

fronting the accounting profession in 1973 is whether financial forecasts should be published along with "traditional financial statements." The question is not simply to forecast or not to forecast; but what should be the auditor's role in forecasting. Such questions as should the forecasts be included in the auditors opinion and if so to what extent must also be answered.

In order to obtain the benefit of accounting academicians' thinking on publishing forecasts a questionnaire was sent to 250. The sample was obtained by a random selection from the American Accounting Association's 1971 roster of members.

Results of the Survey

Of the 250 questionnaires sent, 86 academicians responded, approximately one-third. From this small group certain beliefs became apparent and are summarized in an appendix.

First, the responses favored by over two to one making forecasts available to the public. 52.1 percent of the respondents did not believe the auditor's opinion should include forecasts. Of the 41 academicians responding "the auditors opinion should include the forecasted earnings statement," 75% believe it should include both compilations and reasonableness of the assumptions and methods underlying the forecasts. This 75%, however, are evenly divided on whether the auditor should give positive or negative assurance as to the reasonableness of the assumptions underlying the forecast.

The majority of academicians' who favor forecasts could not foresee any conflict of interest or loss of independence of the auditor who must certify both historical and forecasted data. On the contrary, the majority of academicians opposed to forecasting foresee a conflict of interest and loss of independence. The danger they fear is that auditors and management may compromise in order to achieve the prior year's forecasts.

In summary, academicians favor publishing financial forecasts but believe the auditors' opinion should not include the forecasts.

* The authors wish to acknowledge the support of the University of Delaware Faculty Research Fund.

SUMMARY OF SURVEY RESULTS

(86 Responses)

- Earnings Forecasts should be made available to the public.
Yes—60, No—26
- The auditor's (CPA) opinion should include the forecasted earnings statement.
Yes—41, No—45
- If your answer was "yes" to question number 2, should the auditor report on:
 - Compilation only (mathematics and conformity with GAAP).
 - Both compilation and the reasonableness of the assumptions and method underlying the forecast.

Results:

- | | |
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| (a) Compilation only | 10 |
| (b) Both compilation and reasonableness of assumptions | 31 |
- If you checked 3B (above) do you feel that a CPA should give positive assurance (e.g., "In our opinion, the assumptions are reasonable") or negative assurance (e.g., "Nothing has come to our attention to indicate the assumptions are unreasonable") as to the reasonableness of the assumptions underlying the forecast?

(a) Positive assurance	14
(b) Negative assurance	14
(c) Other	3

Results:

- | | |
|------------------------|----|
| (a) Positive assurance | 14 |
| (b) Negative assurance | 14 |
| (c) Other | 3 |
- Do you foresee any conflict of interest, or loss of independence of the auditor, who must certify both historical (past) and forecasts (future) information?

RESULTS: If Forecasts Should (Not) Be Available

	Should	Should Not
Yes →	10	13
No →	37	8
Possibly →	11	4
No Response →	2	1

Note:

The survey conducted was modeled after a questionnaire sent out by Lybrand, Ross Bros. and Montgomery in *Lybrand Newsletter*, December 1972, Vol. XIV, No. 11.

See *Coopers & Lybrand Newsletter*, April-May, 1973, Vol. 15, Nos. 4 & 5 for results of their survey. (Name changed from Lybrand, Ross Bros. & Montgomery to Coopers & Lybrand.)

SUMMARY STATEMENT OF PEAT, MARWICK, MITCHELL & CO.'S POSITION WITH RESPECT TO NATIONAL STUDENT MARKETING INDICTMENT¹

This is the first time that *victims* of a crime have been indicted along with its perpetrators. The two accountants who were victimized are not included, however, in the indictment's thirteen counts charging conspiracy to defraud and mail fraud.² Instead, they are accused in a single count of filing false statements.

Actually, those allegedly false documents were NSM's interim nine-month financial statements for May 31, 1969 and to which the accountants did *not* conduct an audit. The Grand Jury investigation has since established that the accountants were deliberately deceived, both by NSM's management and by employees of some of its customers, e.g., Eastern Airlines.

Two months later, in October 1969 during the year-end audit, the accountants discovered that NSM's nine-month figures were in fact materially wrong. They immediately communicated this to NSM management and insisted it be brought to the attention of Interstate National Corp., with which NSM was about to merge. They even took the extraordinary step, in writing, of urging both parties, and their law firms and boards of directors, to call off the merger in order to issue corrected interim statements. This is hardly the conduct of criminals!

We believe the allegation of criminality against these two professionals is unjustified, unsupported, and unprecedented. Messrs. Natelli and Scanaroli wholly and categorically deny the charge against them, and we fully support them. A more detailed statement is attached.

We understand that the United States Attorney for the Southern District of New York has today announced a multi-count indictment charging certain officers and other individuals formerly connected with National Student Marketing Corp. with various violations of the Federal

¹ See Editor's note attached.

² A copy of the indictment may be obtained upon request from Peat, Marwick, Mitchell & Co.

laws relating to criminal fraud and conspiracy.

The indictment charges further in a single, narrowly-drawn count that one of our partners, Anthony M. Natelli, and a supervisor who left our employ to join NSM in September of 1969, Joseph Scansaroli, violated the Federal Securities Laws by the filing with the SEC of what the indictment charges are false financial reports with respect to a proxy statement issued by National Student Marketing Corp. in September of 1969.

Messrs. Natelli and Scansaroli wholly and categorically deny the charge against them, and we fully support them. We believe that an early exposition of all the facts relating to their involvement with NSM will show beyond any doubt that the allegation of criminal conduct leveled against these two professionals is unjustified, unsupported, and unprecedented.

The indictment does *not* charge that either of the auditors participated in the criminal conspiracy that allegedly existed among the other named defendants. Indeed, it is our belief that a trial will demonstrate that if any fraud existed, our personnel were the victims of that fraud and that the charges against them stem from a conscious effort on the part of certain of the individuals named as defendants to conceal from and otherwise mislead the auditors as to the state of the financial affairs at NSM.

The indictment specifically charges that in connection with a proxy statement issued by NSM containing, among other things, unaudited figures for the nine months ended May 31, 1969, there was a failure to insist upon disclosure that there had been a retroactive adjustment to the August 31, 1968 audited statements because of the apparent fraudulent reporting of fictitious contracts by a company employee, and a failure to insist that the company change its unaudited figures to write off income from certain other contracts.

In both instances, the professionals made reasonable judgments as to the proper course to be taken in the circumstances and acted accordingly. We stand by those judgments. Most important of all, we have absolutely no doubt they were made in good faith.

By reason of a parallel SEC civil

action pending since February 1972, we have learned that company management and others deliberately lied to and deceived the PMM&Co. auditors with respect to the existence of, and the company's ability to perform on, purported contracts between NSM and its customers. For example, a contractual agreement between NSM and Eastern Airlines, which was shown to the auditors so that they would agree the company could recognize income on the contract in its financial statements, was actually negated by a secret side agreement between Eastern and NSM that was hidden from the auditors. Another graphic example was the apparently false contract confirmation given to the auditors by Juan Homs, then of American Airlines, now a fugitive from another Federal indictment alleging he received kickbacks from American's suppliers.

We are disturbed by the fact that the allegations against the auditors relate to NSM *unaudited* financial statements, where the auditors did *not* perform and were *not* called upon to perform an audit. In August 1969 PMM&Co. was asked to make a limited review of NSM's nine-month interim statements because those statements were being included in proxy material which sought approval of a merger with Interstate Corporation. Mr. Scansaroli, the audit supervisor, questioned some of the contracts on which income was being recognized when they were brought to his attention by the audit senior. He received assurances as to their adequacy from the company Treasurer and satisfied himself that company management had given adequate consideration to those items in the preparation of their financial statements. When the Federal investigators first raised a question about Mr. Scansaroli's good faith "in accepting the company's explanation," Mr. Scansaroli submitted to, and successfully passed, a polygraph examination on this matter.

More important, only two months later in October 1969, when the August 31, 1969 audit was under way and just before the closing of the Interstate merger for which the challenged proxy statement was issued, Mr. Natelli, the audit partner, ascertained through work done by his staff that certain contracts had in fact been cancelled by NSM in the last three

months of the fiscal year. He therefore insisted that their cancellation and other adverse information discovered in the audit be called to the attention of Interstate. *That was done; in addition, Mr. Natelli and others in the Firm actually urged NSM and Interstate, including both boards of directors and the outside counsel for both companies, to postpone the merger in order to issue corrected interim figures.* This action was described by Fortune magazine, in a March 1972 editorial, as going beyond what most auditors would feel their "professional obligations required, and as much as the laws relating to audit-client confidentiality permitted."

Why, then, were Mr. Natelli and Mr. Scansaroli indicted? Apparently because the Government, in its commendable effort to wage war on white collar crime, has also decided to wage war on independent accountants for not detecting that crime when they are actually victimized by it. Apparently, too, the Government wants to make new law governing accountants' responsibility for unaudited statements, a subject uniquely unsuited to development in the criminal courts.

This is an ominous day for the accounting profession, but we are confident Mr. Natelli and Mr. Scansaroli will be vindicated. □

EDITOR'S NOTE: Frequently, allegations charging accounting firms with gross negligence, even felonies, are not accompanied or followed by explanations by the accused setting forth its position. Since CPAs are often questioned by clients and others, sometimes even taunted, on dramatic newspaper accounts about CPAs, it is helpful for them to have knowledge of the position of the charged party (necessarily a subjective position). Thereby they may be able to reach a tentative judgment, if possible, and at least be in a better position to respond intelligently to questions and challenges.

With this objective in mind, and nowise taking any position on the case, we present here the statement issued by Peat, Marwick, Mitchell & Co. on the indictment of a partner in the National Student Marketing Case.

Max Block

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