ACCOUNTING AND AUDITING PREPARATION FOR A PUBLIC OFFERING OF SECURITIES

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"The Rush to 'Go Public'" is the title used by a New York writer[1/] on Accounting and the SEC to describe the deluge of public offerings of securities which has been the experience of the Securities and Exchange Commission for the last two years. A few figures will provide an appropriate background for a discussion of accounting and auditing problems encountered in preparing for a public offering of securities.[2/]

In the fiscal year ended June 30, 1951, securities totalling 6.4 billion dollars were registered on 544 filings, of which 22 percent were by companies without previous experience. The total number of filings and dollar amounts varied in the next ten years from a low of 621 filings for 7.4 billion dollars in 1953, when 23 percent were by companies registering for the first time, to a record high last year of 1830 filings for 20.7 billion dollars including 52 percent for the first time. Current filings are at a still higher rate in number and percent of new filings but not in dollars. The record for the last six years reveals the significant change in the average size of the issues in this short period:[3/]

1/ Louis H. Rappaport in The New York Certified Public Accountant, May 1960.

2/ The Securities and Exchange Commission, as a matter of policy, disclaims responsibility for any private publication by any of its employees. The views expressed herein are those of the author and do not necessarily reflect the views of the Commission or of the author's colleagues on the staff of the Commission.

3/ See Securities Act of 1933 Release No. 4385, July 6, 1961, and the Commission's Annual Reports to Congress.

Fiscal Year Ended June 30	Number of Filings	Dollar Amount (Billions)	Companies with no Previous Filing
1956	981	$ 13.1	42%
1957	943	14.7	32
1958	913	17.0	28
1959	1226	16.6	39
1960	1628	15.8	47
1961	1830	20.7	52

Many of these registrants were "going public" for the first time; others may have sold securities under an exemption or may have had securities traded over-the-counter for many years. Some accounting and auditing problems are common to all of these situations.

These figures reflect both voluntary compliance with the Act and registrations accomplished after various warning procedures available to the Commission. Headquarters and regional office personnel are alert to detect both inadvertent and intentional evasion of the registration provisions.4/ Companies previously registered with the Commission and subject to the reporting requirements of the Securities Exchange Act of 1934 may report the issuance of securities under a claimed exemption which upon review the staff may not agree is available.5/ In other cases failure to register may be due to ignorance of the law or due to intent to evade. When legal action is necessary to enforce compliance with the registration provisions or to prevent fraud in the sale of securities which may be exempt from registration, the action taken is reported in a litigation release. For example, a recent release reported that

4/ See Secs. 5 and 17 of the Securities Act of 1933.

5/ See Secs. 3 and 4 of the Securities Act of 1933.

defendants had consented to a permanent injunction sought by a regional office in a case in which the corporation since 1955 had issued 1,750,000 shares of common stock to the president of the corporation and other persons and subsequent distribution of the stock to the public resulted in a wide-scale public trading market without any registration statement being in effect.[6/] This is not the right way to "go public." Examples of this kind suggest the need for competent legal advice before the launching of a do-it-yourself program for the sale of securities.[7/]

Let us assume that the decision has been made to "go public." Some of the considerations leading to this decision include the need to establish a market valuation of securities for estate planning purposes, mergers, and restricted stock options to employees; a desire to diversify investments; to establish a basis for future financing; and in consumer industries to promote sales. The last point may be expressed in terms of continued growth, improved public relations and prestige. Several of these reasons are often given in response to requests by the Commission's staff for information as to why owners of close corporations desire to sell part of their holdings.

There are, however, some aspects of "going public" which the owners of close corporations may believe to be serious disadvantages whether they actually prove to be or not. The initial filing must disclose much information about the company which the management previously considered

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6/ Litigation Release No. 2090, August 25, 1961.

7/ See Securities Act of 1933, Release No. 4386, July 12, 1961, for a discussion of the "intrastate" exemption (Sec. 3(a)(11)).

highly confidential and, if disclosed, believed to be damaging to the company or to the morale of officers and employees. These disclosures include total sales; the relative importance of major product lines, or services; cost of sales; foreign operations; remuneration of directors and officers; options for the purchase of securities; principal holders of securities; and the interest of management, certain security holders and associates of these in certain transactions.[8/] In the past dividend payments may have been sporadic or none at all. Except for the promotional company this usually means the adoption of a policy of regular dividend payments.

Inviting the public to join in the ownership of common stock requires a reexamination of public relations policies. The stockholders' meeting then becomes a public affair. This is particularly true if the company follows the public offering of securities by a listing on a stock exchange which requires the solicitation of proxies. This may also lead to a challenge for control of the management of the company. Listing on an exchange also invokes the requirement of reporting insider trading in the company's securities.[9/] If the company does not list on an exchange it may nevertheless become subject to the reporting requirements of the 1934 Act.[10/] For companies incurring an obligation under this Act the Commission, soon after the completion of the registration process, sends a letter to the registrant listing the reporting requirements. These

8/ See Form S-1 and other registration forms.

9/ Securities Exchange Act of 1934, Sec. 16.

10/ Sec. 15(d).

include annual reports on Form 10-K, mid-year reports of profit and loss and earned surplus on Form 9-K, and periodic reports of significant events on Form 8-K. It is also the Commission's practice today to require a new company to state in the prospectus its intention as to publication of reports to stockholders containing certified financial statements. Seeking public funds carries with it a responsibility of management to report on its stewardship of those funds.

The securities acts are disclosure statutes and the Commission's rules recognize that a timely report to stockholders can serve a useful purpose in this connection.[11/] An example of the irresponsibility with which the Commission must contend at times is found in a short concluding paragraph in an opinion supporting an order that the registration of common stock on an exchange should be withdrawn. The Commission said that the record in the case abundantly documents the company's "* * * disregard for its obligations under the Act to disclose pertinent and accurate information concerning its condition and affairs to existing and potential investors. Cornucopia's annual report not only concealed the truth but contained information which was materially false; Cornucopia failed to file required reports; and it filed preliminary copies of proxy soliciting material pursuant to Section 14(a) of the Act and Regulation 14 thereunder which were false and misleading in numerous

11/ See Rule 14a-3, Information to be Furnished Security Holders (Reg. 14, Securities Exchange Act of 1934); authority to incorporate by reference in Forms S-8, 9-K and 10-K.

respects."[12/] The lesson here is that a company should not go public unless its management intends to assume the obligations that the action entails.

Preparation for registration is a team effort which has been the subject of briefing conferences, speeches and articles in professional journals. Accountants, lawyers and underwriters' representatives have participated in these activities. Financial printers also have had a special interest in the subject. It may not be out of order to inject at this point that well prepared material puts the examiner in a good frame of mind at the start of the review. Illegible carbon copies of financial data will strain the patience of the most dedicated public servant.

A first registration is not a spur-of-the-moment matter. What has been said should suggest that a first step is to learn something of the rules of the game--get acquainted with the applicable laws, rules, forms, and accounting requirements. Under the Securities Act, of particular importance to accountants (both company staff and outside auditor) are Sec. 7, Information Required in Registration Statement; Sec. 10, Information Required in Prospectus; Sec. 11, Civil Liabilities on Account of False Registration Statement; Sec. 19, Special Powers of Commission--

12/ In the Matter of Cornucopia Gold Mines, Securities Act Release No. 6339, August 11, 1960. See also Litigation Release No. 2078, August 11, 1961, for report of disposition of certain criminal aspects associated with the case. This was an attempt to reactivate a company which had been the subject of a stop order opinion in 1936 (1 SEC 364) which opinion is a leading case on the independence of accountants.

especially that portion which says that the Commission shall have authority to make, amend, and rescind rules and regulations governing registration statements and prospectuses for various classes of securities and issuers, and defining accounting, technical, and trade terms used in the Act; and Schedule A--particularly items (25) and (26) which prescribe the balance sheets and profit and loss statements to be included in the registration statement.

The "first time" registrant may be a small company such as a recent one established in a southern state a few years ago which was the successor to a family-owned business established in Massachusetts in 1880. This company offered less than $300,000 in common stock, and the balance sheet in the prospectus showed total assets of very little more than this. At the other end of the line the first Ford prospectus in 1956 reported total assets of almost $2,500,000,000. And then there are the foreign corporations of which KLM Royal Dutch Airlines may serve as an example. The first filing in 1957 was for 400,630 common shares. The first paragraph under a caption "Purpose of Offering" in KLM's prospectus said:

> "The Company, for the first time since 1927, is offering shares of its capital stock for sale to the public. Since World War II there have been a few isolated transfers by private holders of KLM's stock, but the shares have not been publicly traded. The Company is of the opinion that the sale to private investors of the shares offered hereby and the creation of a broad public market in the United States as well as in The Netherlands will serve the Company's best interests. Giving effect to the sale of the shares covered hereby, 28.3% of the Company's outstanding capital stock will be held by the public."

Examination of the prospectuses reveals that each of these registrants had problems to solve in connection with its filing. The small company's certified public accountant disclosed in his certificate that verification of inventories had caused trouble. The Netherlands accountants had to recast and reconcile their client's accounts to concepts prevailing in the United States. A paragraph on page 3 of the Ford prospectus says "In 1945 Henry Ford's grandson, Henry Ford II, became President of the Company. Since early 1946, new personnel has been brought in, management has been decentralized and a major program of expansion and modernization has been undertaken. Results of operations from 1946 are shown in SUMMARY OF EARNINGS." The financial statements were certified beginning with the year 1946. The answer in Part II of the registration statement to the item regarding experts reveals that the independence of the English accountants with respect to the English subsidiary had to be resolved prior to registration.

The matter of independence of the certifying accountants is of prime importance. Items (25) and (26) of Schedule A prescribe that the balance sheet within ninety days of filing or of a date not more than a year prior thereto and profit and loss statements for three years be certified by "an independent public or certified public accountant." This requirement forced the Federal Trade Commission, initially, and thereafter the SEC to develop a definition of independence. 13/

13/ See Barr, "The Independent Accountant and the SEC," Journal of Accountancy, October 1959.

Interpreting the rules 14/ on this subject is a continuing duty of the Chief Accountant of the Commission. By requiring certification by independent accountants Congress recognized the need for an objective review of the financial statements by qualified persons not a part of management.

The SEC rules prohibit any direct financial interest or any material indirect financial interest in the client, its parents and subsidiaries, and forbids association as promoter, underwriter, voting trustee, director, officer, or employee. Another portion of the rule provides that appropriate consideration may be given to all relevant circumstances of other relationships. The number of questions raised under the rules emphasizes the need for constant reminder of their existence. If the revision of its rules proposed by the American Institute of Certified Public Accountants is adopted, an important present cause of confusion will be removed.

The financial interest prohibition seems fairly clear, yet only recently partners of a firm of accountants which held shares received in payment of prior years' fees wished to certify financial statements for use in a registration statement for the sale of shares of principal stockholders. Although a minor portion of the total registered for sale, all of the accountants' shares were included. Accountants are named as executors in wills of principal officers and owners of client corporations, or as trustees for minor children of such persons. It seems clear that

14/ Regulation S-X, Rule 2-01, and Accounting Series Release No. 81.

a conflict of interests can arise in these situations. The accountant may be more concerned with the welfare of all of these persons than he is for the public investor who is currently being offered an opportunity to buy the shares at inflated prices. This situation brings to mind a standard inquiry made of selling stockholders by the Commission's Division of Corporation Finance:

> "As supplemental information and not as part of the registration statement, it is requested that the selling stockholders advise this Division of the reasons for the proposed sale of their securities and whether any facts or conditions are known to them which might adversely affect the registrant or its business (other than any which are fully disclosed in the registration statement)."

These relationships are so close in some cases as to resemble the family problem. It is impossible to cover all of the variations of family complications, some of which do not raise questions of independence but others clearly do, as in the case of the accountant whose wife is the only daughter of the owner of the client company.

Another disqualifying situation which the present deluge of small company registrations is bringing to light is the common practice of such companies to have their so-called independent accountants keep the private ledger. A situation of this kind is described in "Budgeting for Profit in Small Business," the second in the series on Management Services by CPAs published by the American Institute of Certified Public Accountants. Here the owner of the business with the assistance of his CPA maintained a private ledger which contained records of a private bank account, executive payroll, pensions, fixed assets and depreciation, capital and surplus, tax and some others. By this means over-all financial operations were kept secret from employees. Elsewhere in the same bulletin the "independent CPA" is designated the "captain" of the budget team. Another of this series of bulletins says that a CPA may "function as a public treasurer to small business managements." 15/

Conferences in connection with current filings with the Commission reveal the need for improvement in record keeping and accounting controls in small businesses--even in some of substantial size and extensive operations. Accountants who get as deeply involved as these references imply would appear to be serving as controllers or chief accountants and therefore to have abandoned the role of independent accountant for these clients. The need for management services, particularly for small business, is great and such work is an accounting function, but "care should be taken to maintain a clear distinction between the giving of advice to management and the making of decisions for management." 16/ John L. Carey issued a similar warning in the first of this series of bulletins. 17/ Robert M. Trueblood tackled this problem in his discussion of "The Management Service Function in Public Accounting." An observation pertinent here is:

> "The management service consultant typically does not, and should not, place himself in the position of substituting his judgment for that of management. The management service consultant properly is in the position of providing and

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15/ Number 3, Financing the Small Business, p. 8.

16/ Barr, "Comments on Financial Statements Filed With the SEC," The New York Certified Public Accountant, October 1957, p. 689.

17/ Management Services by CPAs 1, p. 6.

> analyzing data relative to alternative choices, or in outlining the underlying structure of a decision which is to be made. Accepting or rejecting the consultant's recommendations is, of itself, a management responsibility. The situation is similar to publication of financial statements, following discussion with the auditor; the financial statements are nonetheless management's representation to the public." 18/

The Commission's leading case bearing on this subject is that of Interstate Hosiery Mills, Inc. 19/ This was a strange case but it served to emphasize two points important today, that the independent accountant should not keep the books he is to audit and that "The fundamental and primary responsibility for the accuracy of information filed with the Commission and disseminated among the investors rests upon management. Management does not discharge its obligations in this respect by the employment of independent public accountants, however reputable. Accountants' certificates are required not as a substitute for management's accounting of its stewardship, but as a check upon that accounting. * * *" 20/

Cases recently before the Commission suggest a look back to the McKesson affair in which a program for appointment of auditors was suggested followed by a concluding comment:

18/ The Journal of Accountancy, July 1961, p. 42.

19/ 4 SEC 706.

20/ 4 SEC 706, 721. The passage continues: "In our opinion, the conduct of Interstate's management in respect of information which was to be the basis of reports submitted to stockholders and to the New York Curb Exchange and the Commission indicated a complete abdication of responsibility. They brought to bear upon the figures presented by their auditors no judgment of their own, no test from their independent acquaintance with the company's affairs, none of the purposeful skepticism which every author of a public financial statement should direct at his material."

"In approaching his work with respect to companies which file with us or in which there is a large public interest, the auditor must realize that, regardless of what his position and obligations might have been when reporting to managers or to owner-managers, he must now recognize fully his responsibility. to public investors by including the activities of the management itself within the scope of his work and by reporting thereon to investors. * * *" 21/

Collusive fraud, bad bookkeeping, inadequate and destroyed records are recurring problems for the independent accountant. Cases of discovery too late claim the headlines as well as much staff time to make the necessary record to assist the Department of Justice to convict the responsible parties. An example of this is the registration statement filed June 28, 1954, effective July 22, 1954, under which 200,000 shares of common stock were sold for cash shortly thereafter. About a month later the statement was amended with respect to the offering price of warrants still outstanding. This registration statement included unaudited figures for an interim period of six months ended March 31, 1954, which revealed a small profit and as to which the management expressed the opinion that the results for this period were prepared on a basis consistent with the previous five years which were certified and that all adjustments necessary to a fair statement for the six months were included. This representation, which is intended to emphasize the responsibilities of management, has been a requirement for some time. That something might be wrong with these interim figures came to light when the company published an annual report and filed its report on Form 10-K in which a substantial loss for the year was reported.

21/ Accounting Series Releases (1956 ed.), No. 19 at p. 30.

Private investigations followed by public hearings resulted in a Commission decision finding that the registration statement was false and misleading in its representations as to earnings, adjustments and inventories and was deficient in that it failed to disclose large operating losses after the mid-year and before the effective date of the registration statement. This opinion was published January 18, 1957.[22/] Criminal proceedings against the former president of the company for violations of the Securities Act of 1933 resulted in a conviction in United States District Court which, on appeal, was sustained on September 7, 1960.[23/] This case involved deliberate falsification of records, failure to provide for indicated losses on contracts, dubious deferred charges and false representations by management. Such cases, though few in number, indicate the serious responsibility which devolves on management for unaudited financial statements.

Planning for a public offering should begin, if possible, several years before it is expected that the event will take place. With proper planning, audits without limitation as to scope can be carried out yearly and many of the complications of a first audit or a first engagement for which an unqualified certificate is necessary may be avoided.

Certified financial statements as described earlier are required. A fairly typical situation involving inventories is described in the scope paragraph of an accountant's opinion:

22/ In the Matter of Ultrasonic Corporation, 37 SEC 497 (1957).

23/ Danser v. U. S. (C.A. 1, September 1960).

"Our examination of the statements was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. Inasmuch as we were not appointed the independent accountants until after December 31, 1960 we were unable to observe the physical inventory for that or any prior year. We did satisfy ourselves as to the reasonableness of the inventory amounts by other auditing procedures including (1) observation of physical inventories and extensive test counts as at June 30, 1961 and comparison of such inventory quantities with quantities at the end of 1960 by use of purchase, production and sales records (2) customary auditing procedures with respect to pricing and summarization of physical inventories at the end of 1958, 1959 and 1960 and (3) review of gross profit ratios. In order to establish the reasonableness of the December 31, 1957 inventories, we had to rely to some extent on estimates. Therefore, our tests were not conclusive in certain particulars, but insofar as our tests extended, nothing came to our attention which in our judgment would indicate that the inventory amount at December 31, 1957 which was used in the computation of the cost of sales for the year ended December 31, 1958 is not reasonably stated."

The public files on a withdrawn filing show that underwriters are not always happy with the results of an audit. The original filing shows the common first-time audit situation of observation of only the most recent inventory. Time passes with delaying amendments, with one reporting a change in auditors who are to do all the required financial statements. A month later the request to withdraw explained that the report of the new auditors did not show adequate earnings to support the financing and the underwriter was unwilling to proceed.

In another case a corporation had acquired another company with a recognized unbalanced inventory--only passage of time would indicate whether a substantial part could be worked out to recover the cost. The filing was delayed to permit accumulation of additional evidence on which the accountants could render an opinion. Situations such as this one should be resolved before filing, as was done here.

If the accountant's exceptions are so material as to negative his opinion, the financial statements obviously will not meet the standards of the Act. Such a certificate turned up recently in which the accountants stated that they were unable to pass on the collectibility of an account receivable from the parent company (an amount in excess of total common stock equity). An opinion was denied as to the income statement because there had been no arm's-length bargaining in fixing selling prices to affiliated companies. The filing was withdrawn.

The case just cited is another example of a condition which should have been cleared up prior to attempting to go public. The files are full of examples in which it is clear that the registrant's advisers--underwriters, legal counsel and accountants--have cooperated in bringing order out of a family chaos of single proprietorships, partnerships and small corporations. If this is not done, the registrant must set forth in the registration statement the continuing opportunities for profit or diversion of assets from the registrant to such affiliates. These may include landlords, owners of leased equipment, finance and insurance operations, owners of patents, contracts for services and so on.

A change of name to add glamour is not an unheard-of preliminary to "going public." A recent registrant described as engaged in the wholesale and retail meat and provision business and in the development of closed circuit television tubes, cameras, electronic components and equipment changed its name less than one month prior to filing to include the word "Missiltronics." All operations reported in the income statements were for the meat and provision business. The new element was represented by a small amount of deferred research and development in the balance sheet. The company's former name was restored in the first amendment.

Sometimes failure to change the name of an old company may be misleading. The Fall River Exploration and Mining Company, the name adopted in a revised prospectus, is the successor to The Fall River Power Company which succeeded in 1910 to the properties of Pennsylvania Mining Company, a Colorado corporation formed in 1869. The revised prospectus said that "This is an exploratory mining venture and no assurance can be given the prospective investor that commercial ore bodies will be discovered," rather than that of a public utility and the operation of the firm's mining properties as represented in the original filing. Important revision of the financial statements was necessary to conform to the real character of the enterprise.[24/]

Recapitalization is often a necessary step in preparing to go public. Close corporations often show a very small paid-in capital evidenced by a few shares of $100 par value and a very substantial accumulation of retained earnings. Also dividend payments may have been irregular or nonexistent.

A note in a recent filing is fairly typical. Two corporations under common control prior to recapitalization had 50 shares of no par value stock outstanding stated at $22,000 and 10,500 shares of $1.00 par value common and 890 shares of $100 par value preferred and combined

24/ *In the Matter of the Fall River Power Company*, 38 SEC 423 (1958).

earned surplus of about $500,000. The common was changed to 800,000 shares of $.25 par value by exchange of shares and transfer of $167,500 from earned surplus to common stock, and the preferred was redeemed prior to the amendment of the certificate of incorporation. A total of 1,500,000 shares of common was authorized. Two selling stockholders are disposing of 160,000 shares priced at $12.00 per share.

A not uncommon feature of a family corporation is the carrying of personal accounts with the owners. This may be a matter to clear up early--at least the parties involved should be made aware of the detail required in schedules of amounts due from directors, officers, and principal holders of equity securities other than affiliates for all periods for which profit and loss statements are filed.

So far problems in the application of accounting principles have received little attention in this discussion. Such problems are the subject of many conferences with the staff and they may become issues of importance in investigative proceedings. The problems are not confined to small companies. One recurring one is the treatment of overhead in inventories. For the independent accountant to give an unqualified opinion on the financial statements he must consider the materiality of the effect on the balance sheet and the income statements of the omission of overhead from inventory pricing. The exclusion of <u>all</u> overhead from inventory costs does not constitute an accepted accounting procedure. 25/ In some cases the effect of omission is not

25/ American Institute of Accountants, Accounting Research Bulletin No. 43, p. 29.

sufficiently material to warrant a change in accounting or in reporting and no exception may be necessary. In other cases the financial statements may be changed with no change in the books. This requires disclosure and appropriate comment in the certificate.[26/]

Cash basis accounting may be followed in some cases for books and income taxes. As in the case of overhead this will require adjustment to the accrual basis with footnote explanation and comment in the certificate somewhat in this manner:

> "In preparing the accompanying financial statements, but not in its books (Note 3), the company adopted the generally accepted accounting principles of including manufacturing overhead as an element of inventory cost (Note 1), and reporting income from rental plan sales (Note 2) on the accrual method of accounting, which we approve."

Such restatements may involve a provision for deferred taxes to the extent that income taxes have been reduced by the differences between tax accounting and financial accounting.

Accounting for research and development is a very difficult matter today. How long should the certifying accountant listen to the optimistic representations of management where he sees little evidence affording a reasonable basis for an assumption that costs will be recovered? Depending on the circumstances, the treatment may vary appropriately from a simple disclosure of the method of accounting employed with no comment in the certificate to a recognition of substantial losses when all hope of recovery is gone. An intermediate position is retention of the deferred items in the balance sheet but with a clear

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26/ Regulation S-X, Rule 2-02(c)(iii).

warning in the certificate that recovery of the incurred costs is dependent upon future developments. This, of course, is true of all business costs incurred and deferred in accordance with accrual basis accounting, but the problem is aggravated today in many new enterprises.

The adoption of a dividend policy was mentioned earlier as an action concurrent with a first filing. The accounting for stock dividends often requires correction because of the use of par values or minimum stated values permitted by statute rather than current fair values recognized by accountants as the appropriate basis for accounting. There is nothing in the Commission's rules on the subject except the requirements of fair disclosure and that under its administrative policy on financial statements 27/ the accounting must have authoritative support. In this situation support for fair value with respect to recurring stock dividends is found in paragraph 10 of Chapter 7 of Accounting Research Bulletin No. 43. Provisions of state laws are recognized in paragraph 14 of this chapter with the conclusion that "these legal requirements are, in effect, minimum requirements and do not prevent capitalization of a larger amount per share." The Commission's Twelfth Annual Report to Congress for the year ended June 30, 1946 describes 28/ an incident of that year in which the Commission supported independent accountants who took an exception in their certificate because of the client's refusal to record the stock dividend at fair value rather than a lower par value. The company filed amendments which permitted the accountants to certify

27/ Accounting Series Release No. 4.

28/ At page 116.

without exception. An opinion on a recent broker-dealer proceeding describes corporate action in shifting from a cash dividend proposed "in order to increase the confidence of stockholders" to a stock dividend when the company's president pointed out that the financial condition would not support a cash payment. The 3% stock dividend was charged to capital surplus because of the insufficiency of earned surplus. As to this the Commission observed that "We have seen that the dividend was urged by /general partners of the underwriters/ with full knowledge that /the company/ did not have sufficient earned surplus against which the dividend could be charged. Its declaration under such circumstances and at the time /the company/ was considering a public offering of its stock is 'characteristic of manipulative schemes.'" (Collins v. U.S., 157 F. 2d 409, 410 (C.A. 9, 1946)) 29/

This is only a small sample of the accounting questions that are raised today in case after case. Tax allocation, long term leases, poolings of interests, pensions, and consolidated statements as well as the basic problem of defining accounting postulates and principles are currently under discussion in accounting circles. With the rapid growth in the number of stockholders in private corporations, clarification of these matters and others is needed.

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29/ In the Matter of Bruns, Nordeman & Company, Securities Exchange Act Release No. 6540, April 16, 1961, p. 5.