the place of his residence or principal office.

"The Commission will not recognize any certified public accountant or public accountant as independent who is not in fact independent. For example, an accountant will not be considered independent with respect to any person, or any affiliate thereof, in whom he has any financial interest, direct or indirect, or with whom he is, or was during the period of report, connected as a promoter, underwriter, voting trustee, director, officer, or employee.

"In determining whether an accountant is in fact independent with respect to a particular registrant, the Commission will give appropriate consideration to all relevant circumstances including evidence bearing on all relationships between the accountant and that registrant or any affiliate thereof, and will not confine itself to the relationships existing in connection with the filing of reports with the Commission."

PROBLEMS OF INTERNATIONAL FINANCE

Up to now, and very briefly, I have outlined something of the background of the development of accounting principles in America; I have discussed a few such principles and indicated some areas of differences in these as followed in the United States and other countries; and I have referred to some requirements of the SEC as to qualifications of accountants certifying financial statements filed with the SEC as to form and content of the accounts' certification. With this as a background, I should now like to discuss briefly one or two problems encountered by foreign companies in obtaining funds in the United States. I will discuss only the raising of funds from the American investing public which would mean a filing with the SEC.

First of all, I should like to mention that I know of no one in disagreement with the idea of encouraging the flow of private American capital abroad. Our present Federal Administration has made it clear that this is preferable to our program of government aid to foreign countries, and certainly the American taxpayer, who foots the bill for foreign aid, would prefer it. I feel sure also that the foreign countries concerned would prefer it. There are, however, problems met with in so doing, the main ones relating to the form and content of financial statements and the certification by independent public accountants. The SEC has found no way to legally or morally relax its requirements and some foreign companies seeking to register securities have been unable or unwilling to meet such requirements.

I heard of one case recently in which a German company apparently met all other requirements, but could not list its securities because it refused to disclose its sales and cost of sales. Then there was the case of one foreign company which sought to list its securities on a national stock exchange, but could not do so because the independent accountant certifying the financial statements did not meet the SEC's standards of independence.

Although the SEC has clearly indicated that its requirements cannot be completely relaxed, the Commission on the other hand has shown willingness to do whatever is reasonably possible in any particular situation. I mentioned a Registration Statement filed by KLM Royal Dutch Airlines, and an accounting practice by KLM that was at variance with American standards. There apparently were other differences in procedures, but they were not material. This Registration Statement became effective and common stock of KLM was sold to American investors. How was this done? The SEC required that certain supplementary financial data be included in the summary of earnings so that the per share earnings computed in accordance with American standards were shown as well as the per share earnings as computed under the company's regular accounting procedures. The accountant in certifying the financial statements included the following comment in his certificate:

> "While there are certain differences between the accounting principles followed by the Company and those generally accepted in the United States of America, application of the latter, in our opinion, would not have materially affected the determination of net earnings except that "extra depreciation" on aircraft and engines would not have been deducted, as indicated in the Consolidated Summary of Earnings (in United States dollars). Limitation of the depreciation on aircraft and engines to the basis of historical cost in accordance with generally accepted accounting principles in the United States would have required the adjustment shown under "Additional Statement for United States Prospectus" in the Consolidated Summary of Earnings (in United States dollars)."

In addition to KLM, there have been a few other foreign companies that have filed Registration Statements and sold securities in the past few years. Obviously, however, the present situation is not satisfactory from the viewpoint of the SEC or anyone else. What can be done about it? The ideal solution of course would be to establish throughout the world uniform accounting principles and auditing procedures (I have not heretofore commented on auditing procedures but there also exist material differences in

generally accepted auditing procedures in the United States and many other countries) as well as some uniformity in professional standards of the independent accountants required to certify financial statements. I am afraid, however, that attainment of any such ideal is a long way in the future. It is encouraging, however, that serious consideration is being given at the present time to this matter. The SEC, the New York Stock Exchange, the International Chamber of Commerce and others are alert to the problem and stand ready to lend assistance whenever possible. World accounting forums, such as the Seventh International Accounting Congress which I referred to earlier, and the Fourth Inter-American Accounting Conference to be held in Chile commencing on November 15, are helpful. A committee of the American Institute called the Foreign Affairs Committee has had this matter under consideration for more than a year. Nevertheless, there is much to be done before the ideal solution is found.

In the meantime, it is necessary to deal with the matter from a practical viewpoint. Any foreign company wishing to sell securities to the American public must first of all decide to comply with the SEC's rules and regulations regarding form and content of financial statements; and in case its accountants are not independent, then the services of accountants who are independent must be obtained. Generally it is advisable in any event to obtain accounting experts who are familiar with the SEC requirements. It has been difficult for accountants in the United States to keep abreast of these requirements even though they work with related problems constantly; It certainly would be unreasonable under the circumstances to expect accountants in foreign countries to do so.

CONCLUSION

Finally, I would like to suggest to you that you do everything possible to encourage the development of the accounting profession in your countries. I can assure you that we in the United States stand ready to help in any way we can.