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Accountants' Certificates*

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What credit statements should represent, are intended to represent and are understood to represent is a general question of interest both to the public accountants, who as a part of their professional work prepare and certify to such statements, and to bankers and credit men whose business actions are in part influenced by such statements.

Without minimizing the importance of the credit statement as a feature of the professional accountant's work, we must recognize that it is, however, only one feature of a very wide range of valuable service which he is asked to render and does render in modern business.

Not all his audits are intended to lead to credit statements. A cash audit may be made, intended only to verify the honesty of the cashier's handling of funds, a cost audit may be desired to determine whether costs have been properly charged against the several departments or divisions of the business, special audits may be needed to determine an accounting under particular contracts or agreements. In addition, there are the demands for cost accounting, office systems, tax returns and all manner of consulting and advisory services for which the accountant's training, experience and abilities may qualify him. Perhaps in every one of these cases it might be better for the client if a complete audit were made and such a statement prepared as would conform to the highest standards for a credit statement. The public accountant certainly would have no reason to object to the most complete possible use of his services.

The accountant must, however, recognize that there are many perfectly sincere, honest business men who do question whether a full audit of their accounts has any value to them commensurate

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with its cost. The fact that any client or prospective client may not be disposed to avail himself of what an accountant may feel to be the full service which might be rendered is no reason for the accountant to look with doubt and suspicion on such service as the client may ask him to render and is no reason why the accountant should refuse to render such honest and useful service as the client may desire.

A client, fully satisfied as to the honesty with which the accounts are handled, but dissatisfied with the form in which his present operating or financial statements are prepared, may properly ask an accountant, without audit but accepting the books and figures as correct, to do what he can to shape up a better form of statement. The accountant may in a few days render to the client a service of real value to him, whereas it might require weeks to make a proper audit.

Not infrequently the accountant is asked even by bankers themselves to prepare quickly without audit a statement based on book figures with such explanations as may be made to him, in order to make promptly available the information which such a statement may give for whatever it may be worth.

We might continue further to expand these examples of statements which were never intended for and should not be used as a basis for extending credit.

On the other hand, we recognize that the banker does not act solely upon a proper credit statement. If bankers should suddenly decide that loans would not be made except upon properly audited and certified statements, we would have either a great reduction in loans or a deluge of accounting work. Admittedly such a rule is not practicable. Loans will continue to be made and credit will continue to be given on a basis of character and ability of the borrower. There are many cases where financial statements do not justify a loan but where a loan may rightly and properly be made. There are other cases, probably fewer in number, where in spite of satisfactory present financial statements, the loan should be refused. The most important question is not the condition at the time the loan is made but the condition when the loan has to be paid. Regardless of what the present balance-sheet may show, the business which is heading rapidly downhill or is in incapable or dishonest hands is not entitled to the credit which should be extended to the business which is on the up-grade and is being capably and honestly administered.

These matters are mentioned in this preliminary way because in some discussions of the subject of accountants' certificates there seemed to be an assumption on the one hand that the entire work of the public accountant consisted of the preparation of credit statements and on the other that the banker never should make a loan except on the basis of a certified financial statement which he had before him.

To recognize conditions as they actually exist is not to minimize the importance of the financial statement as a basis for loan or credit or the importance of a proper certification thereof by the public accountant. Possibly it means that the banker might often avail himself to advantage of a wide range of valuable information which the accountant could furnish to him but which is not and can not be reflected in the formal balance-sheet or even in the summarized income account. Perhaps accountants' credit statements ought to be expanded to give important information as to gross sales, percentage of net to gross, distinction between profitable and unprofitable departments, and particularly to set forth and give their comments upon the comparative showing over a series of years. However, this is not the subject I would here discuss.

In this discussion I shall use the term "accountants' certificates" in a broad way to mean

> The written declarations signed by accountants which set forth the nature of the financial statements they submit, and this regardless of whether the expression "We certify" is or is not used therein.

I use the expression thus broadly because I am trying to deal with substance rather than with form. Form is not unimportant and uniformity is certainly a great convenience, but if we can agree as to substance, there need not be great difficulty in agreeing as to satisfactory form.

The three great divisions of philosophy were stated by Kant to be

(1) What can we know.
(2) What ought we to do.
(3) For what may we hope.

Let us consider our subject from these viewpoints.

WHAT CAN THE PUBLIC ACCOUNTANT KNOW?

Anyone who has sat on the witness stand with his testimony subject to cross-examination by a keen attorney is made to realize how very little after all he really knows. Under such a searching the public accountant finds that generally his knowledge is confined to the statements and figures set forth in the books and records (as to which the records themselves are the best evidence) and to the statements which have been made to him by others (which are simply hearsay). If he happened to be on the ground during the period as to which he is testifying, he may have some personal knowledge, but this is simply knowledge which he has as an individual and not particularly as a public accountant. He may, when duly qualified as an expert, state his opinions and conclusions from the facts developed, but such testimony becomes admissible only when the facts have first been evidenced.

Even though fully qualified to testify as to accounting matters, he can express no opinion as to values unless by different tests he is shown qualified to do so, nor is he permitted to express his opinion as to authenticity of signatures or entries unless qualified as a hand-writing expert.

For example, as to real property, the accountant finds that all he really knows is that the books and records show its cost to be a certain aggregate amount which may represent the total of various items therein set forth. Possibly he may find the books charge against building A the cost of certain steel work which the voucher states was purchased for building B. He may even find that other records show this particular steel to have been used in building B, but even so he does not yet have definite knowledge whether the steel was used in building A or in building B. He may make inquiry of those who were on the job during construction and everyone whom he asks may agree that this steel was used in B rather than A. He may be wholly satisfied in his own mind as to the fact, yet the most he can say is that he believes what has been told to him although he must recognize that he does not have real knowledge of the fact. Possibly he may happen to be an engineer or to have enough engineering knowledge and ability so that he can state the detailed steel requirements of such a building and reach the conclusion that the particular steel in question could not have been used in the building as it stands. His ability to do this must, however, be based on engineering rather than on accounting knowledge.

But even though he has determined what the records show to be the cost of this building and is satisfied that this is the true cost, this gives him no real knowledge as to its value. Possibly he may have a record of a price at which it was sold or may find records of offers which have been made for its purchase or its sale. Possibly he may make such investigations as satisfy him that the transactions or the offers were bona fide, yet unless he actually participated in these transactions in some way other than as an accountant, he can hardly have real knowledge regarding them.

Possibly he may have such experience in real-estate dealings that he will form in his own mind some conclusion as to the real values involved. Possibly he may have enough knowledge of the people concerned to reach his own conclusion that if X offers \$500,000 for the property it must be worth at least \$750,000, or he may possibly reach a conclusion that if it stands on the assessment rolls at \$500,000 it represents a value of at least \$800,000, but whatever these conclusions of his may be as to value, they must be based on some knowledge and experience which he has otherwise than as an accountant.

As to machinery and equipment his knowledge is likewise limited. The accountant may see what items are, in the books and records, stated as the expenditures for machinery and equipment. He may find vouchers and receipts for all such payments. He may take the vouchers and records and go through the plant asking someone to point out to him the various individual machines. He may consult the records to see what they show as to dismantled and obsolete items. He may interview machinists, foremen and superintendents. Thus he may reach a conclusion in his mind as to what is the cost of now existing plant and equipment; yet he must recognize that, after all, the real facts which he knows are few. Then he must recognize that even though he is satisfied a machine cost \$1,000 that is only slight indication of its value. He may find what he considers a reasonable allowance made for depreciation, but this at best is a mere estimate. But even after he reaches his conclusions as to a fair basis of depreciated cost, he is still left with an uncertainty as to whether or not the machine is really worth anything. Even though the machine be working full time and full capacity, there is still the possibility that it ought to be thrown out and a newer and better machine installed in its place. If the accountant happens to be likewise an engineer, qualified to form an opinion on this subject, he may state his conclusions as an engineer, but he will do this as an engineer and not as an accountant.

The accountant may, of course, prepare his statement to evidence appraisal or engineering conclusions. He may in his statement show a real-estate appraisal of $100,000 instead of a cost of $50,000, or he may show for plant and equipment $500,000 determined by engineering appraisal instead of $1,000,000 shown by the books and records. If he does this, the fact with which he is concerned is that he is stating an appraisal rather than a book figure.

What was the value two years ago of all the then existing machinery and equipment of the Ford plant? Only one who knew the detailed plans for the new model could have told. Should an accountant then reporting have written it down to its scrap value? Should he have set up a contingent liability of $50,000,000 or $100,000,000 for reconstruction and bringing the new model into production? Certainly not, as the accountant looks on the balance-sheet. When I, as an accountant, see a statement certified to by a fellow accountant, I neither consider nor expect that he has been going so far beyond the natural limitations of accounting knowledge as to forecast management policies for the future and their financial results and requirements. It is perfectly true that an accountant may make a particularly valuable report, if in collaboration with the management he can set up the probable financial results of proposed business action. Perhaps it might be well for all concerned if every banker, before making a loan, should insist on a definite statement of the management's policies for the ensuing six months or year, with a corresponding budget and financial forecast, to be reviewed by a public accountant and accompanied by his report and comments thereon. In many cases such a statement would far outweigh the balance-sheet in importance. Many a bad loan or bankruptcy might be thereby avoided.

But such a forecast is not a balance-sheet, and no recognition of the great importance of such forecasts can justify their confusion with the balance-sheet, nor should such forecasts be introduced into the balance-sheet except when so clearly stated that there can be no question that present fact and future expectancy are so mingled therein.

But we do not finish with this question when we determine how one accountant will look upon the certificate of another. If the statement and certificate, which I as an accountant understand to have a certain meaning, does not have the same meaning to you who receive it, there is an element of danger and wrong which needs to be corrected. If we accountants have been wrong in giving certificates in such language as gives to you a mistaken impression of what we have done and what responsibility we assume, the English language is rich enough and broad enough to furnish all the words needed to make our certificates carry their right meaning. But this can be done only if the certificates can be written to contain all the words necessary to carry the right meaning.

If, for example, as to inventories, we wish the accountant's usual short certificate to be understood as meaning what I believe it to mean, we can readily have him add the statement that inventories as set forth in the statement are represented to him to have been taken by responsible officers or employees of the company and to be priced at cost or market, whichever is lower, with due allowance for obsolete, damaged or useless stock, and that his general examination and test of the records and of stocks on hand indicate that this is so.

Should such a statement as this be added wherever this is the fact, or can we satisfactorily leave the short certificate in substantially its present form and have this understood?

This is an important question to be answered because we should not ignore a condition where the accountant who says this is blamed for a qualified certificate and unsatisfactory work, whereas the accountant who does not say it, because he believes it is understood without his saying it, is complimented for a better certificate and better work. It is important to accountants to avoid unfair criticism but it is more important to us and to you that you should not take your actions upon an assumption that our certificates mean something that they do not mean and were never intended to mean.

Turn to the other end of the statement. What can the accountant know as to so-called "cash in bank"? He knows that he has a bank certificate of the amount which the bank states as a credit to the client's account. Against this he may find that the records show certain cheques issued but not yet charged up by the bank. The accountant does not know and can not know that there are no cheques which have been drawn on the bank account but have not been entered in the company's records. He may take advantage of the time between the closing date of the books and the termination of his audit to make further check of the bank accounts to see that no such unentered cheques have, during this interval, been paid by the bank; yet he can not know that there is not some such cheque outstanding which has not yet been presented to and paid by the bank.

Similarly, consider notes payable. The accountant may verify the correctness as to amounts and maturity dates of all notes payable shown by the records. He may receive statements from all those banks, or others, shown by the records as probable payees of outstanding notes, yet this does not prove that there may not be other unrecorded notes outstanding.

Let us further consider cash. The certificate of a bank as to the amount which it has to the credit of a client is not necessarily evidence that this balance will ever be realized. Presumably the bank is sound and solvent, but the accountant as he receives such a certificate does not have knowledge regarding this. If the accountant were to delay his statement until he could personally verify by adequate examination the condition of every bank in which the client had deposits, few clients would receive certified statements until long after they had ceased to be of value for credit purposes.

As to accounts receivable, ordinarily the accountant is not permitted to ask for verification from his client's customers. It is customary to do so for stock-exchange houses and a few other lines. Perhaps the practice should be further extended, but at present the trade sentiment is so strongly against it that the accountant rarely has the benefit of this knowledge. He can ascertain the balances shown by the records as being outstanding for longer than the usual collection period. He can make some inquiry and reach conclusions largely on hearsay as to their status, but there is only a very limited range of facts which he can know.

Inventories are most difficult ground. If he took enough men into a plant he might actually count all the articles in the inventory. However, almost never could he get a large enough force of men with enough knowledge of the articles in the inventory of that particular business to determine the exact nature and quality of every article on hand.

Take, for example, a clothing manufacturer. Is an accountant supposed to be able on examination to recognize from his own knowledge every piece of goods on the shelves, to know whether it is a pattern which will sell or will not sell, to say whether coats and suits and even women's clothing will have a salable value at least equal to the prices at which they are carried in the inventory? Any accountant who could do this has apparently missed his vocation; he ought to be an extremely successful merchant.

Let me here point out that the very term "auditor" means one who hears. Unless the name is itself a misnomer, the auditor is primarily one who receives his information from others, by word of mouth or by written record, and is not one who depends primarily on his own personal knowledge. He hears and considers what is before him and from it he reaches his conclusions. We need not rest this point on the derivation of the word, for we know the general thought that if anyone is so closely a part of any business that as a participant he has personal knowledge of all its transactions, he has by this very fact largely disqualified himself as an independent auditor whose certificate is desired.

The English law, which requires the naming of official auditors who shall report directly to the stockholders, notably adheres to this basic thought as to the auditor. The companies "consolidation" act of 1908, section 113 (2), reads as follows:

> "The auditors shall make a report to the stockholders on the accounts examined by them, and on every balance-sheet laid before the company in general meeting during their tenure of office, and the report shall state—
>
> (a) Whether or not they have obtained all the information and explanations they have required; and,
>
> (b) Whether, in their opinion, the balance-sheet referred to in the report is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs according to the best of their information and the explanations given to them, and as shown by the books of the company."

Space does not permit me here to quote at length from English decisions, but I would quote briefly from the Kingston Cotton Mills case:

> "It is no part of an auditor's duty to take stock. No one contends that it is. He must rely on other people for details of the stock-in-trade in hand. In the case of a cotton mill he must rely on some skilled person for the materials necessary to enable him to enter the stock-in-trade at its proper value in the balance-sheet."

My reason for quoting this English law and referring to the English decisions is not to show that English courts have accorded a measure of protection to accountants, but rather to show how clearly the English law recognizes that the independent auditor has to rely on the information which he obtains rather than on his own personal knowledge. My purpose in discussing the question, "What can the public accountant know?" is to show that by the very nature of things the public accountant must be limited as to his personal knowledge of affairs and must reach his conclusions from what he is able to find in the records and the information and explanations which he receives from others.

Thus limited at best, the accountants' knowledge is even further limited by the authorization which he may receive. It is and must be a part of the accountant's professional ethics that he will not endeavor to take advantage of an opening given to him to obtain knowledge which is not within the scope of the client's authorization to him. If the accountant does not believe that he can fairly and honestly undertake an engagement subject to the limitations imposed upon him, he may refuse it, but if he does undertake the work he must respect these limitations—and they are just as effective in limiting what he can know as are the inherent difficulties referred to previously.

Let me here say that in pointing out that accountants' certificates do not mean as much as some people would like to think they mean, I am not saying a word to detract from the real value which they have. Their greatly increasing use has not been because of false ideas of what they represent, but because of their proven value. In fact, such over-confidence in the accountant's certificate as does exist is largely due to the value which in actual practice these certificates have been found to have. Because accountants have found, even within their natural limitations, so many cases where accounts receivable were padded, inventories overvalued, liabilities understated and contingent liabilities ignored, there has been a growing conviction of the value of the accountant's certificate for such protection as it can and should give.

The accountants sincerely hope that they may do nothing to disturb this. There is no surer way to lose the confidence now reposed in them than to seem to do that which they can not do. Accountants are not possessed of an infallible truth-detector, nor do they have the gift of prophecy, yet we hope they may disclaim these and still leave themselves a useful position in the business world.

WHAT OUGHT THE ACCOUNTANT TO DO?

Recognizing this limited knowledge which the accountant can have and the dependence he must place upon what he finds in the records and upon the information which he receives from others, we then come to the question of what ought the accountant to do.

In the first place we may fairly assume that the accountant does not want to give and the banker does not want to receive an accountant's certificate which purports to set forth a knowledge of the facts which the accountant does not possess. There have been dishonest accountants as there have been dishonest bankers, but each is the exception, so we may here direct our question to the accountant who is as anxious to give as the banker is to receive the right and proper certification.

In Professor David Himmelblau's book on *Auditors' Certificates* (page 120) he makes these statements:

> "The ideal certificate is one that conveys precisely the right shade of meaning to anyone who studies carefully its every word and at the same time creates the correct general impression in the mind of anyone who reads it casually.
>
> "Certificates should be so worded that double meanings are impossible and no opportunity is given for drawing deductions not intended. In identical sets of circumstances the certificate of one auditor should mean precisely the same as that of another, and exactly similar meanings should attach to the words used."

This is the ideal and it is an ideal we should approach as closely as in our strenuous business life we may. No one can take exception to Professor Himmelblau's statement as a standard toward which we should strive. Similarly no banker would take exception to the statement as a banking standard that no loan should ever be made which the borrower will not be able to repay, or that credit should not be extended to a man who will be unable to pay his debts. Attorneys should so draw agreements that they can not be misunderstood. Likewise we all agree that no law should ever be enacted by congress which does not clearly express the legislative intent. It is not a lowering of standards or being false to the highest ideals to admit that none of these standards I have mentioned is now attained nor is it pessimistic to doubt that any ever will be fully attained.

The accountant is just as desirous of writing certificates which will clearly convey his meaning as the banker is to make sound loans. Unfortunately neither is perfect.

In a recent paper Melville M. Parker states:

> "It is becoming an accepted fact that a direct responsibility rests on the accountant to present his findings so that none can misunderstand."

I wish we might attain this ideal which no one yet has been able to attain. The great division of the Greek and Roman Churches came largely from a dispute as to a single Biblical word.

But granting that the accountant should make his certificate so clear and definite that he can reasonably expect it to be understood by the one who reads it as carrying the meaning which the accountant intended it to carry, then we might ask what kind of certificate he ought to give.

It need hardly be pointed out that the accounting profession is sincerely desirous of holding as high and responsible a position as possible in the public estimation. Accountants do not wish to evade responsibilities which they can properly assume and they ought not to do so.

I can not forbear here to cite those statements which usually appear on announcements of security issues, such as:

> "While we do not guarantee the above information, it is obtained from sources which we believe to be reliable."

or, perhaps better,

> "The statements contained herein, while not guaranteed, are based upon information and advice we believe to be accurate and reliable."

Such qualifications may in some cases be used purely to evade responsibility, yet we know that our better houses honestly and sincerely intend that the statements they make in their offering circulars shall be accurate and reliable. Is it too much to ask you to believe that the accountant, although ready to express his opinion and take his full responsibility, is equally desirous to disclaim those responsibilities which from the very nature of his work he can not assume?

Mr. Parker, in his paper referred to, cites as "a simple and straightforward certificate" the following:

> "We have audited the above balance-sheet and certify that in our opinion it properly reflects the financial position of the X Company as of December 31, 1926."

He also cites and condemns a certificate which includes the following statements:

> "The inventories were taken by the company's representatives and the quantities were not verified by us. We were not in a position to appraise the value of patents or goodwill, and provision for federal income taxes is subject to adjustment upon final determination of the liability therefor."

Mr. Parker particularly comments that the auditor "accepts no responsibility for the valuation of patents or goodwill." Is this comment deserved? Does the banker believe that the accountant is ordinarily accepting responsibility for the valuation of patents or goodwill? Is anyone wise enough to state the true value of the goodwill of General Motors, or Woolworth, or Montgomery Ward, or Macy? Or the value of the patents of General Electric, or Timken or Radio Corporation? Or the value of the franchises of American T. & T. or Western Union?

When the accountant states his opinion that a balance-sheet "properly reflects the financial position of the company" is he supposed to be stating what he believes to be the true values of goodwill, patents and franchises? If so, then few certificates should be issued without qualification, for rarely, if ever, has the auditor attempted to pass upon such values.

Next, as to federal income taxes, each of you knows the uncertainty of their amount. Until the statute of limitations has run there is no certainty as to that liability. Even if the certifying accountant has himself prepared the tax return, rarely can he say that this is the true tax liability. Nor can he state as the true tax liability whatever amount any government employee or even the commissioner himself may propose. Great injustice would have been done to corporations and their stockholders if every additional assessment which has been proposed during recent years had been set forth as a liability, direct or contingent, on the balance-sheet. To some extent, every certificate must be read as subject to undetermined tax liabilities. Perhaps accountants should more generally state this qualification.

I have a letter from a banker whose opinion I greatly esteem, in which he expresses his thought that where tax authorities have already entered claims or indicated that taxes for any year are to be opened up, out of which claims may be made, the accountants should certainly ascertain it in making the audit and should set up the facts as a contingent liability in their report. He likewise suggests that in so far as an official confirmation of tax settlement down to a certain year has been furnished, the audit report should set forth such confirmation.

Frankly, I believe that more attention should be paid to these tax claims. I know that if I were a banker this is one of the first questions I should wish to ask. Yet as I have considered case after case which has come before me I find it impossible to do justice to the usual situation without a much more extended discussion than is possible in any brief report. There was a time after the war when it seemed almost necessary that every statement should be qualified as being "subject to final determination of federal income-tax liabilities." This seemed about all we could say. The treasury department was running wild in its letters stating proposed additional taxes. In many of these cases I would not have felt justified in stating the amount which the department was proposing without adding an expression of my own belief that no such amount was due.

There are three positions I see which we may take:

(1) We may assume that the uncertainty and indefiniteness as to tax liability is so well recognized and generally understood that there is no need for us to state this as a qualification in our reports.

(2) We may assume that the situation is not generally understood so that we should make this as a qualification wherever there has not been a final and definite closing of tax liabilities to date. If so, we must then qualify practically all the certificates we issue.

(3) We may regard this not as a qualification of the certificate, but simply as a matter to be explained, and present a summary of the situation, as my banker friend referred to above has suggested, but we can do this only by abandoning the so-called short certificate and substituting for it the more lengthy accountant's report.

This is a subject I shall refer to later at more length.

As to the matter of inventories, I quote from Professor Himmelblau's book (page 53). As to certain certificates he comments:

> "It is stated that the quantities were accepted by the auditors upon the management's certification to the auditor. Is this to be considered as a qualification? Hardly so, for the certificate merely states the audit practice which is customary in 99 per cent. of the audits. Inquiry has developed that the same scope of audit was followed in many certificates that do not mention this point and apparently contain no qualification whatsoever. If this point is to be viewed as a qualification, then an 'unqualified' certificate . . . would become a rarity."

Mr. Parker's commendation of the short certificate and his condemnation of the long certificate seem to bring us squarely to the crucial question as to what the accountant ought to do. The probabilities are that the auditor who signed the short certificate which Mr. Parker commends as "a simple and straightforward certificate" had not himself verified the quantities in the inventory or appraised the value of patents or goodwill, and did not question that federal income taxes would be subject to adjustment upon their final determination. It is true that in the certificate which Mr. Parker condemns the auditor does not express his opinion that the statement properly reflects the financial position of the company, but he does state that he has audited the records. As I read his certificate I see no reason why he should not have so expressed his opinion.

If this is so, then we have two auditors' certificates which both mean the same thing. One does not state certain inherent limitations upon his work because he assumes they will be taken for granted, and he accordingly is commended. The other auditor, by stating these limitations, gives to them such an emphasis that his certificate is condemned as "practically worthless."

This criticism of Mr. Parker's is cited because it is typical of what many bankers say. Some of them even go so far as to say that when an accountant gives his certificate to a balance-sheet it should mean that the assets there listed will realize at least the figure at which they are carried on the balance-sheet. As I have pointed out, this is something which the accountant does not and can not do.

When the accountant states that in his opinion a balance-sheet "properly reflects the financial condition of the company," or that it "correctly sets forth the financial condition of the company," he does not mean that this is a correct statement of realizable values. He only means that in his opinion the balance-sheet has been properly prepared from an accounting viewpoint. This includes proper reserves for bad and doubtful accounts, proper reserves for depreciation, the entry of all known and definitely determined liabilities, etc. It does mean that inventories are stated on a proper basis with allowance for spoiled or unsalable goods, but it does not mean that he is passing upon the actual collectability of the accounts or on the actual values of the assets. It does not mean that he is stating the balance-sheet on the basis of his personal knowledge of the facts, but on the basis of his examination of the records and, as the English phrase it, "according to the best of his information and the explanations given to him." The auditor is responsible for reasonable diligence in examination and inquiry and for a fair judgment upon the information before him, but he is not an appraiser or underwriter of values.

The most important question as to what the auditor ought to do seems to hinge on the question of what is ordinarily understood and what ought to be understood by a certificate which states that in his opinion the balance-sheet properly reflects the financial position of the company. If bankers, credit men and the public at large generally understand that such a certificate means and should be understood to mean that the accountant has done more than he has done and that he accepts a responsibility which he does not and can not accept, then it seems to me we must abandon the short certificate.

We may cover some of these matters by the wording of the balance-sheet. The trouble is that if we try to say "Plant and equipment—book value," we seem at once to raise a question, and yet, except where plant-and-equipment item is based on an appraisal and so stated, that is about all we can say that the balance-sheet figure represents in most cases.

If we abandoned the short-form certificate and used a longer form, we should avoid many difficulties. We could then make comments upon various items without so unduly magnifying them that our comments would seem to be reflections upon the correctness and propriety of the accounts.

Nevertheless we still leave the underlying question as to what should be done to prevent our certified statements being considered as representations of the realizable value of assets.

It is at this point in our consideration that we come to the suggested remedy of a service classification. If we draw up certain schedules of the details covered by class A audit and verification, and of others by class B, class C, etc. shall we eliminate much of the present uncertainty and misunderstanding? It may well be urged that a certificate which states "we have made a class A audit" will mean something definite to one who has clearly in mind just what class A schedule represents. But it will mean nothing to the man who is ignorant of this schedule. Such a certificate could hardly be used on a report to stockholders, as it would be meaningless to most of them.

Again, it would require some close discrimination as to the merits of the several schedules as applied to various conditions. For a small company $5,000 of advances to employees may be a serious matter, whereas, for one of our great corporations an aggregate of $5,000, representing a lot of small items, sinks into insignificance. No one could reasonably ask that the auditor should inquire with as great care into this feature where it is unimportant as where it is important. Or, yet again, we can not hope to get as careful and accurate a check upon the merchandise for sale by a department store as we can of the metals for sale by a mining company, whereas the merchandise for sale in the mining company's store is probably of so little importance that any errors in it will not materially affect the showing of financial condition of the company. I am frankly at a loss to see how such schedules can be drawn up which will properly care for this matter of perspective.

I wonder if such schedules are our remedy, or if we can not do more by using simple English words to indicate what we have and have not done.

In saying this, I would not in any way discourage any attempt to formulate schedules of what, in various circumstances, might be done and what a certificate in each such case would represent. It would certainly tend to a recognition of the problems and difficulties inherent in the situation and so accomplish much good. Even though it might result in showing that such scheduled certifications are not themselves the solution, it might well be a step toward the right solution.

This is an expression of my personal thought. I understand this question is receiving definite consideration by a committee of the American Institute of Accountants. I am not a member of such committee and nothing that I here say should be considered as representing the deliberations or conclusions of that committee. I believe that the considerations which I have mentioned will presumably enter into their deliberations and will inevitably influence their conclusions, yet as they consider this subject they may see further and better than I now do what is its right solution.

FOR WHAT MAY WE HOPE?

We may hope for much from the mutual consideration and discussion of this subject between the accountants who issue these certificates and the bankers and the credit men who receive them. It is not surprising that there should be today some question and dispute on this matter.

Accountancy is a relatively new profession. Its development has come with the demands of modern business. Many of us can remember when the request of bankers for audited statements as a basis for loans was considered as a direct reflection on the borrower. Many business men prided themselves that they had never furnished any financial statements to their bankers.

I need not tell you how greatly the situation today has changed from what it was a generation ago. This rapid growth and development have inevitably brought the many problems which we are today trying to solve.

The recognition by credit executives and accountants that there is a real problem to be solved as to accountants' certificates is in itself a hopeful sign. The fact that a committee of your organization is closely in touch with the committee of the American Institute of Accountants and that both these committees are giving their consideration to this subject should eliminate those misunderstandings which are usually the greatest bar to a proper solution of such a question as this.

If those who receive our statements believe that there are things which the accountant ought to do and can do, the accountants will gladly do what they can to see that such work is properly and satisfactorily performed. If the accountants have been guilty of issuing certificates which, though perfectly clear to them and in accord with accounting precedents, are misunderstood by you who receive them, the accountants can and should do what is necessary to avoid such misunderstanding.

The solution will not come, however, from asking the accountant to do what in the very nature of affairs he can not do, nor will it come along lines which assume that the accountants will never issue any statements except those which are appropriate for credit purposes.

Much of the present difficulty, I think, comes because the audit is usually made by the accountant solely at the request of the client and subject to whatever limitations the client may impose. The accountant, if he accepts the engagement, is bound by the limitations which the client imposes. Often we should have a very different situation if the instructions as to the audit were given at a conference in which the banker participated, yet rarely is this done.

Again, many difficulties could be avoided if the bank asked that on delivery of the report to it the accountant should be present to participate in its consideration. Of course, the accountant is only in a position to give to the bank information as to his client's affairs with the approval and authorization of the client, but rarely would a client refuse authorization for such a conference if it were requested by the bank.

I realize that the possibilities of such conference are limited and could not apply to every one of a chain of credit men who received the client's statements, but I believe much would be accomplished if, where possible, such conference could be arranged.

Then again the accountant finds it impossible to persuade the client that he should have a full audit made of his affairs when the client finds the banker entirely ready and willing to accept certificates of limited audit. When the banks readily accept and make loans on limited certificates, not merely the client but even the auditor is bound to feel that that is all the bank requires.

Professional accountants do hope that they may continue to hold the highest confidence of credit executives and of the public and hope they may so conduct themselves and so present their certificates as to merit that confidence. They hope for the mutual understanding which is essential to this end. If they seem to have erred, they hope that they may be told, so they can either present their justification or can provide against a continuance of such errors, but they do hope that those who criticize their certificates will do so with the recognition of the problem with which the accountant is confronted and with the belief that the accounting profession desires to meet the highest standard for its certificates that anyone can reasonably ask.