

COMMISSION'S EXHIBIT #237-A

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AMERICAN INSTITUTE OF CONSULTING ENGINEERS, INC.
New York

February 25, 1939.

Hon. WILLIAM O. DOUGLAS, *Chairman,*
United States Securities and Exchange Commission,
Washington, D. C.

MY DEAR MR. DOUGLAS: We understand from newspaper reports that the Securities and Exchange Commission has instituted a proceeding and is holding hearings in the course of which the general subject of audit procedure is receiving consideration, with particular attention being given to the auditing of accounts receivable and inventories of materials and supplies, semifinished and finished products.

The American Institute of Consulting Engineers has authorized me to call your attention to the fact that in many types of business corporations the capital investment in plant and property is of greater importance than that in accounts receivable and inventories; and that balance sheet audits by accountants are not ordinarily well adapted, both because of the procedure followed, and because of the experience of the men engaged on the work, to support certification as to the existence, condition, use and usefulness of the property or the adequacy of the reserves provided to record the depreciation existing therein. In fact, certificates based upon such audits are frequently accompanied by qualifications and reservations with respect to the plant and property account and the depreciation reserve accounts.

It is suggested by the American Institute of Consulting Engineers that such audits and certificates could contribute more effectively to the disclosure of complete information and the avoidance of misleading investors and the public if they included engineering audits and engineering certificates by independent consulting engineers as to the existence, condition, use, and usefulness of plant and property and the adequacy of the balances in reserves for depreciation. Even if complete detailed engineering examinations cannot be justified annually because of the cost and time required, it would be possible to supplement existing audit procedure helpfully by annual engineering spot-checks of plant and property accounts and depreciation reserve accounts and by periodic engineering audits and certificates at reasonable intervals of time.

If it would be helpful to your Commission in connection with the proceeding previously referred to, the American Institute of Consulting Engineers will be glad to appoint one or more of its members as a committee to appear before you for the purpose of amplifying these suggestions and to answer any questions relative thereto which the Commission may desire to ask.

Very truly yours,

(Sgd.) DUGALD C. JACKSON,
President.

CC: SEC., 120 Broadway, N. Y. C.

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COMMISSION'S EXHIBIT #237-B

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MEMORANDUM OF THE FUNCTION OF THE ENGINEER IN VERIFICATION OF INVENTORIES AND PROPERTY ACCOUNT

1—INVENTORY

The engineer can contribute to the value of an audit of inventory by co-operation with accountants in the specific items of:

(a) Verification of quantities.

(b) Commercial utility, particularly where condition and grade have a very material effect on value.

(c) Possibly, also, in connection with pricing.

NOTE.—The engineer would not assume responsibility for title to the inventory but should make inquiry of the responsible officers of the company as to the ownership of the goods inventory and the extent to which goods on the company's property may have been purchased and belong to other parties.

2—PROPERTY ACCOUNT

(a) *Fixed assets.*—The engineer may contribute to the value of an audit of the reported item of property account as shown on the balance sheet by a comparison of the actual physical property to which title is claimed with the investment cost as shown by the books, particularly with regard to the existence, use and condition of the plant, and its adequacy and suitability for the purposes for which it is used.

(b) The engineer can also determine, as a result of study, whether or not the amount which has been charged to record the loss due to depreciation is reasonably adequate.

NOTE.—The item of depreciation affects not only the balance sheet accounts but also the income account.

As to items (a) and (b) above, the engineer should be able to rely on the accountant's report as to the figures recorded in the accounts, but should be able to contribute to the interpretation and evaluation of these figures, since construction costs, condition, adequacy, and suitability fall within the limits of his experience rather than within the experience of the accountant.