

EXCERPTS FROM TESTIMONY

BEFORE S. E. C. HEARINGS

By Samuel J. Broad

“In most accounting organizations an unduly large proportion of the work falls in the short period from, say January 1 to March 31; probably more than half the number of engagements handled in a year reach their culmination within this period. This has resulted in a situation which no one deplores more than the auditor, namely an excessive physical burden on all members of the accounting organization, as well as the necessity for supplementing staffs by the addition of temporary assistants. Under such continuous forced pressure one would be a hardy soul who could conscientiously assert that the accountant has as much time for reflection, or can give all his clients the same amount of time, service and attention as he could if the work were spread more evenly throughout the year so that a full-time permanent staff could be occupied more or less continuously throughout the twelve-month period.

“Such idealistic conditions will probably never arise, but there is much that can be done to alleviate the situation referred to. There is no particular virtue in having a company’s fiscal year end at the close of the calendar year; on the contrary, in many lines of business some other date would have distinct advantages to corporations and their officials in that the accounts could be closed at the end of a season of activity and before the commencement of the next season. At such a time inventories, accounts receivable, and accounts payable are normally lower and the Company is usually in its most liquid position, so that statements based on a relatively larger proportion of completed transactions could be prepared in which the elements of judgment and estimate would be minimized. Furthermore, the officials and their staff, in a

season when activities are reduced, could give more attention to closing transactions with less interruption to their normal daily duties. This idea of the “Natural Business Year” has been supported by accountants quite strongly but, as they would themselves also benefit from the change through relief in the present congested period, support from influential disinterested bodies or from industry itself would be much more effective.

“Another important step in the direction of greater regularity of employment, and consequently more efficient handling of work, could be taken if more of the auditor’s work could be done before the end of the fiscal year. All of the examination, even of the Balance Sheet, need not necessarily be made at the year-end; for example, a review of the methods of internal check and control or of the methods of controlling and checking inventories could be done just as effectively throughout the year. Again, if accounts receivable are to be confirmed, either in part or in whole, there is no particular necessity for doing this at the Balance Sheet date; in fact there are advantages in choosing other and different dates from year to year.

“But, to afford the auditor an opportunity to do this work, it would be necessary that he be appointed early in the year instead of, as is frequently the case now, towards the end of the fiscal year or after its close.

“The time of the appointment is important, but perhaps of even greater importance is the method of appointment. It is essential that the auditor be truly independent. What he sometimes does now by permission, he should be entitled to do by right.

“The Securities Acts place very substantial responsibilities on auditors, and also very substantial liabilities. Nowhere, however, do they implement these by giving the auditors any power or authority such as is given by legislation in other countries to enable him most effectively to meet his responsibilities. Reference to the Dominion Companies Act (Canada), for

example, will bring out what I have in mind. After defining the duties of auditors, the Act proceeds to specify their rights as follows:

‘Every auditor of a company shall have a right of access at all times to all records, documents, books, accounts and vouchers of the company, and shall be entitled to require from the directors and officers of the company such information and explanation as may be necessary for the performance of the duties of auditor.

‘The auditors of a company shall be entitled to attend any meeting of shareholders of the company at which any accounts which have been examined or reported on by them are to be laid before the shareholders for the purpose of making any statement or explanation they desire with respect to the accounts.’ (Section 120, Dominion Companies Act).

“The suggestion has been made quite often in recent weeks that, in the case of listed companies at least, auditors should be appointed by the stockholders, rather than by the management, and should report to them. This is not a panacea because presumably under our American practice the stockholders, who support the management, either by giving them their proxies or by voting for their continuance, would probably confirm the auditor of the management’s choice. However, if such a procedure resulted in the earlier appointment of auditors, in giving them additional powers, including the right of access to the records at any time, the privilege of being present if they thought it necessary at stockholders’ meetings where the accounts were presented, and if notice of a proposed change of auditors were required to be given to stockholders with a statement as to the reason for the change, undoubtedly the auditors’ position would be strengthened.

“An alternative, and perhaps preferable procedure, which has been suggested and which has many of the same advantages, would be to have the auditors selected by the Board of Directors, as representatives of the stockholders, the appointment to be made at the Board Meeting succeeding the annual meeting. The method adopted under the New York Banking

Laws of appointing a committee of Directors, other than officers, to take responsibility for audit matters has much to commend it. The auditor's report should be made to the Board, or the committee of the Board, as representing the stockholders, and the auditors should have the right to appear at Board Meetings at which their report is presented if special circumstances, in their opinion, warrant it. If their appointment for the succeeding year is not renewed, the Board should report to the Commission the reasons for the change and the auditors should also have the privilege of presenting their side of the case.

“Some plan might well be developed by which the auditors would have closer contact with Boards of Directors in other respects. They might be requested to attend meetings of the Board at which matters relating to the accounts are to be considered. Closer contacts of this nature would, I believe, be advantageous to both the Directors and the auditors and would lead to a closer understanding of mutual problems.”