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In all my years -- Classification of accounting services

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IN ALL MY YEARS—CLASSIFICATION OF ACCOUNTING SERVICES

The idea of a classification of accounting services originated with John R. Wildman who was the senior technical partner for the firm of Haskins & Sells during the 1920's and under whose direction the writer was employed fifty years ago. In 1916 Wildman, who was then head of the Department of Accounting at New York University and the author of several textbooks on accounting, along with five other educators founded the American Association of University Instructors in Accounting (later the American Accounting Association) and was elected its first president. Wildman introduced the concept of service classification into the practice of Haskins & Sells in the Fall of 1925 based upon an evaluation of 5,000 engagements. About four years later and after a review of about 20,000 additional engagements Wildman presented the matter of classification of accountancy services to the American Society of Certified Public Accountants and several state societies for adoption.

The American Society of Certified Public Accountants issued its first report on the subject in December 1929. A second report was issued in September 1930 and a third and apparently final report was issued in July 1931. Among the state societies which sponsored the concept of classification of accountancy services were New York, New Jersey, and Pennsylvania. One of the purposes of classification of accountancy services was to minimize misunderstandings between the accountant and his client as to the services to be performed. Professional opinion on the subject, however, was not unanimous. The American Institute of Accountants (into which the American Society of Certified Public Accountants merged in 1936) issued a report to its members dated October 8, 1931, saying that the matter of adoption of a classification of accountancy services had been considered by its Committee on Education and its Council, and that the latter had "unanimously resolved that it would be impracticable and unwise for the Institute to issue any classification of accountancy services at present." This action on the part of the Institute was a deep disappointment to Wildman.

The matter of classification of accountancy services was not the only area of difference between the American Institute of Accountants and the American Society of Certified Public Accountants. The primary difference had to do with the requirements for membership. The Institute was patterned more after the English concept, professional recognition being based upon membership in a professional society, the membership requirements including the passing of a written examination and professional experience; no CPA certificate was required. The American Society of Certified Public Accountants felt that a CPA certificate was an essential prerequisite to membership. The American Society's viewpoint prevailed at the time of the merger in 1936 which was facilitated by Colonel Robert H. Montgomery's insistence that the merger take place when he was asked to once again serve as the Institute's president. There were many who at the time of the merger wanted the Institute's name changed to the American Institute of Certified Public Accountants, but this change did not take place until more than twenty years later. Thus, the unanimous rejection of the concept of classification of accountancy services by the Institute's Council in 1931 quite possibly may not have been an unbiased evaluation of the concept on its merits.

Disregarding the non-auditing functions set forth in the classification of accountancy services as endorsed by the American Society of Certified Public Accountants, such as special investigations, preparation of financial statements from books and records without audit, tax services, system services, and budgetary services, brief comments might be in order regarding the auditing services included in the recommended classification.

1. Detailed audit. Detailed audits involved 100% examination of all recorded transactions. Very few detailed audits were performed as such an audit would be impracticable except for very small entities.

2. Test audit or sometimes referred to as a general audit. This was the customary type of auditing service rendered involving an examination of the transactions on a test basis accompanied by a certificate covering both the balance sheet and the income statement.

3. Examination of financial condition and review of operations, sometimes referred to as a general examination. This type of service was developed in connection with the offering of securities to the public and usually involved an examination covering a period of years. It was made with the view that there was no overstatement of net assets or of net profits; in other words, that the net

assets and net profits were at least as good as represented. This type of service was not designed to detect lapses of fiduciary integrity or any understatement of assets which may have been concealed in the operating accounts. It was this class of service which was affected the most with the passage of the Securities Act of 1933; nothing less than a general audit would suffice thereafter.

4. Examination of financial condition. This type of service applied primarily to financial organizations, like banks and stock brokerage firms; generally speaking the income statements of these organizations were not subjected to audit until a later period.

Haskins & Sells has continued the use of classification of accountancy services, originally adopted in 1925, to this date modified as required by the enactment of the Federal Securities Acts.

The writer had an interesting experience in 1928 involving a general examination of four prominent cotton mills which were contemplating a merger which was never consummated. The professional services required included a review of the income statements for a period of ten years. One mill apparently was following what might be termed pre-1913 (income tax) accounting as it provided for depreciation only in those years in which it otherwise recorded a profit. And in one year a new mill was constructed at a cost substantially in excess of the original estimate; the new mill was recorded in the accounts as an asset at the estimated cost and the excess, amounting to millions of dollars, was charged off against earnings for the year!

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WORTH NOTING

"Nothing is as powerful as a good idea, but nothing is so powerfully sure-fire as a good idea whose time has come."

G. Herbert True

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