

**Robert J. Sonnelitter, CPA
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September 28, 2011

Public Company Accounting Oversight Board
Attention: Office of the Secretary
1666 K Street, N.W.
Washington, D.C. 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 34

Dear Members of the Public Company Accounting Oversight Board:

This is to provide my comments on PCAOB Rulemaking Docket Matter No. 34 regarding PCAOB Release No. 2011-003, Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements and Related Amendments to PCAOB Standards (the "Release").

I am a Certified Public Accountant who has experience auditing large and small public companies. I currently work in quality control for a New York City based registered public accounting firm that audits smaller reporting companies and non-accelerated filers; however, my comments are intended to relate to auditors' reports on the financial statements of all sizes of public companies. Some general comments about the release and my comments on each of the four alternatives follow.

I am not convinced that significant changes to an auditor's report would be useful for investment decisions. An audit of the financial statements provides assurance as to the fair presentation of financial statements in accordance with a particular accounting framework. However, investment decisions cannot be based on the auditor's report. Such decisions must be based on information related to the company being considered for an investment. In addition, while objective analytics may be performed, investment decisions are always subjective. The investor must chose the extent to which he or she relies on objective analysis of the amounts presented in a company's financial statements and elsewhere, the extent of reliance placed on financial statement disclosures, and the extent of reliance placed on other available information about the prospective investment.

As stated in the Release, an audit of financial statements has long been recognized as a valuable process. As indicated in the appendix to this response, since the beginning of the twentieth century some form of assurance service has been provided by public accountants. Over time, both businessmen and public accountants came to realize that assurance with respect to financial statements must be provided in relation to some form of standard or standards; hence the development of accounting standards. So assurance with respect to financial statements progressed from the 1902 "certification" that United States Steel's financial statements were "correctly prepared" from its books to the present form of assurance which attests to whether a company's financial statements present financial position, results of operations, and cash flows fairly as that term is viewed under some framework of standards. After 1934, auditor's reports began to refer to 'fair presentations' in accordance with 'accepted principles of accounting.'

Historically, and currently, the purpose of the audit has been limited to being an attestation relating to the financial statements and the standards under which they have been prepared. Over the last 100 years, attestations beginning with "verifications" and "certifications" and progressing to the modern audit have related to financial statements, not to any other information. The attestation has been confined to the financial statements and the basis (i.e., standards) under which the financial statements were prepared. The standards behind (or basis used in) the preparation of financial statements is the most important factor to be considered with respect to the financial statements and an investor's or other user's analysis. It is not a coincidence that accounting principles and auditing standards developed in tandem with one another as businesses became more sophisticated. The accounting principles underlying financial statements facilitate the understanding of them, the auditing standards simply provide assurance that the financial statements have been prepared using the stated accounting principles (e.g., U.S. GAAP, IFRS, etc.).

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Thus, the basis for analyzing a company's financial statements must be the accounting principles under which they were prepared. I believe that much of the so-called "expectation gap" results from the confusion of auditing standards with accounting principles. Frequently, I find clients and their attorneys referring to a "GAAP Audit." Such a reference indicates a confusion of auditing standards with accounting principles. In addition, I believe that misunderstandings/confusion exists over the difference between audit risk and investment risk.

Generally accepted accounting principles ("GAAP") have been developed, as intended, to provide investors with a wealth of information for use in making investment decisions and I believe that significant changes to the auditor's reporting model could or would dilute the preeminence of GAAP as the basis for assessing financial statements. Financial statements prepared in accordance with GAAP provide investors with an abundance of information about the preparation of financial statements which includes information about how the elements of the financial statements are derived. For example, disclosures with respect to the fair values of financial instruments include information about the fair values are determined. Likewise, disclosures about share-based compensation include information about how the amounts of these expenses are computed. Therefore, while I concur that an audit of financial statements has value, the value does not relate to providing information about the financial statements. Information about the financial statements is provided by the financial statements themselves, including the related disclosures as required by GAAP. The value of an audit relates to the support it provides about the relevance and representational faithfulness¹ of the financial statements.

Because I believe that GAAP provides the best means for communicating information about a company's financial position, results of operations, and cash flows, I believe that the so-called pass/fail model is appropriate. Auditors are expected to render their opinion with respect to fair presentation. In my opinion, the following should be considered:

- An opinion is a subjective judgment which, by its nature is singular. One can have an opinion on this matter or that matter; but one cannot have multiple opinions on the same item or matter of interest. Thus, an opinion is a yes or no proposition. Of course there may be areas of uncertainty to be considered in forming an opinion, but the opinion is not a definitive statement. So uncertainties affect the formation of an opinion but they are not part of the opinion; consequently the financial statement presentation is considered either fair or not fair under the applicable set of standards.
- Under present auditing standards, an auditor may add a paragraph emphasizing a matter that was considered in forming the opinion; however, the matter being emphasized is only one of many matters considered by an auditor in forming his or her opinion. Since the auditor's opinion is the result of his subjective judgment based on many factors, there is a danger that an emphasis on any particular matter would mislead or confuse the user of the financial statements.
- Under present auditing standards, an auditor's report may be qualified due to a limitation in the scope of the audit or due to a departure from generally accepted accounting principles.
 - The reference to a scope limitation in the auditor's report may mislead or confuse the user of the financial statements. The fact that the scope limitation is not so egregious as to cause a disclaimer of opinion implies that the auditor has overcome the limitation; therefore, the limitation should not need to be mentioned in the opinion.
 - The reference to a departure from generally accepted accounting principles in the auditor's report may also mislead or confuse the user of the financial statements. As above, the fact that the departure is not so egregious as to cause an adverse opinion implies that the auditor has overcome the materiality of the departure; therefore it should not need to be mentioned in the opinion.

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To summarize the preceding matters, I believe that the role of an audit of financial statements should be limited to the objective stated in AU§110, *Responsibilities and Functions of the Independent Auditor*. That is, the expression of an opinion on the fairness of the financial statements presented by management.^a

^a As the Board knows, fairness must be related to some set of standards of application. Fairness is not an absolute, it implies some degree of reasonable deviation as well as being a judgment related to matters that, by their nature, may only be applied by exercising some degree of judgment. Fairness includes the concept of importance or materiality.

The Release observes that “The auditor's report is the primary means by which the auditor communicates to investors and other users of financial statements information regarding his or her audits of financial statements.”² I disagree. The auditor’s report is not intended to communicate information regarding the audit; it is intended to communicate the auditor's opinion on the financial statements.³ The scope paragraph explains the nature of what was done to enable the auditor to express his or her opinion. The Release also states “Some investors indicated that if they had a better understanding about the audit and how the audit was conducted relative to a particular company, then they would have a better perspective regarding the risks of material misstatement in a company's financial statements.”⁴ However, the standard audit report already states that the audit was performed in accordance with the standards of the PCAOB (or the “Board”). So it seems that providing “a better understanding about the audit and how the audit was conducted” could involve a treatise on the requirements contained in the auditing standards of the PCAOB as well as a copy of some key audit work papers. Satisfaction beyond referring to the auditing standards of the PCAOB is both not practical and ill advised.

Based on the above observations, I believe that the current and ever increasing disclosure requirements of GAAP provide investors and other users of financial statements with more than adequate information for making investment decisions. I also observe that the mission of the FASB relates to ensuring that financial statements provide useful information to investors and other users of financial reports for purposes of decision making.⁵ Furthermore, I believe that the expected benefits of providing more information about the audit as compared with the hindrance from providing excessive information must be considered. I believe that too much information about how the audit was conducted would lead to more confusion, especially with respect to distinguishing accounting principles from auditing standards. In my view, another aspect of the “expectation gap” that has often been discussed also stems from a misunderstanding about the purpose of an audit.

I understand that the Board's Standing Advisory Group ("SAG") and Investor Advisory Group ("IAG") suggested, and the U.S. Department of the Treasury Advisory Committee on the Auditing Profession ("ACAP") recommended, that the Board undertake a standard-setting initiative to consider improvements to the auditor's standard reporting model; however, it is most important to consider why those suggestions and recommendations have made. That is, why do these and the other groups mentioned in the Release believe changes should be made and how widespread is that belief.

After considering the information and viewpoints received from the comments to this Release, if the Board decides to pursue the notion of changing the auditor’s report, I believe that more in-depth analysis should be made. While the PCAOB Staff (the “Staff”) has conducted outreach activities, the degree to which those activities represent the attitudes of the population of users, preparers, and auditors of financial statements is not clear. For example:

- Statements throughout the Release indicate the attitudes or viewpoints of “some,” or “many.” However, it is not clear how extensive the attitudes or viewpoints of “some,” or “many” are by comparison to others who may have different attitudes or viewpoints.

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- I believe that the perspectives of those financial statement users that were not part of the outreach activities as well the perspectives of those who were part of the outreach activities but did not participate or respond must be considered. In my view, such non-participation implies that there is no objection to the status quo.
- The Release provides an overview of the participants of the outreach, but no indication is given with respect to how extensive was the participation of each group by comparison to other groups. Certainly, there would be bias if the participation, attitudes or viewpoints of any one group (e.g., investors, preparers, auditors, audit committee members, regulators and standard-setters, and academics) was over or under weighted by comparison to other groups.
- The Release does not indicate or analyze the degree of weighting given to the perspectives of each of the above participating groups. In view of the goal of providing useful information to investors and other users of financial statements, I believe that:
 - the perspectives of investors and other users of financial statements should be given top priority,
 - the perspectives of a) audit committee members, b) preparers, and c) auditors should be given the next priority,
 - the perspectives of government, regulators and standard-setters, and academics should not be considered because those groups do not actively participate in the investment process. Government and regulators and standard-setters exist to serve investors and other users of financial statements and academics study the accounting, auditing, financial statement preparation, and investment processes.^b
 - ^b In my view, the role of regulators and standard-setters and academics should be to assist in determining the information desires of investors and other users of financial statements. Regulators and standard-setters must also balance those desires against what information can feasibly be provided.

I am also not convinced that there is widespread “grass roots” dissatisfaction.

A. Auditor’s Discussion and Analysis (“ADA”)

I believe that having a supplemental narrative is not a good idea. In my view, such a supplemental report could confuse investors and shift their focus to the matters discussed in the ADA and away from the financial statements as a whole. As a result, an ADA would not facilitate an understanding of the auditor’s opinion because it could or would bring about the loss of an investors primary perspective toward the financial statements as a whole.

I especially do not believe that a discussion about the auditor’s views with respect to estimates and judgments affecting the financial statements would be beneficial. The auditor’s basic views with respect to such estimates and judgments are inherently part of the auditor’s opinion on the financial statements as a whole. Any supplemental views that are either favorable or unfavorable could cause undue optimism or pessimism on the part of investors.

The Release states: “An ADA could give the auditor greater leverage to effect change and enhance management disclosure in the financial statements, thus increasing transparency to investors.”⁶ To the contrary, an ADA could cause management to be less forthright with their auditors for fear of negative statements.

Generally, an ADA could reduce investors’ focus on the financial statements and cause an inappropriate increase in their focus on the auditor’s opinion and comments. That kind of shift in focus undermines the

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effectiveness of disclosures required by generally accepted accounting principles and can only increase an auditor's liability risk.

B. Required and Expanded Use of Emphasis Paragraphs

This alternative seems to be a watered down version of an ADA that would be included in the auditor's opinion instead of as a supplemental narrative. Therefore, I do not agree that it would be appropriate for the same reasons as above. Furthermore, I believe that mandating the use of emphasis paragraphs in audit reports and to highlight the most significant matters in the financial statements and to identify where these matters are disclosed in the financial statements is not or should not be necessary. Emphasis paragraphs like these can amount to condensed footnotes and, as above, undermine the effectiveness of disclosures required by generally accepted accounting principles.

A requirement that an auditor should "justify" the audit assessments made in forming an opinion on financial statements would shift the focus to individual matters relative to the financial statements at the expense of a focus on the financial statements as a whole.

C. Auditor Assurance on Other Information Outside the Financial Statements

As pointed out in the Release:⁷ "Providing assurance on information outside the financial statements would increase the scope of the auditor's responsibilities, require the development of new auditing standards, and might result in projects separate from the auditor's reporting model project."

The substantial increase in the cost of an audit should be carefully weighed against the added benefits that investors might receive. Regulation S-K contains fairly detailed requirements about the content of the MD&A and much of the information includes management's subjective judgments and analysis about causes behind changes in operations and about the future. The reliability of this type of information, no matter how carefully it is prepared, is questionable due to its nature. Therefore, the cost of auditing it may well outweigh the perceived benefits. I believe that the cost would outweigh the benefits provided to investors.

D. Clarification of the Standard Auditor's Report

The standard auditor's report already has explanations about an auditor's responsibility and what an audit represents. I do not think that additional explanations about what an audit represents and the related auditor responsibilities would provide significant additional value to investors. I believe that auditor's reports should be as clear, concise, and to the point as possible.

I do not believe that any of the four alternatives presented in the release would provide substantial benefits.

- I especially believe that requiring an ADA or mandating the use of emphasis paragraphs would be detrimental for the reasons discussed above.
- Assurance on Other Information Outside the Financial Statements could cost more than the value of any expected benefits.
- In the interest of clarity, some modification to the standard auditor's report might provide some small benefit. Therefore, I have the following suggestion:

Report of Independent Registered Public Accounting Firm

In our opinion, the accompanying balance sheets of X Company as of December 31, 20X3 and 20X2, and the related statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 20X3 present the financial position of the Company as of [at] December 31, 20X3 and 20X2, and the results of its operations and its cash

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flows for each of the three years in the period ended December 31, 20X3, in conformity with accounting principles generally accepted in the United States of America.

Our opinion is based on our audits which we conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States). The financial statements referred to above are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. Financial statements presented in conformity with accounting principles generally accepted in the United States of America are inherently free of material misstatement and require management to estimate the amounts of some of their elements.

Audits conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States) require that auditors obtain reasonable assurance about whether the financial statements are free of material misstatement and that they assess the whether the accounting principles used are appropriate and appropriately applied. An auditors' assessment of the risks of material misstatement of the financial statements affects the type and amount of supporting evidence that is examined during the audit to reduce such risk to a minimum. Our audits did not extend to information presented outside of the financial statements; consequently, we have no opinion on any such information.

Notes regarding changes to the form of opinion:

- The opinion paragraph is placed first because the opinion on the financial statements is the primary matter of interest.
- The second paragraph adds a brief explanation about the nature of financial statements when they are presented in conformity with GAAP.
- The third paragraph adds a brief explanation about how audit risk assessment affects the audit.

Thank you for the opportunity to express my views on this issue.

Sincerely,

Robert J. Sonnelitter

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¹ See Statement of Financial Accounting Concepts No. 8, Chapter 1, *The Objective of General Purpose Financial Reporting*, and Chapter 3, *Qualitative Characteristics of Useful Financial Information*. Paragraph QC 5 states: The fundamental qualitative characteristics [of financial statements] are *relevance* and *faithful representation*.

² Page 2.

³ See AU§110.03 and AU§508.

⁴ Page 7.

⁵ The mission of the FASB is to “establish and improve standards of financial accounting and reporting that foster financial reporting by nongovernmental entities that provides decision-useful information to investors and other users of financial reports. That mission is accomplished through a comprehensive and independent process that encourages broad participation, objectively considers all stakeholder views, and is subject to oversight by the Financial Accounting Foundation’s Board of Trustees.”

⁶ Page 13.

⁷ Page 23.

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Appendix: Historical Auditor's Reports

An audit of financial statements has long been recognized as a valuable process. Since the beginning of the twentieth century some form of assurance service has been provided by public accountants. Over time, both businessmen and public accountants came to realize that assurance with respect to financial statements must be provided in relation to some form of standard or standards; hence the development of accounting standards. So assurance with respect to financial statements progressed from the 1902 "certification" that United States Steel's financial statements were "correctly prepared" from its books to the present form of assurance which attests to whether a company's financial statement present financial position, results of operations, and cash flows fairly as that term is viewed under some set of standards.

The following are examples of two early reports, each without a scope paragraph.

The 1902 Annual Report of United States Steel includes a certificate from Price Waterhouse which stated:

We examined the books of the US Steel Corporation and its Subsidiary Companies for the year ended December 31, 1902, and certify that the Balance Sheet at that date and the Relative Income Account are correctly prepared therefrom.

The 1915 Annual Report of Sears, Roebuck and Co. includes a note placed at the bottom of the Statement of Net Profits from The Audit Company of New York which stated:

We have made an audit of the books and accounts of Sears, Roebuck and Co. for the fiscal year ending December 31, 1915, and in accordance therewith we certify that in our opinion the foregoing statements of Income and the General Balance Sheet are true exhibits of the results of operations of the Company for the said period and of its condition as of December 31, 1915.

I have observed that, in 1917, The Federal Reserve Board prepared A Tentative Proposal entitled "UNIFORM ACCOUNTING." The proposal was meant as tentative proposal for a uniform system of accounting which "suggested standard forms of statements for merchants and manufacturers" and recognized the need for "(1) The improvement in standardization of the forms of statements," and "(2) The adoption of methods which will insure greater care in compiling the statements and the proper verification thereof." This proposal included instructions for the auditing procedures necessary for a balance sheet audit which included also some account descriptions, instructions for what should be addressed in the accountants' certificate, a proposed form of accountants report, and a proposed form of presentation of an income statement and balance sheet. The instructions were:

The balance sheet and certificate should be connected with the accounts in such a way as to ensure that they shall be used only conjointly. This rule applies also to any report or memorandum containing any reservations as to the auditor's responsibility; any qualification as to the accounts, or any reference to facts materially affecting the financial position of the concern.

The certificate should be as short and concise as possible, consistent with a correct statement of the facts, and if qualifications are necessary the auditor must state them in a clear and concise manner.

If the auditor is satisfied that his audit has been complete and conforms to the general instructions of the Federal Reserve Board, and that the balance sheet and profit and loss statement are correct, or that any minor qualifications are fully covered by the footnotes on the balance sheet, the following form is proper:

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I have audited the accounts of Blank & Co. for the period from to and I certify that the above balance sheet and statement of profit and loss have been made in accordance with the plan suggested and advised by the Federal Reserve Board and in my opinion set forth the financial condition of the firm at and the results of its operations for the period.

(Signed) A. B. C.

The following is an example of an auditor's report issued after the above 1917 proposal:

The 1926 Annual Report of Abraham & Straus, Inc. includes a note placed at the bottom of the Balance Sheet from Touche, Niven & Co. which stated:

We have examined the books and account of Abraham & Straus, Inc. for the year ended January 31, 1926, and we certify that the above balance sheet and the accompanying income and surplus account are in accordance therewith and, in our opinion, exhibit a true and correct view of the financial condition of the Corporation at January 31, 1926, and its operations for the year then ended.

In 1929, a revision to the 1917 suggestions was issued by the American Institute of Accountants (now the AICPA) entitled "VERIFICATION OF FINANCIAL STATEMENTS" and submitted to The Federal Reserve Board. That document was oriented more toward auditing procedures necessary for a balance sheet audit, and included a proposed form of accountants report. The instructions in that document were:

The auditor's certificate should be as concise as may be consistent with a correct statement of the facts. If qualifications are necessary, the auditor must state them clearly.

The balance sheet, the profit-and-loss statement, the auditor's certificate, and any report or memorandum containing reservations as to the auditor's responsibility, any qualifications as to the accounts, or any reference to facts materially affecting the financial position of the concern should be connected in such a way as to insure their use conjointly.

If the auditor is convinced that his examination has been adequate and in conformity with these general instructions, that the balance sheet and the profit-and-loss statement are correct, and that any minor qualifications are fully stated, the following form of certificate may be used:

I have examined the accounts of company for the period from to

I certify that the accompanying balance sheet and statement of profit and loss, in my opinion, set forth the financial condition of the company a and the results of operations for the period.

The following is an example of an auditor's report, which includes an explanation about the scope of the audit work performed that was issued after the above 1929 proposal:

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The 1930 Annual Report of American Telephone and Telegraph Company includes a note placed at the bottom of the Statement of Earnings and Expenses from Lybrand, Ross Bros. & Montgomery which stated:

We have audited the accounts of
AMERICAN TELEPHONE AND TELEGRAPH COMPANY
for the year ended December 31, 1930. We have reviewed reports for that year rendered to the company by the associated and controlled companies and find that the American Telephone and Telegraph Company's proportion of the aggregate net income of the associated and directly and indirectly controlled companies as shown by such reports exceeded the dividends of \$148,178,885 this company received on stocks owned by about \$10,000,000. We have not, however, audited the accounts of the associated and controlled companies.

We certify that, in our opinion, the accompanying balance sheet (on pages 14 and 15) and the above statement of earnings and expenses (subject to the explanation in the preceding paragraph) set forth correctly the financial position of American Telephone and Telegraph Company as at December 31, 1930 and the results of its operations for the year 1930.

In 1934, a document entitled "AUDITS OF CORPORATE ACCOUNTS" was prepared that included correspondence from 1932 to 1934 between the Special Committee on Co-operation with Stock Exchanges of the American Institute of Accountants and the Committee on Stock List of the New York Stock Exchange. The correspondence included a "Statement of Certain Accounting Principles Recommended by the Committee of American Institute of Accountants on Co-operation with Stock Exchanges," a "Revised Suggestion of a Form of Accountants' Report," and discussions about auditing procedures. Correspondence from the New York Stock Exchange stated that after July 1, 1933 all listing applications from corporations must contain the certificate of independent public accountants. The correspondence includes a suggestion for a form of Accountants' Report which includes a statement describing some of what was done (i.e., a partial scope of the procedures) in performing the examination ("audit"). The suggested form of Accountants' Report is below:

We have made an examination of the balance-sheet of XYZ Company as at December 31, 1933, and of the statement of income and surplus for the year 1933. In connection therewith, we examined or tested accounting records of the Company and other supporting evidence and obtained information and explanations from officers and employees of the Company; we also made a general review of the accounting methods and of the operating and income accounts for the year, but we did not make a detailed audit of the transactions.

In our opinion, based upon such examination, the accompanying balance-sheet and related statement of income and surplus fairly present, in accordance with accepted principles of accounting consistently maintained by the Company during the year under review, its position at December 31, 1933 and the results of its operations for the year.

With this suggested form, accountants' reports became more comparable to the modern form of accountants' reports. The following is an example of an auditor's report that was issued after the above 1934 correspondence:

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The 1934 Annual Report of National Food Products Corporation includes the **Certificate** of Peat, Marwick, Mitchell & Co. which stated:

We have made an examination of the Balance Sheet of National Food Products Corporation as at December 31, 1934, and of the Profit and Loss and Surplus Accounts for the year 1934. In connection therewith, we examined or tested accounting records of the Company and other supporting evidence and obtained information and explanations from officers and employees of the Company; we also made a general review of the accounting methods and of the operating and income accounts, but we did not make a detailed audit of the transactions.

The securities representing the investments were confirmed by inspection or by acknowledgment from the holder; the investments in subsidiary and controlled companies and the other investment are stated at cost which was \$1,322,424.37 in excess of their appraised value or quoted market price as indicated on the Balance Sheet. Sundry securities are carried at a net amount of \$3000.00 after deduction of a reserve of \$263,748.42 which was provided from Capital Surplus pursuant to resolution of the Board of Directors.

In our opinion, based upon such examination and subject to the foregoing qualifications, the accompanying Balance Sheet and related Income and Surplus Accounts fairly present, in accordance with accepted principles of accounting consistently maintained by the Company during the year under review, its position at December 31, 1934 and the results of its operations for the year.

In January 1936 the American Institute of Accountants published a bulletin: "Examination of Financial Statements by Independent Public Accountants." This bulletin contained a discussion regarding accounting principles but did not mandate the application of any such principles. This bulletin was published as a revision to the 1929 pamphlet "VERIFICATION OF FINANCIAL STATEMENTS" and included a form of accountants' report. The bulletin contained the following notes about the use of the suggested accountants' report:

1. It is contemplated that, before signing a report of the type suggested, the accountant will be satisfied that his examination has been adequate and in conformity with the principles outlined in this bulletin.
2. The report should be addressed to the directors of the company or to the stockholders, if the appointment is made by them.
3. The statement of what has been examined would, of course, conform to the titles of the accounts or statements reported upon.
4. In the second sentence, any special forms of confirmation could be mentioned: e.g., "including confirmation of cash and securities by inspection or certificates from depositaries."
5. This certificate is appropriate only if the accounting for the year is consistent in basis with that for the preceding year. If there has been any material change either in accounting principles or in the manner of their application, the nature of the change should be indicated.
6. It is contemplated that the form of report would be modified when and as necessary to embody any qualifications, reservations or supplementary explanations.

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The non-binding reporting guidance was followed in the cases below:

The 1936 Annual Report of Dow Chemical includes the Accountants' Certificate of Haskins & Sells which stated:

We have made an examination of the balance sheet of The Dow Chemical Company as of May 31, 1936, and of the related summary of income and surplus for the year ended that date. In connection therewith, we made a review of the accounting methods and examined or tested accounting records of the company and other supporting evidence in a manner and to the extent which we considered appropriate in view of the system of internal accounting control. We did not verify the quantities in the inventories but were furnished with a certificate of officials of the company as to quantities upon which the inventory values were based.

The accounts of subsidiary and affiliated companies carried as investments at cost of \$1,155,580.00 in the accompanying balance sheet were not examined by us at May 31, 1936. Examinations of the accounts of three of the companies, the investment in which amounted to \$341,579.00, are now in progress, and the accounts of another of the companies, the investment in which amounted to \$665,001.00 were examined by us as of March 31, 1936. We have not made an examination of the accounts of one remaining company, the investment in which amounted to \$149,000.00.

In our opinion, based upon such examination and subject to the foregoing, the accompanying balance sheet and related summary of income and surplus fairly present, in accordance with accepted principles of accounting consistently followed by the company, its financial condition at May 31, 1936 and the results of its operations for the year ended that date.

The 1938 Annual Report of the Radio Corporation of America includes a report of Arthur Young & Company which stated:

We have made an examination of the Consolidated Balance Sheet of RADIO CORPORATION OF AMERICA AND SUBSIDIARY COMPANIES as at December 31, 1938, and of the Consolidated Statement of Income and Earned Surplus Accounts for the year 1938. In connection therewith, we examined or tested accounting records of the Corporation and its Subsidiaries and other supporting evidence to the extent which we considered sufficient and obtained information and explanations requested by us from officers and employees of the Companies. We also made a general review of the accounting methods and of the operating and income accounts for the year, but we did not make a detailed audit of the transactions. Following the practice of prior years the Companies' methods of taking inventory were reviewed and approved by us; we satisfied ourselves as to prices and computations and made substantial physical tests of quantities at the various locations. For certain foreign subsidiaries, whose assets amount to 3% of the total assets, we have accepted and incorporated in the consolidated statements, after a scrutiny and review sufficient to satisfy ourselves as to their accounting principles followed, the audited accounts prepared by their public accountants as at either October 31st, or November 30th, 1938.

The changes explained in Notes 1 and 4 to the Statement of Income, while they depart from the practice of prior years, are entirely consistent with accepted principles of accounting.

In our opinion, based upon such examination, the accompanying Consolidated Balance Sheet and related Consolidated Statement of Income and Earned Surplus, together with the notes thereon, fairly present, in accordance with accepted principles of accounting which have been consistently maintained by the Corporation, its financial position at December 31, 1934 and the results of its operations for the year ended that date.

In 1939 the American Institute of Accountants' Committee on Accounting Procedure issued Accounting Research Bulletin ("ARB") No. 1, *General Introduction and Rules Formerly Adopted*. ARB 1 again adopted six basic accounting principles that were adopted in 1934. In the same year, the American

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Institute of Accountants' Committee on Auditing Procedure issued Statement on Auditing Procedure ("SAP") No. 1, *Extensions of Auditing Procedure*.

The Auditor's Reports below were issued after the AIA (now AICPA) began to issue ARBs and SAPs:

The 1942 Annual Report of Humble Oil & Refining Company includes the report of Price Waterhouse & Co. which stated:

We have examined the consolidated balance sheet of Humble Oil & Refining Company and its wholly owned subsidiary, Humble Pipeline Company, as at December 31, 1942 and the consolidated statements of income and surplus for the year then ended. Our examination was made in accordance with generally accepted auditing standards applicable in the circumstances, except that it was not practicable to confirm receivables from the United States Government, with respect to which we have satisfied ourselves by means of other auditing procedures. The examination included such tests of the accounting records, without detailed audit of the transactions, and other supporting evidence and such other procedures as we considered necessary.

We have accepted the balances of the fixed (capital) assets and relative reserves of the companies as at January 1, 1934 at the amounts shown on the books and records of the companies.

The income account for the year 1942 includes profits which were realized on sales to various departments and agencies of the United States Government. The profits realized therefrom are subject to renegotiation under the War Profits Control Act, but the amount of the adjustments, if any, which may result from such renegotiation is not presently determinable.

In our opinion, with the reservation in the preceding paragraph, the accompanying consolidated balance sheet of Humble Oil & Refining Company and its wholly owned subsidiary company and the related statements of income and surplus, together with the notes thereto, present fairly the consolidated position of the companies at December 31, 1942 and the consolidated results of their operations for the year, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

The 1950 Annual Report of the American Express Company includes the **Accountants' Certificate** of Haskins & Sells which stated:

We have examined the balance sheet of American Express Company as of December 31, 1950, and the consolidated statement of income and surplus of the Company and consolidated subsidiaries for the year then ended. We have also examined the consolidated balance sheet of the Company's principal subsidiary, The American Express Company, Incorporated and consolidated subsidiaries, as of December 31, 1950. Our examinations were 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; as to American Express Company, it was not practicable to reconcile the individual liability balances of travelers cheques and drafts (money orders) with the respective related control accounts but, in view of the accounting procedures followed and the system of internal accounting control in effect, we satisfied with respect to the aggregate amounts of these liabilities by examination of the control accounts.

In our opinion, the accompanying balance sheets and statement of income and surplus, with their notes, present fairly the financial position of American Express Company and of The American Express Company, Incorporated at December 31, 1950 and the results of operations of American Express Company and consolidated subsidiaries for the year then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

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The 1955 Annual Report of Boeing Airplane Company includes the **Accountants' Report** of Touche, Niven Bailey & Smart which stated:

We have examined the balance sheet of Boeing Airplane Company as of December 31, 1955, and the related statements of net earnings and earnings retained for use in the business for the year then ended. Our examination 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. We were unable to obtain satisfactory confirmations of receivables from the United States by direct communication, but we satisfied ourselves as to such accounts by other auditing procedures.

In our opinion, the accompanying balance sheets and statements of net earnings and earnings retained for use in the business present fairly the financial position of Boeing Airplane Company at December 31, 1955 and the results of its operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Also in our opinion, the action of the Board of Directors on December 12, 1955, in setting aside the sum of \$3,250,000 for the year 1955 under the Incentive Compensation Plan for Officers and Employees, is in conformity with the provisions contained in the first paragraph of Section 2 of such plan.

The 1968 Annual Report of Magma Copper Company includes the **Auditors' Report** of Arthur Andersen & Co. which stated:

We have examined the consolidated balance sheet of MAGMA COPPER COMPANY (a Maine corporation) and subsidiaries as of December 31, 1968, and the related consolidated statements of income, retained earnings, and source and disposition of funds for the year then ended. Our examination 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.

In our opinion, the accompanying consolidated balance sheet and consolidated statements of income, retained earnings, and source and disposition of funds present fairly the financial position of Magma Copper Company as of December 31, 1968, and the results of their operations and source and disposition of funds for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.
