

EX-OFFICIO MEMBERS

WILLIAM G. McADOO
 SECRETARY OF THE TREASURY
 CHAIRMAN
 JOHN SKELTON WILLIAMS
 COMPTROLLER OF THE CURRENCY

FEDERAL RESERVE BOARD

WASHINGTON

W. P. G. HARDING, GOVERNOR
 PAUL M. WARBURG, VICE GOVERNOR
 FREDERIC A. DELANO
 ADOLPH C. MILLER
 CHARLES S. HAMLIN

H. PARKER WILLIS, SECRETARY
 SHERMAN P. ALLEN, ASST. SECRETARY
 AND FISCAL AGENT

ADDRESS REPLY TO
 828 FEDERAL RESERVE BOARD

I inclose herewith for your information copy of a letter received from Mr. E. N. Hurley, Chairman of the Federal Trade Commission, under date of September 18th. Mr. Hurley addressed me in this communication because of our past acquaintance and for the further fact that we have discussed the general bearing of this particular problem on the work of the Federal Reserve Board as well as of the Federal Trade Commission. While Mr. Hurley has impressed me very much with the importance of the subject, I have an open mind on the question, and would like, before presenting it to my colleagues on the Federal Reserve Board, to have the opinion of prominent bankers upon it. May I ask you, therefore, to kindly take Mr. Hurley's proposal under consideration and give me your views as to the feasibility of carrying it out?

Yours very truly,

Member, Federal Reserve Board.

Incl^osure.

828-a

FEDERAL TRADE COMMISSION

WASHINGTON

September 18, 1916.

Hon. Frederic A. Delano,
Federal Reserve Board,
Washington, D. C.

My dear Mr. Delano:

In view of our many conversations on business conditions as found by the Federal Trade Commission, I wish to call to your attention the deplorable lack of adequate accounting methods in our industries. In order to remedy this condition, the Federal Trade Commission has been doing educational work along accounting lines. This work has been very effective. We are sending out daily to manufacturers and merchants upon request about 2,000 of our accounting pamphlets. We have received thousands of letters approving our work and showing the necessity for further effort in this direction.

In the second place, the Commission is cooperating with many trade associations which are endeavoring to get their members to adopt sound accounting systems. We send our experts to meet with them and discuss the features of cost accounting that are peculiar to the particular industry. We tell them to work out a system of cost keeping. When they bring it in the Commission will counsel with them and will approve it as a basic system for that industry. With this general standard officially approved, details to vary, of course, with the individual companies, the association has a strong argument to bring its members into line with sound accounting.

Much more should be done, however, to insure the preparation of financial statements which will show the true standing of business concerns.

In our investigation we have found a very decided tendency on the part of business men to overvalue their assets and

-2-

frequently to understate their liabilities. The overvaluation of assets is, in a large measure, due to the failure of business men to make adequate provision for depreciation. In many cases, the difference between the value of the assets shown by financial statements and the actual value is so great that many concerns showing a comfortable surplus are in fact insolvent. It is also important in this connection to consider how much of expenditures for jigs, tools, dies, and patterns are properly chargeable to capital, and how much to the cost of production.

In many cases of commercial failure concerns had made statements for credit purposes, a comparatively short time before their failure, which showed them to be in good financial condition. This is true even in some cases where statements have been prepared by public accountants.

The great difficulty is that no matter who prepares the statement, whether the manufacturer or merchant himself, or a public accountant, the person preparing it is either the prospective borrower or some one in his employ, and the natural tendency is to make as favorable a showing as possible.

In order to increase the reliability of balance sheet statements and to enable the banker to place more confidence in them, some plan must be devised whereby the authority of the banker over the accountant will at least equal that of the borrower, particularly as to the form of the statement and as to the methods used in determining the value of assets and the ascertainment of liabilities.

Knowing your interest in this matter, I now wish to suggest a plan which I am sure will accomplish this result and place our industries on a much sounder basis. The plan suggested is, first, that a standard form of statement be prepared, on which form all statements for credit purposes be made. Second, a general set of rules be laid down for the valuation of assets and the ascertainment of liabilities, and these rules subscribed to by the accountant and followed by him in the preparation of statements. Third, all statements be prepared or verified by an accountant who has registered with the Federal Reserve Board or the Federal Reserve Banks, and the Board or Banks should have the authority to revoke the registry of an accountant for any unreliable work, after giving

-3-

the accountant an opportunity to be heard. This plan, if followed, we believe could not help but result in the presentation of more complete and accurate statements. The rules could be drawn by the American Association of Public Accountants for the approval of the Federal Reserve Board or Banks.

It is well known that public accountants are willing and ready to do their part in having the banker presented with a balance sheet that will show a concern's true financial position. The trouble is that many business men disagree with the public accountants as to what shall be written off for depreciation, and how other items shall be treated. The accountant, although desirous of being conservative, realizes that unless he agrees with his client he is likely to lose him. The result is usually a compromise.

Bankers and public accountants have a vital interest in every movement that makes for the welfare of American business and general prosperity. It is to their interest, and it is a part of their responsibility, to do their share towards bringing about a better knowledge of business conditions and greater efficiency.

I firmly believe that a close cooperation as outlined above is bound to be directly helpful to every manufacturer and merchant in the country.

I appreciate that present bad methods can not be remedied in a short time, but a start must be made in some cooperative way. If the Federal Reserve Board, the bankers of the country, and the American Association of Public Accountants will work with the Federal Trade Commission in its labors with the various trade associations of manufacturers and merchants, I am sure a great deal can be accomplished within a comparatively short time.

I hope the Federal Reserve Board will find it possible to give this matter special attention. The Federal Trade Commission will be pleased to furnish detailed information to substantiate its views.

With kind regards, I am

Very truly yours,

EDWARD N. HURLEY
Chairman.

10/6/16