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Accounting or Chaos

By JANE GOODE, C. P. A.*

Accounting was utilized by the desert caravans and the galleys which covered the great trade routes of the ancient world but as a profession it is as modern and streamlined as the newest plastic furniture. As late as twenty-five years ago, the professional accountant was regarded as a sort of public bookkeeper and auditor. Now he is regarded as a business and financial advisor and tax counselor in a rapidly changing social order.

We live under a system based upon the sanctity of private property; a system in which most of us believe. Through the centuries, we have developed a social order under which private property could be held, used and enjoyed. Until a comparatively short time ago, there was tangible evidence of an individual's wealth: a home, houses rented for income, merchandise in his store, grain, fruit and livestock on his farm. But the last few decades have witnessed the development of the modern corporation. Our economic environment has changed and the change has been due not only to scientific and industrial development but to evolution of the business enterprise itself. There has been a rapid growth in size and complexity, a greater continuity, a widening separation between the higher ranks of management and the technical staff and between management and ownership.

The tangible evidences of an individual's property (with the exception, of course, of personal belongings) has, for the most part, given way to intangibles in the ownership of securities. Our business enterprises have grown to such stature,

that it is no longer possible, or even desirable, for one individual or a small group to own all the land, buildings, machinery and raw materials needed by a going concern or to assume the risks of such a business. So it has been found expedient to pool various kinds of wealth and issue receipts for interests therein and we call these receipts securities. Theoretically, the power of management of one's property is still vested in the stockholders but obviously it isn't because they are constantly changing and too scattered to permit the harnessing of their power for constructive use. There are very important social implications in this change from a tangible form of property to intangible. This separation between ownership and management exists in the three forms of government dominating the world today. The distinction, however, lies in the fact that in the democracies, this management is one of private contract whereas in the totalitarian forms of government, management is vested in the political system.

We all recognize that continuity of management is vital to success and the real owners of the business, therefore, must believe in the integrity and good judgment of those executives who are responsible for management. Unfortunately, there are many sordid experiences in our financial history because the management was all too seldom called to account or because of the lack of proper controls. And so, the costly mistakes of the past with their attendant social dislocations have sponsored (?) the rapid growth of governmental supervision and the development of the profession of accountancy. From a tool *OF* control, policemen and policed have learned to use it as a tool *FOR* control.

Keeping abreast of the times, and reinforced by income tax laws, accountants in their role of disinter-

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ested outsiders had developed a code of good accounting procedure just as the law merchants of the middle ages had attempted to regulate trade. From variety of experience, a capable accountant can tell whether the management is building up secret reserves while withholding just dividends from stockholders on the ground of lack of earnings or whether it is failing to maintain adequate ones while demanding increased compensation on the ground of fictitious earnings. He can ascertain whether the asset accounts are padded and achieve a reasonable certainty that the liabilities are fully stated. Occupying a position of public trust, licensed by the state after complying with certain inflexible regulations, conforming to a code of ethics enforced by the professional societies, the accountant can be depended upon to give an unbiased opinion of the condition of any enterprise he examines. Until the last decade, few people knew what a certified public accountant was. Business looked upon him as a necessary evil because the banks required his statements for credit purposes. The investing public paid little attention to his certificates and certainly were not influenced by the qualifications he made to the extent of asking the management for more detailed information.

In almost every case of abuse of the power of management which received publicity during the worst years of the depression, it was found that information concerning financial operations had been suppressed or mis-stated. Sometimes the accountant's work is so circumscribed that it means little but the qualification in his certificate is always a flag of warning. The code of principles developed by the profession of accountancy is one to which management must conform—all our states have recognized the social value of his work and incorporated these principles into their civil laws. Of course, there are some border-

line cases but, in general, these principles are recognized all over the world.

Perhaps during 1941 you kept a record of all the income you received and listed all your expenditures. That's bookkeeping. At the beginning of 1941, you estimated the year's income and apportioned it to various uses. As you know, that's budgeting. At the end of 1941, you added all your expenditures for food, clothing, medicine, entertainment, etc. The totals told you whether or not you had spent too much for any one item, where you might effect some savings this year, whether you had built up the allotted reserves which to you are savings, whether your current income could take care of the debts you had incurred. Now that is accounting. True, it is a very crude form but I think it will enable you to see why accounting is the basis of every business enterprise. It doesn't make any difference whether that business enterprise is the home, the United States Steel Corporation, the Red Cross or the Federal Government. It aids the management of all these enterprises to a more effective control. Accounting is a more exact science than law or medicine. Every intelligent person knows the difficulties which surround a diagnosis even when it is made by the most skilled and experienced practitioner. We all know that lawsuits are not always won or lost on the merits of the case but sometimes on a tiny technicality. But when the competent accountant studies a business, creates and installs a system whereby the activities of that business can be recorded in such fashion that its assets are completely safeguarded and the management can at all times be quickly and easily provided with true and accurate facts to guide it in decisions which are constantly required, the vulnerability of that enterprise can be immediately detected.

Accountants are not economic doctors and do not seek a voice in

management. Their role is merely to localize responsibility — to provide the TOOL for control. Their profession, too, is in the throes of evolution because nothing is static. Accountants are facing problems caused by the existing crisis for which there are no precedents to aid in the solution. And they are holding to the long range viewpoint as they work on these problems. For example, take that branch of the profession known as cost accounting. That is one of the most important factors in the establishment of the high living standards we Americans enjoy. Control and cut costs and goods can be sold cheaper. Cost accounting is like a dress pattern. If you want to get certain results, you must adhere to basic design. Cost accounting is based on budgeting and experience. In these days of priorities, overtime, two and three daily shifts, heavy wear and tear on machinery with no time for repairs, plant conversions—to name but a few of the new factors in industrial life—management is depending solely on accounting to keep going. Taxation depends on accounting and applies to the tax collector as well as the taxpayer. Although every business is compelled by law to keep books, the business and financial world has learned the value of accounting and as long as any form of civilization exists, this tool will be used.

So much for business. What I have said about the relationship of accounting and business is but a brief introduction to my real subject. I called it "Accounting or Chaos." I have attempted to show why neither business nor government can get along without it. An understanding of its methods and functions shows quite clearly that accounting is the central feature of any system of economic control. Such an understanding is tremendously important and if I had anything to do with the training of children, I would certainly see that they were accounting conscious from the time they knew what money meant. I do not mean

that they should be taught the technique of accounting but I do think everyone should know what it is and what it does. Short of manpower as she is, England has placed professional accountants on the exempt list for military service.

American people have an inherent distaste for critical analysis of any situation. Whatever one's opinion of German philosophy and culture may be, we must admit that virtue which expresses itself in careful, painstaking and complete grasp of any subject matter. The German Government has had our unwilling admiration for the machine built from scratch. It used this tool I am talking about. A few years ago, all business in Germany was divided into six groups — industry, trade, commerce, banks, insurance and utilities. The Chambers of Commerce were made semi-governmental agencies. Every enterprise in Germany had to align itself with one of these groups. Each group was compelled to work out a uniform accounting system and a satisfactory cost system, because these are aid to a national economy for they lower costs and prices. I am quoting an official statement made on November 11, 1937—

"The new aims of German national economy require increased achievement and greater economy on the part of the entrepreneur. Prerequisite for the fulfillment of this great task are a profound knowledge and complete comprehension of all business transactions. Therefore, a well rounded accounting system is the basic element for the function of industrial organization."

There were four basic purposes:

- 1—Periodical statements.
- 2—Price calculation, supervision of costs, examination of prices.
- 3—Supervision of development and results of managerial economy.
- 4—Planning and budgeting.

and the system took four basic forms:

- 1—Bookkeeping.
- 2—Cost accounting.
- 3—Statistics.
- 4—Budget.

Now there is nothing in this procedure that is not followed by every enlightened business man in this country. The distinction is that with two exceptions such information is not required or used by our government for control. The exceptions are the railroads and the utilities. Accountants have recognized the values of uniform systems of accounting for years and so does your investment counselor. Much progress has been made along these lines but there is still considerable latitude in the industrial world. Starting right at the top, the accounting and auditing systems of all our governmental agencies need a complete overhauling. The handicap is a human one—people dislike change. Over and over again, I have seen offices where there is much duplication of work which in itself is utterly useless. "But we have always done it that way" takes precedence over any ideas about current necessities. A classic example of that is in our Federal Government. I hope I have made it clear that one of the chief purposes of accounting is to provide the executives with information so that they may make satisfactory decisions on matters for which they are responsible. Every executive we had had in the White House in recent years has been handicapped by the antiquated system by which we are running the greatest business the world has ever seen. Mr. Hoover complained bitterly about it. So has Congress and President Roosevelt. You all know that we have a Bureau of Budget but few know that it is most inadequately staffed and yet its chief function is to investigate departmental estimates and work programs. However, a step forward has developed—Congress has increased the appropriation for this Bureau threefold. It has been reorganized by moving it from the Treasury Department to the Executive Office of the President and there is gradually being built up a strong staff.

We had a committee to study Administrative Management but its

recommendations relating to accounting and auditing have not been adopted. It recommended:

- 1—That a new officer be appointed to function under the title of Auditor General reporting to Congress.
- 2—That there be a joint Congressional committee on public accounts to receive and act on such accounts.
- 3—That the present accounting and control functions of our Comptroller General be transferred to the Treasury or the Bureau of Budget and carried out by an officer responsible to the President.

All this was seriously opposed on the ground that it would give too much authority to the President at the expense of Congress. How could it? Unfortunately accounting has a peculiar language of its own and few members of Congress really understood the issues that were being debated because of that terminology. Our present system:

Is not up-to-date.

Does not provide the President, Congress, Bureau of Budget or any other executive branch with essential information.

Audit system is seriously defective.

Congress is inadequately provided with information on financial operations and practices.

Rulings of the Comptroller General are sometimes based on whims and seriously hamper every administration.

Failure to distinguish between accounting and auditing.

We are bending every effort to win the war. But that isn't our big task. We have to win a peace. Even though it may seem that all our efforts are being utilized now, we simply must find time to plan for the peace and especially the interim period. We must find a way to stabilize prices and solve the problem of distribution. Neither is possible without accurate data and neither government nor private business can function without that data. Our government has been in the hands principally of lawyers, professional politicians and, in recent years, economists. It needs accountants too. Accountants are concerned with the immediate situation while the econ-

omists consider the long range trends of society. Here are some other distinctions and you will see why human beings need both:

Accountants think in terms of

- The Owner
- Costs
- Realities
- Constant Price Levels

They apply their principles to particular cases

They treat their work as a means of communication

Economists think in terms of

- Enterprises
- Values
- Abstracts
- Changing Price Levels

They apply their principles to average conditions

They treat their work as a science and sometimes fail to realize science isn't static

We are all scared—not because of the war (we know we will win it) but of what will come after. I am not a prophet and I do not attempt forecasts. I only know that the clouds are not too dark in some directions. We are beginning to realize there is such a thing as the consumer approach to economics. We are beginning to appreciate the complexity of taxation and the widening of the income tax base may have a salutary effect on the soak-the-rich advocates. There is a definite trend toward centralization and a dim realization that cooperation is needed instead of competition.

I know we *can* solve the peace but I am not at all sure that we will. This negative viewpoint is based on these reasons:

- 1—We are still too greedy and self-centered. We haven't yet learned that it is only through social balance that we can achieve any personal security. It is still "me" first and you can't have anything unless you do as I say.
- 2—We are too lazy. It is much easier to accept ready made opinions through the printed or spoken word than think things through for ourselves.
- 3—We are afraid of change. We cling to the past even though it has completely

destroyed every vestige of security beneath our feet.

- 4—We are too intolerant. We like to read only that which confirms our ideas and listen only to expressions of our own philosophy. We apply nasty labels to all that we do not wish to hear.

Women could solve this problem if they were awakened. As a whole they are not involved in the complexities of modern life and are not tied to loyalties which prevent them from acting freely. They have the ability to see clearly but they don't. I was discussing certain political situations with a friend several days ago and when she had no facts to support her opinions, she took refuge in "I hate them, I hate them, I hate them." And that from a woman who earned at one time \$20,000 a year as manager of a department store in one of our eastern cities. Are we to make decisions which control the destiny of the human race, which will preserve our civilization or destroy it, on an emotional basis or can we learn to see the issues objectively?

I think it is definitely up to the women to preserve the democratic ideal that people should be judged and rewarded according to individual competence and achievement. They must teach their daughters that equality means responsibility and raise their sons to neither fear nor resent women. It is up to women to use their talents for organization and construction. We are going to need vision if we expect to survive and I think you might agree with my definition of vision as an awareness of problems and a practical approach to the solution of those problems. And it is my intense conviction that we must have a realistic conception of the mess we are in and how we got there before we can hope to climb out of it. Education is a slow process but, as one writer puts it, "our understanding of boom and bust has increased enormously since 1917." However, it is true that most of us remain irresponsible students in the school of Life.

Optional Tax on Individuals

By RUTH A. CLARK, C. P. A.

The 1941 Federal Income Tax Act provides for an Optional Tax on individuals with gross incomes of \$3,000 or less and derived solely from salaries, wages, compensation for personal services, dividends, interest, rents, annuities, or royalties.

The purpose of Form 1040-A is to simplify the preparation of returns of individuals in the lower income brackets.

However, unless a taxpayer has no substantial deductions, the use of Form 1040-A will probably result in a higher tax. It is therefore advisable to compute the tax under both methods and elect to use the form resulting in the lower tax.

The use of either form constitutes election and once made is irrevocable for that particular taxable year. If the optional method was elected and later the taxpayer discovered a deductible bad debt or loss, he could not file an amended return on Form 1040. However, the following year, the taxpayer could elect to use either method. For example, if the taxpayer filed his 1941 return on Form 1040-A, he could elect to file his 1942 return on Form 1040.

Under the optional method, the status of the taxpayer on the last day of the year governs the amount of personal exemption and credit for dependents. A taxpayer acquiring a dependent during December may find it advantageous to use Form 1040-A since there is no proration of the credit as provided under the regular method. On the other hand, if a taxpayer had a dependent for a good portion of the year but not on December 31st, then the use of Form 1040 would prove to be more advantageous.

If a husband and wife elect to file separate returns, one may elect to use Form 1040 and the other 1040-A. It is advisable to compute the tax under both methods as the use of 1040-A may result in a higher tax.

If a joint return is filed, the \$3000 limitation applies to the combined Gross Income. If separate returns are filed, the \$3000 limitation applies to the Gross Income of each.

If a husband and wife file separate returns, and one spouse elects to use Form 1040-A, the other is entitled to a personal exemption of \$750.00 only. The tax liability of the spouse using Form 1040-A would be that of a single person.

If an individual derives any income except from the prescribed sources, he cannot elect to use the optional method. For example, if the taxpayer had any gain from the sale of property or income from a trust, he could not file his return on Form 1040-A.

While the optional method was adopted in the 1941 Act to simplify the filing of returns by the taxpayers in the lower brackets, it appears that this adoption may result in more computations as the individual is, generally speaking, interested in filing his return under whatever legal method results in the lower tax.

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From the Mailbag

"... Our plant was one of those which the O. P. A. C. picked for price control figures in the frame industry. In order to give them the cost figures they wanted I made quite a study of the cost problem involved and am trying to build an article around this. Do you want anything as technical as this?..."

"... We are a little disorganized here due to the possibility of blackouts. We haven't had but one, but the authorities have requested people to stay home at nights. Los Angeles covers a territory more than 400 square miles and some of our members come from suburbs beyond that area. We have voted to change our dinner meetings to Sunday morning breakfasts...."