1947

Challenges to the accounting profession, 1947, papers presented at the sixtieth annual meeting of the American Institute of Accountants

American Institute of Accountants

Challenges *to the* Accounting Profession

1947

PAPERS

PRESENTED AT THE

SIXTIETH ANNUAL MEETING OF

THE AMERICAN INSTITUTE OF ACCOUNTANTS

Challenges *to the* Accounting Profession

1947

★

PAPERS PRESENTED AT THE
SIXTIETH ANNUAL MEETING OF
THE AMERICAN INSTITUTE OF ACCOUNTANTS
NOVEMBER 3-6, 1947
MIAMI BEACH, FLORIDA

★

THE AMERICAN INSTITUTE OF ACCOUNTANTS
13 EAST 41ST STREET, NEW YORK 17, N. Y.

PRICE: ONE DOLLAR

Contents

The President's Report

BY EDWARD B. WILCOX, ILLINOIS

WHEN THE REPORTS of the secretary and the various committees, to the council, and the report of that body to the members, are all laid before us, the activities and achievements of the American Institute of Accountants are impressive. These reports provide eloquent testimony to the generous and thoughtful service of many of our members, wherein lies the greatest asset that the Institute has or ever can have. It seems appropriate for the president to report that this asset is properly accounted for and that it continues to grow in value. Indeed, so great has it become, that to cite its make-up, item by item, or to present even an adequate summary of its content would be to engage in unwarranted repetition. It consists of the hundreds of members who serve on committees, who sacrifice time to attend meetings, who pay their own expenses to do so, who engage in active committee correspondence, who make addresses at meetings devoted to accounting, who contribute to the literature of accounting, and who reflect credit on their profession by unrewarded public service. The substance of all this is in the reports and the publications that you see. There is, however, an aspect of the Institute which is not in the reports, and which may be particularly visible from the comparatively unique viewpoint of its president. This viewpoint shall determine the theme of my report.

The Institute is a great human institution with all the faults and all the grandeur that follow inevitably from human qualities. It is not a finished thing because nothing human is ever finished, and it is not a perfect thing because nothing human is ever perfect. Yet, it has a proud past and the possibility of a great destiny, and there are in it elements of nobility and unselfish service that transcend human failings. It presents a challenge to all of us because it has demonstrated what great things can be done, even while the things undone may seem overwhelming. It is the kind of organization that merits deep and abiding faith unimpaired by full recognition of shortcomings, limitations, and imperfections.

In the briefest of terms, the Institute exists to unite the accounting profession in the United States, and to advance the interests of that profession by enhancing its usefulness to society as a whole. The state of the Institute in furtherance of these aims is one of great unfinished achievement. An increasingly united profession is evidenced by the growth of the Institute to over 11,000 members, although there are at least as many more eligible certified public accountants who should be in it and aren't. In enhancing the usefulness of accounting, the Institute has achieved unquestioned leadership in the fields of auditing and accounting procedures. In some other countries this leadership is lodged in bureaus or crystalized in laws, but here it is a living growing thing in the hands of a profession. This is a well earned tribute to two of our important committees and to the Research Department, but their work is unfinished, and the position of leadership which we now hold can be lost if that work is not vigorously carried forward.

The Institute owns the foremost accounting publication in the United States—*The Journal of Accountancy*—and its circulation is now well over 40,000. This is a well established and successful magazine, and a credit to the Institute and the accounting profession, but its possibilities for growth and usefulness are still largely ahead of it. Many of our members have contributed generously of time and talent toward solution of accounting problems of government, and so to the social usefulness of our profession and to its prestige and standing, but not all of our recommendations have been adopted, nor have the accounting problems of the peoples' business yet found perfect answers. Higher standards of professional performance and reliability are being sought, and in great measure have been achieved, through our code of ethics, through widespread adoption of sound uniform CPA examinations, through improvements in accounting education and raised educational requirements, and through studies of selection of personnel. Yet the incompetent and the unfit are still among us; there are still failures; and our work is not done.

On behalf of the Institute I acknowledge a deep debt of appreciation to our committees and staff for their achievements. It has been an inspiring privilege to see at close range their competence, diligence, unselfish devotion, and sacrifice. But the work is not finished, and the obligations to carry it forward are great.

Outside our organization there are those who would do us harm or mischief if they could. I refer particularly to those non-certified public accountants who would destroy or weaken the CPA degree, and the achievement of standards it represents, and also to those lawyers in bar association committees on unauthorized practice of the law who would limit our usefulness particularly in the tax field. The facts about these groups and the problems they create, are in appropriate reports. The point I wish to emphasize here is that by dint of diligence and vigor we have met with large measures of success in dealing with these attacks, but the battles are not over. I am really glad that they are not because I believe it is a healthy thing for a human institution to have at least an occasional fight on its hands. It saves us from the danger of smug complacency, and forces us to continual reexamination of our position and representations. Those who would harm us, really help us by keeping us alert and active, conscious of our imperfections and the unfinished nature of our tasks.

Nor is there complete peace and apathy within our own ranks. There are those who question that the form of government of the Institute is adequately democratic and truly representative of its members. Some believe or profess to believe that there is somewhere a power behind the throne—a small group or inside gang of dictators. Others think that the Institute is predisposed for the benefit of some types or classes of members or their firms to the neglect of others. I think it is appropriate for me to report that I believe that the Institute is truly representative of its members and highly sensitive to their interest and wishes, and that, close as I have been to it during the past year, I have never been able to discover the inside gang of dictators. In my opinion the nice balance between control by elected officers and committees, and continuity by the staff is as close to the optimum point as it can possibly be. But I would rather have these things questioned and found in good order than blindly accepted when they might be awry.

There is also controversy regarding the Institute's policies on accountancy legislation, public relations, and institutional advertising. These subjects are covered in appropriate reports. I am happy that my own honest convictions are in agreement with the stated policies of the Institute on these matters, but I am even happier that open discussion of them has developed during my term of office. It would be easy to speak and write in praise of achievements, integrity, mother love, and the Star Spangled Banner. Emphasis on trite platitudes is a splendid way to avoid painful contact with thorny problems, but free and open discussion is one of our American traditions of which I am most proud. I am glad we have it in the Institute, and I am confident that it will lead as nothing else can, to wise and widely accepted solutions. These internal problems on which there is now disagreement are one part of that great imperfect unfinished gloriously human organization which is the American Institute of Accountants. I am very proud of it.

The accounting profession, which the Institute represents, is a vital part of a living evolving nation in a changing world. Nothing in this great environment is finished or perfect, and the responsibilities on its citizens are heavy. These same responsibilities rest on us as members of the Institute. Let us never cease our efforts to increase our usefulness, to maintain and raise standards, to tell our story to the world, and to meet the changing and growing needs of tomorrow as we have those of yesterday. Let us try to see ourselves honestly for both what we are and what we might be. Let us face our imperfections without losing faith in our greatness, and let us believe in ourselves and each other that we may always go along together in performance of the never finished tasks of a respected and united profession.

Remarks of the Incoming President

By George D. Bailey, Michigan

You have highly honored me today in electing me president of this fine organization. I assure you I realize that it is an honor that carries with it a great responsibility—the responsibility of doing all that is possible that this may be a better profession and a better Institute at the end of my term of office than it was at the beginning.

Fortunately for me, the American Institute of Accountants is a soundly functioning, going organization. The work done by my predecessors and their associates has been well done, and the usefulness of the Institute to the profession, to accounting, and to society has been increasing year by year.

The president of the Institute does not have a colossal task. The permanent staff of the Institute is exceptionally competent and, what is more, has earned the confidence of the accountants and the public. The other officers are sure to carry more than their share of any load. As for committee work, I know of no other organization where it is considered such a privilege to serve on committees, or where so much individual effort is so gladly given to committee work. Because of all this, the labors of the president are not those of a Hercules, but rather is he occupied in the much more pleasant fields of policy and coordination. I hope I may do as well as my predecessor, now retiring. Again I thank you for the honor.

There is, however, serious business ahead for all of us. I was much impressed ten years ago at the fiftieth annual meeting in New York to hear the president, Robert H. Montgomery, refer to the position accountants had attained somewhat as if it had been given to them, rather than completely earned, and to caution that we would need to bestir ourselves to hold that position. Well, we have been bestirring ourselves, and we have not only held our position but have improved it. But I am not so sure that the test has really come upon us, or that equally important and challenging days do not lie ahead. Perhaps we have dealt with the easier problems and merely postponed the difficult ones.

What is our goal? It is not an absolute one with an end to the road; rather it is relative only. To me, our goal is to make accounting more and more useful to society—to all segments of society that use it, but primarily to our system of economy, to the American way of doing business, to freedom of choice, and freedom of operation. Our profession is inextricably interwoven in the fabric of that free economy—is, in fact, one of the major requirements of that system. But we can keep ourselves a free profession, and help keep our economy free, only if accounting does serve adequately the changing needs. The profession must take the responsibility for leadership in the development of accounting. It cannot do so by anything less than a constant re-examination of the usefulness to our present economy of our long-established principles. Just as some theories of the historic economists have little validity under current conditions, just so may some of the historic principles of accounting have less validity in the social economy of today. In order to keep government out of our traditional field, we must serve society as a whole better than a governmental bureau could do.

The comfortable profession, as we have known it for years, is showing signs of becoming an uneasy one. For instance, there are those who think the accountant has not measured up to his responsibilities in appearances before governmental bodies, and that his sphere of such activity should be reduced. There are those who feel, even, that his position as an advocate on taxes is inconsistent with his basic position in society. There are those who say that his principles of accounting permit too wide a variation for financial reporting, that financial statements are not sufficiently indicative, that too much is left by the accountant to the decision of the client who pays him; and there are those who say that there is not enough difference between the certified public accountant and the non-certified public accountant to justify the privileges built up by the CPA degree.

We must never let those comments be justified. That these or similar comments are being made about other professions does not affect our responsibility. None of them can be disregarded; we must meet them all, every one of them, if we are to continue to be of maximum usefulness to the national economy.

Let us be quite clear upon one point. We owe our position as a recognized profession to those of our activities in which the public sees its own interest affected. These are our activities, particularly in the field of financial reporting to "non-insiders"—the field which most requires professional objectivity and independence, complete impartiality, more than normal competence, and better than average judgment.

Many of our members render useful services to their clients in the fields of administrative accounting, tax accounting, and even bookkeeping. These services are of great economic value to the community, and it is entirely proper that certified public accountants should render them. But it is not these services which are primarily responsible for our recognition as a profession, in whose work the public as a whole has a vital interest. The position of the profession, in my opinion, and the position of all in the profession would be most immediately weakened and jeopardized by a loss of confidence in our actions in the areas that touch the public as a whole.

Thus, the rules of professional conduct, the standards of auditing procedure, and the generally accepted accounting principles are "musts" for the entire profession. There can be no double standard within the CPA ranks if we hope to meet successfully the challenge of the non-CPA.

By the same token, our work in fields where there is advocacy must always subordinate argument to a full presentation of all facts, and we must assume the responsibility for such facts.

And we must make financial reporting more and more useful and more and more reliable.

These are not days when we members of the American Institute of Accountants can rest on our laurels or we accountants assume that we have fully earned our position. But we can meet the challenges—of that I am sure; just as I am satisfied that our system of a free competitive economy will meet the challenges to it and that our profession will have a lasting opportunity for usefulness.

Accounting Aid in Labor-Management Relations

(Taking the Fits Out of Profits)

BY DONALD R. RICHBERG, WASHINGTON, D. C.
Former NRA Chairman

IN THE HOPE of saying something worth while in a short time I shall limit my remarks to a discussion of the aid which accountants can render to those engaged in fixing wages by collective bargaining.

There are many other problems of labor relations in which reliable and understandable accounting statistics are helpful to a just solution. But wage-fixing presents the most difficult and most vital problem; and the same accounting service which furnishes a guide to reasonable wages will shed light on other issues.

As a further conservation of your patience and my energy I shall consider only labor relations between employers and employees who are trying to preserve and improve a free economy. It should be evident that nowadays business monopolists, labor monopolists and government monopolists are doing their best, separately and jointly, to destroy a system of free, competitive capitalism. Accountants and economists are frequently hired to rationalize the programs and to obscure the objectives of these authoritarians. The opinions of such persons do not appeal to me and I shall make no appeal to them.

I am an old-fashioned liberal, unwilling to sell my individual liberty for a promise of security. To me the tyranny of labor leaders or politicians is just as offensive as the tyranny of capitalists. The modernized liberal, who seeks freedom from worry or work by pledging allegiance to feudal lords of labor or politics, appears to me to be hopelessly muddle-headed. There is no freedom from worry or work in slavery; and without freedom of contract in a competitive system economic slavery is inevitable. There is no freedom of contract exercised in an agreement which is forced upon anyone by a monopolist of labor power, money power or political power.

In view of the frequency of this procedure in recent years, perhaps I am naïve to think that genuine collective bargaining and voluntary agreements can be made the basis of labor-management relations in the future.

There is little accounting aid which can be given to a lonesome employer, or even to a single industry, when the CIO launches a wage movement on the basis of a miraculous assumption that industry in general can increase wages 25 per cent without increasing prices.

There is little accounting aid which can be given to free labor or management when labor-management monopolies regulate wages, prices, and production to promote their immediate and short-sighted interests.

There is little accounting aid which can be given to consumers when government officials decree wage and price increases on the basis of political, instead of economic, judgment.

But, despite the substitution of collective coercion for collective bargaining in recent years, and despite the modernistic tendencies of labor, management, and politicians to communize industry, let us indulge ourselves for a little time in the hope of a reinvigorated democracy and a revived competitive economy in which wages may be fixed by genuine collective bargaining between a free employer and a free labor organization.

There is really no place in a competitive system for industry-wide contracts between an employer association and a labor union, except possibly in an openly monopolized, publicly regulated industry. But, for the benefit of those who fondly cling to certain private benefits of standardized wages, regardless of overbalancing public detriments, let us assume that in industry-wide bargaining accounting aid could be rendered similar to that which is necessary and useful in bargaining between one employer and his employees.

Personally, I think that industry-wide statistical conclusions are too inaccurate, confusing, and conjectural to form the basis for anything except arbitrary, unfair, and monopolistic agreements. But, in deference to some popular heresies, I will assume that the intelligent process of bargaining between an employer and his employees can be extended intelligently to industrial bargaining. After this conciliatory gesture permit me to confine my discussion to a consideration of the accounting aid which can be given to both labor and management in either a small or a large enterprise when they are both seeking to determine by fair negotiation how the rewards of their common endeavor should be divided.

There are two objectives of such bargaining: One, to adjust inequities between workers and workers; two, to adjust inequities between employer and employees.

If we can make sure that the total payroll gives to the employees as a whole their full, fair share of the company's earning power, it ought to be comparatively easy to adjust inequities within the wage scale. A single labor union ought to accept the responsibility of establishing wage differentials applying to its members. If more than one union were involved the issues should be decided by direct agreement or by submitting to the decision of arbitrators selected by labor or management or both.

It is not too much to hope that organized labor will come eventually to an understanding of the imbecility of workers striking against workers. The widespread disgust with jurisdictional strikes must soon compel organized labor either to settle its internal quarrels by self-discipline or to accept willingly some form of public settlement.

Thus I come, at long last you may think, to a discussion of accounting aid to collective bargaining in fixing just wages to be paid by an employer to his employees. Primarily that means accounting aid in providing a reliable basis for determining just what amount of pecuniary gains of an enterprise are available for distribution between the owners, the managers, and the employees.

You are all aware that the standard forms and methods of accounting provide a most inadequate basis for a clear understanding by employees of what wages the company can or ought to pay. Indeed, in this day of industry-wide bargaining, complicated by local management, local enterprises, and national unions, violent objections are raised by labor to a defense of "inability to pay," and equally violent objections are raised by management to a claim based on "ability to pay."

But, in solving our simplified problem of making a fair contract between one employer and his employees (which is the heart of a competitive, capitalistic system), we must be able clearly to determine the ability or inability of an employer to pay wages. If, on past experience and reasonable prognostication he is able to pay wages which are requested, there is still the question as to whether prices should be maintained or competitively cut, or whether abnormal gains from a peculiarly successful business should be shared by all those responsible—the labor that is so productive, the management that is so capable and the owners who have risked their capital.

If, on the other hand, experience indicates an inability to pay, the question remains as to whether there is weak management, tight-fisted ownership, or unproductive labor, which should be improved; or whether prices can be raised without losing business; or whether this is marginal enterprise which should be kept going by reasonable sacrifices by all concerned.

However, regardless of any ultimate solution, it is evident that the facts which will clarify the issues for all concerned must be brought to the conference table. This means that there should be a simplified accounting to show on an annual basis, past, present, and estimated, the facts as to the following items:

(1) What are gross operating revenues?

(2) What is the actual capital now used and useful upon which the owners are entitled to a reasonable return?

(3) What are the fixed charges that must be met in order to maintain solvency?

(4) What are the current costs for materials or services which must be paid to those outside the enterprise?

(5) What are inevitable taxes (not based on net income) and any other unavoidable expenses?

(6) What are actual and estimated taxes based on net income?

(7) What should be laid aside for replacement of depreciated or obsolete property?

(8) As further items for deduction from gross revenues, what are management estimates of necessary reserves for contingencies, or for additions or betterments, after due consideration of the extent to which new capital can and should be obtained for the latter purposes?

(9) What amount is left for the compensation of labor, management, and owners?

In order to avoid technical criticisms of this suggested accounting, on the ground of omissions or disregard of so-called accounting principles, let me add: I do not care what forms or designations are used so long as the accounting brings to a focus, first, the fixed obligations and uncontrollable outgoes of the enterprise, and second, the money which has been, and which probably will be, available for annual distribution among the human beings who take the risks and should share the gains of their joint enterprise, and third, the deductions that should be made from this available cash to protect or promote the interests of all the joint enterprises in maintaining or improving their business.

It may be objected by some corporate managements that such an accounting implies a right in labor representatives to have a voice in determining management policies and the ownership return. My first answer is that I firmly believe that management should be left free to manage. Small stockholders are free to sell and individual workers are free to quit if they do not like a management. But, if stockholders in a majority are displeased they can change the management.

And so, my second answer is that, if a majority of the employees, upon adequate information, feel that the management is treating them unfairly, they should be in a position to get the facts and then to compel consideration of their views by the management and by the owners. Thereafter, if the employees undertake to change the management policy by striking, they will be acting on the basis of a demand which public and private pressure can intelligently support or oppose, as reasonable or unreasonable.

Even if a particular management is unwilling to have its accounts restated in this manner, accepted accounting methods should provide the basis for such a restatement by accountants representing labor unions or public bodies. It is, however, my thought that usually a management will help itself by taking the initiative in having such an accounting made, because until the common interest of labor, management, and ownership in a joint enterprise is made a reality by some sharing of responsibilities, as well as some sharing of gains and losses, there will be no lasting basis for industrial peace or for the perpetuation of democratic government.

There is a further step in the suggested accounting procedure which might well be utilized to avoid the most confusing and misleading factor in wage negotiations. The word "profits" has been made by persistent propaganda the symbol of an unjustified and evil gain. This odium is a marvelous aid to communists; and the outstanding labor organizations blindly feed more and more of this ammunition to communists every day in the year.

Conservatives try to meet this propaganda by stoutly maintaining that capitalism is a "profit" system, and property owners who pay good wages are entitled to all the remaining "profits." Some liberal minded employers urge a division of profits with employees. And then a large number of labor leaders proceed to show their economic blindness by opposing any profit sharing, although at the same time they are demanding a guaranteed annual wage. Yet, the fact is that any guaranteed wage must be a *minimum* wage, because the *maximum* wage that can be paid must always be a contingent wage.

The accountants can render a great service in laying the basis for fair wage fixing if they will assist in bringing out of the mystic maze of corporate accounts the simple figure of the annual amount "available for distribution" to labor, management and owners. I would call this "distributable proceeds." It would be the source of wage payments, management salaries, ownership dividends, and reserves for contingencies and betterments.

Perhaps, in self-protection, I should explain that for more than thirty years I have been intensively engaged in analyzing public utility accounts, as counsel for consumers; in analyzing corporate accounts, as counsel for labor unions; and in working over and proving up corporate accounts as counsel for private corporations subject to SEC regulations. Hence I am acutely aware of problems in connection with depreciation, maintenance, inventories, costs and fixed charges and many other accounting questions to which no reference has been or will be made.

But, I am thoroughly convinced that until the "profit" demon can be exorcised and organized labor can be forced to face and deal with economic facts, there will be no possibility of negotiating settlements of wage demands on a satisfactory and enduring basis. Just so long as labor representatives are encouraged to seek success in forcing delusive wage increases that injure the workers more than anyone else, we shall have a perennial series of wage increases, price increases, inflated dollars, and inflationary profits, with the ever-rising threat of national disaster and political revolution.

If, however, our corporate accounting could make clear to an intelligent worker that there are really no "profits," in a business except when there are unusual gains, in which he can expect to obtain his just share, perhaps he would see more plainly the folly of stopping production and reducing the amount of "distributable proceeds" out of which he must get his livelihood.

If corporate managers and labor representatives could agree on a sane method of distributing these proceeds then the accountants could establish a "surplus" item that might finally exorcise the "profit" demon.

To accomplish this there should be deducted from the "distributable proceeds," first, the total of "normal wages" which would be the total amount of assured wages fixed by collective bargaining as minimum compensation for the wage-earners. This should never exceed the amount of an annual payroll which, in the light of past experience, can be surely met. Thus something resembling an annual guaranteed wage would be established for the normal force. In fact, such an agreement might make it possible for many concerns to establish an annual wage assurance.

Second, there should be deducted also the "normal dividend" on common stock which had been established by agreement as minimum compensation for the capital invested—an amount sufficient to encourage further investments if needed.

Third, the amount remaining, if any, after deducting minimum compensations for labor and for investment might be designated "available surplus."

A permanent wage agreement would provide that in an annual negotiation it would be determined, whether there should be a distribution from this surplus of an amount sufficient for both a supplemental wage to the employees and a supplemental dividend to stockholders, and a transfer of the balance, if any, to an earned surplus account available for betterments. Or the negotiators might decide to retain the distributable surplus for a year in order to protect future wages and dividends.

Of course there are many varieties of agreement which might be made, including for example the transfer of a fixed amount of any available surplus to earned surplus and distribution of the balance. But the main point is that wage demands could be formulated on a firm basis of economic reality—not demanded on the hazardous assumption that future "profits" can be divided before made, or under the delusion that price increases need not follow wage increases.

Recently I studied an analysis of income and expenses for the year 1946 published by a public utility, which was largely in accord with the accounting procedure which I have suggested. It showed operating revenues amounting roughly to $6,500,000. From this amount was deducted a total of inevitable expenses not including wages but including taxes and depreciation, which amounted to almost $3,000,000.

This left a little over $3,500,000 for payment of wages and salaries. The wages alone amounted to over $3,300,000—or nearly 94 per cent of the income available after payment of other necessary expenses. After deducting these wages and the modest amount of $61,800 for all salaries of executive officers, there was left in net earnings from operation a little over $156,000, or less than 1½ per cent return on the property used in this public service. It is a further interesting fact that in the expenses deducted before the deduction of wage payments there was also an item of $620,000 covering dismissal wages and pensions — which should really be regarded as an additional wage payment.

You may expect me to report that on the basis of such a candid showing this company has no labor troubles and faces no demands for increased wages. Unhappily that is not true. Nor would I attempt to argue that industrial peace will be established by proving and compelling universal acceptance of the simple fact that 86 per cent of the total revenues of our major industries are paid out for labor. But I do believe that the only road toward industrial peace and the only road that leads away from the economic and political catastrophe of communism is the road of candid accounting and fair distribution of the proceeds of corporate enterprise.

If the accounting is to be candid it

must be understandable by a man of ordinary intelligence, without much explanation. If the distribution of proceeds is to be fair it must be one that will be acceptable to employees who have at least as much influence over wages as large stockholders have in obtaining reasonable dividends. In truth if the organized employees can't exert more influence over management than most stockholders do they are not likely to be satisfied!

Since I have taken advantage of the opportunity of addressing you to present only one general suggestion of accounting aid in labor-management relations, I should not close without expressing my appreciation of the efforts of many progressive accountants in recent years to make real contributions to the solution of labor problems. Not only have many suggestive ideas been brought forward, but much progress has been made in simplifying and popularizing corporate statements.

Most important of all is the maintenance of professional integrity. I am a member of a profession which actually has ethical standards, but which is regarded apparently with at least as much popular suspicion as popular esteem. So I sometimes sigh enviously at the respectful manner in which courts, commissions, and committees accept cheerfully the exhibits, and swallow gratefully the pronouncements, of accountants. Even labor leaders, suspicious of necromancy in complicated tabulations, will usually assume that the figures presented by a qualified accountant are correct and the computations accurate, even though they may suspect that the distinction between earned surplus and paid-in surplus is an invention of the devil.

Also, I have had one comfort in addressing you in my assumption that you would realize that my criticisms of labor leadership do not spring from emotional or economic bias but from a lifelong study of mathematical and economic facts. There are a great many otherwise sensible people who have no understanding of the relationships of wages, prices, cost of living and inflation, people who do not know that to bring about a general increase in wage levels, while trying to hold down prices and the cost of living and to prevent inflation, is sheer lunacy. Any accountant must know that.

Any accountant knows that, normally, increased costs should be balanced by increased revenues. Any accountant knows that so-called material costs are largely labor costs—and that direct and indirect labor costs are the dominant items of expense and the basis of all prices. If wages of steel workers are increased and at the same time in a general wage movement the wages of coal miners, ore miners, and transportation workers are likewise increased, it should be obvious that steel prices must reflect the increased material costs that will be paid by steel companies. But when an economist points out that the labor costs of industry as a whole take approximately 86 per cent of operating revenues he is met with a roar of protest from labor representatives who shortsightedly see only the direct labor costs of one enterprise or industry.

In the case of the public utility which I previously described direct labor costs were about 50 per cent of operating revenues, but the important facts were that all material costs and taxes were largely labor costs and after these were paid the employees of the utility took over 94 per cent of the distributable proceeds.

I feel assured that any accountant knows that "earnings" and "income" are not "profits." I feel sure that no modern accountant will ever quote Mr. Webster to the effect that the excess of income over expenditures is a "profit"—at least no accountant who wants to render any aid in improving labor-management relations. The necessary compensation of invested capital is no more a "profit"—in the popular sense of the word—than the necessary compensation of labor is a "profit."

And so I come to my final conclusion that the accountant who is to render valuable aid in collective bargaining should be, not only a master of figures, but also an artist—a very careful artist—in the use of words.

Accountancy Legislation and the Public Accountant

By Walter G. Draewell, California

Member, American Institute of Accountants

The backbone of any profession is high standards of competence and conduct, for it is through the medium of high standards that the public welfare is served. Those standards may be formulated by statute or by voluntary means, or by a combination in which the minimum standards prescribed by law are supplemented by self-imposed standards of a higher order. In any case, they must be free from motives which are primarily self-serving. Particularly where legislation is employed, such legislation must truly implement professional standards if it is to have a rightful place on the statute books. To have authority, standards must be binding upon the entire profession, and this carries the presumption of unity. With these self-evident propositions before us, let us examine the professional status and standards of the public accounting profession.

Today there are certified public accountants and public accountants who offer their services in fields which are identical in every respect, except that the right to use the CPA title is reserved to the certified public accountants. There are laws in all states, the District of Columbia, and the territories which fix minimum standards of competence for certified public accountants, whereas there are no laws whatsoever fixing standards of competence for public accountants, unless the accepted meaning of standards can be stretched to cover the secondary levels of competence provided for public accountants in the recently enacted New Mexico law, to which I shall allude later. The laws of some states prescribe standards of conduct or codes of ethics for certified public accountants and public accountants alike, while those of other states are silent on the subject. The certified public accountants have professional societies in every state of the Union and the territories together with a dynamic national organization, all of many years' standing and all with codes of ethics. The public accountants have only recently formed professional societies in a number of states, together with a parent organization; all of them may be presumed to have adopted codes of ethics as a matter of course, but it remains to be seen whether those codes or the organizations themselves will minister to professional standards. Membership in the professional organizations of either group is voluntary, and neither includes all those eligible for membership. In a few of the less populous states, there are societies which admit both certified public accountants and public accountants, the latter usually as associates, and in many of the smaller communities throughout the country there is professional fraternization of an informal nature between the certified and non-certified groups.

It goes without saying that such a patchwork will hardly meet the test of professional solidarity and unity. The state of mind within the profession concerning the issues involved in this array of inconsistencies is far from reassuring. Feelings have run high and the friction generated by the clash of opposing views has tended to becloud the real issues and objectives. To clear the atmosphere, let us glance into the background of the profession and some of the problems which are now disturbing it.

In common with the other learned professions, public accounting came into being and grew in response to a need for services requiring absolute integrity and a high degree of technical skill. In the origin of public accounting there was also, and perhaps even more compelling, the need for objective judgment, which we call independence. Independence is as indispensable to public accounting as justice is to law and the "Hippocratic Oath" is to medicine. And the reality of independence does not hinge upon the various levels of other professional attainments signified by titles such as chartered, certified, registered, licensed, etc. This leads to the conclusion that there is no "chartered public accounting," "certified public accounting," or any other special shade or hue of public accounting. Accordingly, as the first step in clarifying the issues now under consideration, we must keep our sights trained on the whole of the public accounting profession and not on one or more of its denominations.

Many of us rather thoughtlessly fall into the error of associating the birth of public accounting in this country with the enactment of the first accountancy legislation some fifty years ago. There is evidence that services described as public accounting were offered long before that, although it remained for the twentieth century, with its matchless development of commerce and industry, to bring about the most momentous changes of all time, particularly in the United States of America. The impact of two world wars and an intervening depression of worldwide dimensions was tremendous. The wars ushered in complicated and far-reaching income tax laws and other regulations, the processing of which gave professional accounting great impetus. Particularly the last war, with its vastly broadened tax base and more minute regulation of business, saw also the emergence of a horde of individuals who, sensing profit in the bewilderment of small businessmen and other citizens, set out to capitalize on that bewilderment under the guise of public accounting. The depression witnessed the enactment of securities and exchange legislation which exerted a great influence on modern public accounting thought and, together with income taxes, cast the spotlight on the public accounting profession.

The significant advances of the twentieth century are evidence of much tempering and shaping by evolutionary forces, and, more than that, they are a monument to the broad vision and high calibre of the founders of the profession. I refer specifically to those who brought recognition to the profession by giving it cohesion and by distilling practices and ideals into standards. This was accomplished in Great Britain by the formation of Societies which were incorporated by royal charter, the first one being formed in 1853. Under authority granted by their respective charters, the various societies set up standards of competence and conduct for their members and issued degrees or, more precisely, special titles. The example and encouragement from that source did much to promote the formation of accounting societies in the United States. One of these was the American Institute of Accountants, which was founded in 1887 under the name of the American Association of Public Accountants.

Through the efforts of these societies, there evolved the first accountancy law, which was enacted in the state of New York in 1896. This has been designated as a permissive type of legislation, and it departed from British models chiefly in the manner of conferring titles. In the United States, the authority became vested in the state government, whereas in Great Britain it was the function of the chartered societies. However, both were voluntary and neither sought to restrict or regulate the practice of public accounting except in the use of titles.

The New York law was the forerunner of permissive legislation which in the course of time was adopted by the other states in the Union and the territories. During the twenties, the evolution of thought on accountancy legislation began to manifest itself by the introduction of modern regulatory legislation, and today there are eighteen states which have laws setting up minimum standards of competence for all those wishing to enter the public accounting profession.

Notwithstanding the lofty aims of accountancy legislation, and its undisputed contribution to the public welfare through the medium of professional standards, its history contains many angry chapters. The birth of accountancy law is now heralded as "the most important milestone in the history of accountancy," yet, all was not bliss when it was conceived nor has tranquility distinguished its career. From all accounts, the enactment of the first law was not accomplished without first a reconciliation of divergent views of the two accounting societies of that day. Then in 1901, the waiver clause was reopened to those who could have qualified in 1896. Since that time, New York and all other states have experienced many baldly cynical attempts to lower professional standards by the waiver route. And, sad to relate, the proud standards of the CPA certificate of New York have finally fallen upon evil days as the result of a foul blow delivered by the legislature this year. The consequences of that action must be reckoned in the future, but it seems safe to predict that there will be serious repercussions in the other states.

The troubled career of permissive legislation deserves considerable emphasis, since there are some who seem to believe that threats of waiver are uniquely a feature of modern regulatory legislation. They describe regulation as "appeasement," a "rash experiment," "frivolous," "insupportable," and even "catastrophic," and condemn it accordingly. This is exaggerated anxiety at best and could be dismissed lightly were it not for the zeal and eloquence of those who hold such views. Whatever the imperfections of regulatory legislation may be, that form of legislation has nothing sinister in its objectives and it is no more hospitable to evil designs than is legislation of the permissive type. The issues of *The Journal of Accountancy* of two, three, and four decades ago abound with accounts of threatened waiver and other dilution of standards, and that was during the years when permissive legislation held full sway. These incessant attacks, which reached some sort of climax in the infamous Oliver Bill of New York, should give pause to those for whom permissive legislation holds so much enchantment. This turbulent history is submitted neither as an indictment of permissive legislation nor as a reinforcement of regulatory legislation. Both have been or may be victimized by those whose scruples have failed to keep pace with their ambitions. The choice between the two forms of legislation should be made solely on the basis of their prospective long range contribution to professional standards.

I have mentioned that modern regulatory legislation first appeared upon the scene in the twenties. Its advent seems to have been marked by little more than earnest debate of the merits of regulation. It seems to have been regarded as a natural step in the development of the profession, so long as it was constitutional and free from injustice. The state of Maryland is generally regarded as the birthplace of modern regulatory legislation with the enactment of such a law in 1924. Of the eighteen states which have adopted regulatory legislation to date, nine did so in the twenties, three in the thirties, and six in the forties.

One is led to wonder whether the seeming wane in popularity of modern regulatory legislation after the twenties was prophetic of the bitter controversy to follow. It may be mere coincidence, but, as the public accountants began to identify themselves more actively with the modern regulatory movement, the cautious attitude of some certified public accountants turned to one of suspicion and then to firm conviction as to the unmitigated perils of regulation. The latter stage has seen the certified public accountants squared off against themselves over the asserted right and wrong of regulation. Charges of visionary and reactionary are exchanged freely as the stalwarts on each side face each other belligerently and uncompromisingly. Both sides piously invoke professional standards and the public welfare as a cover for a violent contest of wills. There is pause only at such times and in such areas as the initiative on regulation is lost to groups of public accountants.

During recent years, a further note of discord has been injected by certain public accountants who advocate measures which might well set the stage for the collapse of organized professional standards and justify the worst fears of those opposed to regulation. The unyielding impact of opposing views on these measures has defeated modern regulatory legislation in some states or, as in California, caused the enactment of an abortive law. This is not to imply that the certified public accountants have erred in their judgment of the immediate issues, but simply to point up the utter folly of indulging in what virtually amounts to civil war. The situation is further aggravated by those from the ranks of the public accountants who stridently charge the certified public accountants with having set themselves up as the "chosen instrument" of the profession. This is of a piece with the "economic royalist" chant of a few years ago and is no less stupid or vicious. Recourse to such tactics has made the opponents of regulation even more resolute and provoked a matching intemperance, which is certainly no antidote for, or a rebuttal to, class conflict propaganda.

This outline is perhaps a bit unvarnished, but it is a not unfair sketch of a disorderly situation within the profession. As with all generalizations, it is not equally applicable to all certified public accountants or public accountants or to all sections of the country, for, as in all lines of human endeavor, it is the aggressive and articulate minority which attracts the most attention. It is small wonder that the spectators have become bewildered and exasperated at this house doubly divided against itself. It behooves the profession to face the situation squarely and set that house in order. It must declare itself on the subject of legislation and bring about some semblance of consistency, and in the process it must frame a constructive relationship between certified public accountants and public accountants, if there is to be an atmosphere which is congenial to professional standards.

You will have observed that I have spoken repeatedly of *modern* regulatory legislation. I have called it modern in order to distinguish it from that form of regulatory legislation which was under consideration in earlier years and which contemplated outright waiver. For perhaps thirty years after the enactment of the first permissive law, there was considerable agitation both within and without the ranks of the certified public accountants for bringing the entire profession under regulation by that means. Actually, the subject of regulation or restriction for public accounting has engaged the minds of public accountants ever since they first began to assert themselves as members of a profession. I did not look up the record of the proceedings whereby the public accountants first became organized, but subsequent accounts of those happenings indicate that regulation was seriously contemplated in both Great Britain and the United States. This was quite natural when one recalls that the philosophy of regulation goes back to the merchant and craft guilds which came into being in the Middle Ages. These guilds set the pattern for the apprenticeship system in Great Britain and its parallel, experience requirements, in the United States. The first unsuccessful attempt at accountancy legislation in this country also contained some regulatory features. From that time forward, the subject seems to have been given much serious thought. In the very first issue of *The Journal,* which came out in November 1905, there appears an article on "Professional Standards," written by Robert H. Montgomery, in which, among other things, he advocated regulation. In the following month, namely, December 1905, J. M. S. Goodloe contributed an article, entitled "Should the Practice of Public Accounting be Limited to Certified Public Accountants?" and he answered that question in the affirmative. Similar views were expressed by other leaders of that day and later. Such opposition as existed may be summed up as reluctance to reopen waiver and misgivings concerning the wisdom of inviting wider bureaucratic control which was deemed to be inherent in regulation.

In 1924, the certified public accountants and other interested parties in New York drew up a regulatory bill, which reopened the waiver clause, and they succeeded in having it passed by the legislature, only to have it vetoed by the governor. In 1925, the New York Society sponsored a similar regulatory bill, but this was defeated in the legislature. In 1926, still a third bill of that type was introduced, but this time the New York Society joined the opposition because of the reckless abandon with which waiver certificates were to be issued, and the bill was defeated. General professional interest in the waiver clauses of the regulatory laws proposed in New York, and the many problems with the existing permissive legislation, such as the urgent need for stabilizing standards so as to remove the obstacles in the way of reciprocity between states, seem to have overshadowed the Maryland law of 1924 and similar non-waiver legislation enacted in other states. Certainly there was no semblance of the stout opposition which that form of legislation has encountered in more recent years.

There is one further point in connection with the evolution of thought on the subject of regulation for the public accounting profession in this country. It seems clear from the record that regulation was manifestly desired at the very outset, but it was deemed premature because the profession had not become fortified with the necessary literature and educational facilities for the training of recruits, and that, in turn, magnified the constitutional obstacles which were considerably more formidable then than they are today. The idea seems to have been that the profession had to learn to walk before it could run, and the permissive type of legislation seems to have been adopted as a more or less temporary device to bridge the gap. This pattern has a respectable counterpart in the growth and development of the public accounting profession in Great Britain, where the public accountants began to exert themselves to bring about unity and regulation even before the turn of the century. Finally, in 1946, a regulatory bill was drafted which had the approval of all interested parties, and it is now before Parliament. It is significant also that the province of Quebec has recently turned to regulation, and that other provinces of the Dominion of Canada have it under consideration.

We see then that the idea of regulation for the accounting profession has had long standing, widespread, and solid support. The earlier plans for regulation contemplated waiver, but efforts to establish it in that manner met with no success. The modern type of regulatory legislation has avoided the problem of waiver by licensing the public accountants. This is referred to rather scoldingly by some as "two class" legislation, a designation which is true only in the narrow sense that there is statutory recognition of two classes of public accountants. Actually, a second class of public accountants was established by the enactment of the first permissive law over fifty years ago, under which anyone was permitted to engage in the practice of public accounting, but the privilege of using the CPA title was reserved to those who met certain minimum standards of competence. Regulatory legislation, such as is now under consideration, operates to bring about a closed profession in an orderly fashion by means of setting those minimum standards of competence for the CPA certificate as a requirement for all further recruits to the profession, but without altering the position of those who are already established as public accountants, other than to give them the statutory title of public accountant. Curiously enough, the type of regulatory bill which is sponsored by the National Society of Public Accountants would reverse the wheels of progress by substituting a level of standards lower than the minimum standards now required for the CPA certificate and discontinue further issuance of the CPA certificate. Obviously, this is but the first knock on the back door for a waiver hand-out.

I have stated that the choice between permissive and regulatory legislation should be made solely on the basis of their prospective long-range contributions to professional standards. We are all acquainted with permissive legislation, so let us examine the regulatory type more critically. This entails a determination of the proper scope of regulation, in conjunction with a study of its constitutionality, its benefit to the public, its benefit to the profession, and its hazards.

Generally speaking, there is quite a wide difference of opinion between the certified public accountants and the public accountants as to what is considered the proper scope of regulation. The Institute, with one eye on constitutionality and the other on the stature of the profession, has placed a fairly narrow construction on it. It leans to the view that the police powers of the state cannot be invoked properly except in those areas which involve the public interest, by which is meant those situations which involve the signing of reports or statements "in a manner indicating that the signer has an expert knowledge of accounting or auditing." On the other hand, the public accountants, perhaps in the hope of legislating competition out of existence for a considerable volume of their services, would extend the field of regulation to include part-time or public bookkeeping, the preparation of all manner of governmental reports, and other independent services of a clerical nature. It seems to me that both views are somewhat extreme. I believe that the modern concept of regulation will include all services, the performance of which requires professional skill, and will exclude those which are of a routine character.

I do not pretend to pass upon the constitutionality of regulation in the field of public accounting. There has been much discussion and competent legal opinion on this subject. In general, we may say that the court decisions have varied with the manner in which the legislation was written, and, more particularly, with the recency of the decisions, since the recognition of the need to protect the public from incompetence in this field is a modern trend. The current situation is summed up in the following language in *American Jurisprudence* (Vol. 11, page 1032, Sec. 275):

"The power of the state to provide for the general welfare authorizes it to establish such regulations as will secure or tend to secure the people against the consequences of ignorance and incapacity. To that end it may exact a certain degree of skill and learning in professions and pursuits which concern the public health and welfare and are of such a character that a special course of study, training, or experience is needed to qualify one to pursue such callings."

From the foregoing, it would seem to be within the police powers of the state to insure that persons who represent themselves as members of a profession have the minimum qualifications necessary to the discharge of those responsibilities. Hence, the public interest or welfare, as applied to the public accounting profession, seems not to be limited to those areas in which known or potential third parties are involved but to any services of a truly professional character.

Many certified public accountants and public accountants have felt that, in order to qualify for a waiver license, there should be evidence of some degree of competence. The regulatory laws of some states have contained provisions to that effect, while in other states there was doubt as to the constitutionality of depriving a person of his legitimate means of livelihood even though it had become that but recently. Indications are that the setting of reasonable standards as a prerequisite to the issuance of a license is more a matter of the pleasure of the various legislatures than a matter of constitutionality.

Professor A. C. Littleton, of the University of Illinois, reasons well for regulation as an instrument for the welfare of the public and the profession in the January 1947 issue of *The Accounting Review* which was reproduced in a later issue of *The Journal* in the following part:

"Some observers will interpret the growing tendency in the profession to favor restrictive legislation as indicating one more area where monopolistic ideas are hard at work. Actually this movement is the most tangible evidence to appear in fifty years that large numbers of professional accountants are becoming increasingly alive to the existence of two underlying facts: that the success of the profession as a whole amounts to more than the sum of the successes of its members; that the welfare of the profession (and through it, of individuals) is closely bound up with the contribution it makes to the public welfare. Since dependable accounting information is indispensable in a modern industrial and capitalistic democracy, it is in the public interest that such information shall be inspected by independent, competent, and impartial experts. It then becomes a matter of public interest that the competency of the 'inspectors' shall be tested and that the 'inspecting' shall be restricted to the competent. This is the essence of the idea back of restrictive legislation for public accounting. And support by professional societies of this legislative development is more by far an indication of recognition that the public interest can best be served by competent individuals who are under the restraints of professional discipline than it is a sign of big ideas of occupational monopoly."

The benefits to the profession claimed for regulatory legislation parallel all those claimed for permissive legislation and include also the promise of ultimate unification or stabilization of the profession. Obviously, the mere enactment of legislation, whether it be permissive or regulatory, cannot perform the magic of conjuring up professional standards of competence or conduct where none existed before; neither can it transform weak or wayward standards into strong or upright standards. But legislation does lay the foundation upon which may be built a structure which, with the passage of time and well-directed effort, will support a higher level of minimum standards, and, in the case of regulatory legislation, it will also foster uniform standards. The benefits of establishing and enforcing standards of conduct are, of course, available as soon as the enforcement machinery functions. On the other hand, the standards of competence will rise but slowly as the incoming members are carefully screened and the existing members gather weight. Ultimately, all practicing accountants will have measured up to uniform minimum standards, and that is the paramount aim of regulatory legislation, one to which permissive legislation can not hope to aspire.

Since professional standing is solely a matter of personal attainment, it is difficult to see how a person of meagre qualifications can injure the prestige of the profession any more with a license than without one, particularly since legislation provides the machinery to place such a person under restraints. Insofar as legislation can confer professional standing upon any individual, to that extent, at least, those who become licensed must be recognized as professional accountants, even though there be some whose professional qualifications are but barely marginal. Whatever unearned laurels may be bestowed, that is a small price to pay for unity, without which the profession cannot achieve a uniformly high level of standards.

One of the gravest dangers to the prestige of the profession is lack of unity, and it behooves every member, whether certified or not, to bend every effort to remedy that condition. Without unity, the profession may become the prey of those who, among other things, would seek to curtail its activities. As you know, the public accounting profession has had to combat repeated attempts to make income tax practice the exclusive field of the legal profession, notwithstanding the fact that accountants pioneered the field and continued to render this indispensable service over a long period of years without aid or comfort from other sources, save where the practice of law, as such, was involved. The leaders in the legal profession are quite conscious of the fact that their total membership exceeds by a considerable margin the visible demand for legal services, and since the economic status of its members has such a strong influence on professional standards, they are much concerned with enlarging the exclusive field of their profession. Since probably upwards of fifty per cent of the legislators throughout our land are members of the legal profession, it is not unreasonable to expect that sooner or later considerable capital will be made out of any noticeable lack of unity in the public accounting profession. Here again, legislation cannot perform a miracle, but it will put an end to the influx of unfit persons who coast along on the coattails of professional accountants with impunity and to the detriment of the profession.

We come now to the hazards of regulation. This is not to suggest that we can make a study of the price tag and thereupon decide with finality whether or not we shall embrace regulation. At best, any choice as to regulation itself is but temporary, for we cannot long withstand the broad and resistless trend of the social, political, and economic forces in which regulation is bound up; to attempt to reverse the course of this trend is as futile as it was for King Canute to attempt to stay the ebb and flow of the ocean tides. Rather, the choice is whether regulation will be adopted or imposed. In either case, it is only prudent for us to acquaint ourselves with some of the consequences of regulation.

One of these is that the CPA experience requirements may be placed in an untenable position, since there is rather persuasive precedent in other professions for the granting of degrees upon passing a suitable examination. It has been asked quite earnestly by legislators and others why the demonstration of an adequate knowledge of theory must be supplemented by a thorough grounding in the application of that theory. We would be well advised to re-examine the profession from the standpoint of minimum standards of competence and also the schooling facilities for professional accounting so as to be prepared to meet attacks from that quarter convincingly and constructively.

Another possible consequence is that control of the profession will fall into the hands of government bureaus. That there is such a possibility must be conceded, since it is inherent in bureaucratic philosophy to seek expansion of its area and degree of control. However, the experience of other professions, as well as the accounting profession in those states which have regulation, has been that control has been delegated to leaders of the profession. By way of a partial exception, I must say that the Department of Professional and Vocational Standards in California has shown symptoms of an appetite for continued licensing, probably as a result of exposure to the controversy which preceded the enactment of the present law.

Still another possible consequence is that, in the course of time, there will develop a shortage of public accountants which will necessitate some further licensing at a lower level. The states which have had regulation for twenty years or more have encountered no such difficulty. It is inevitable that the number of those seeking to qualify for a CPA certificate will multiply as the privilege of entering the practice of public accounting without adequate training is removed. In California, the highest number of candidates who sat at the CPA examinations in any one year before the enactment of the present regulatory law in 1945 was 400, whereas, with the some 900 who are to sit for the examination which takes place later this month, there will have been over 1400 candidates in 1947. (No attempt has been made to eliminate repeaters from these figures.) There are undoubtedly a variety of reasons for this trend, but it does suggest that we may expect an ample supply of recruits to the public accounting profession. In this connection, it must be kept in mind that public bookkeeping is not public accounting.

As I see it, the more serious of the possible consequences of regulatory legislation lie in three objectionable provisions which are sponsored by the leaders of the National Society of Public Accountants, namely, representation on the state board, continued licensing, and overthrow of the CPA certificate. From my contacts with a considerable number of public accountants in California, I am led to believe that these proposals originated with certain leaders in the National Society of Public Accountants who consulted only themselves. It is my opinion that the violent attitude toward the CPA certificate is unknown to the rank and file; that continued licensing does not have popular support; and that there is general indifference to the matter of representation on the state board. It is probable that even its advocates see no hope of making headway in the elimination of the CPA certificate, but are using that to strengthen their position in bargaining on the other two proposals. At least that was the way things seem to have worked out in New Mexico, where a split board and continued licensing were written into the law and discontinuance of the CPA certificate was threatened. The situation in New Mexico is even more sobering than that of California, and the experience of both states illustrates what can be done by the public accountants when they become mobilized and can enlist legislative support in their cause. Since the more serious problems which can grow out of the failure to exercise timely initiative presented themselves in California, I shall review briefly the events which took place in that state.

Regulation in California had its origin with the public accountants who drew up a bill providing for a separate class of public accountants to be known as "registered public accountants" who were to be governed by a separate state board. Such overtures as were made by the public accountants to the certified public accountants were rebuffed, because, up to that time, the thinking of the certified public accountants had been conditioned along the lines of resistance to all change. The rank and file of certified public accountants were not aware of the issues and they fell prey easily to the fearsome spectre of waiver. Those who sensed the trend of events were not heard or, being heard, were not understood or not heeded.

The public accountants became organized and embarked upon a highly successful program of enlisting the support of legislators in their cause. In the course of events, the certified public accountants found themselves declared in as virtual co-sponsor of the public accountants' bill. The two principal points of difference concerned representation on the state board of accountancy by the public accountants and continued licensing of public accountants. Under cover of the contest which was waged on these issues, the state employees performed the feat which has given the California law such dubious fame, namely, the provision for licensing thousands of the lowest grade accounting clerks. Naturally, this cast overboard the qualifications provisions which the public accountants had properly hoped to have incorporated in the bill, and to all intents and purposes made a mockery of licensing. It is to the credit of the administrative committees of public accountants, who later screened some 15,000 applicants, that anything was salvaged. When the smoke of battle had cleared away, the certified group had retained exclusive representation on the state board and withstood the pleas for continued licensing, while the noncertified group gained regulation and, as already indicated, was granted sole jurisdiction over license credentials.

The basic impropriety of the scheme to install members of the noncertified group on the state board and thereby invest them with authority over the certified group should need no argument. Even token representation could easily become mischievous by serving as an entering wedge for proportional representation, meaning possible control of the state board, and the latter could be but a prelude to granting certificates by waiver. It would be a betrayal of the profession and the public to court the risk of such an eventuality, no matter how remote.

Continued licensing has no justification in logic or precedent. Those who cite the medical and nursing professions in support of having two permanent classes of public accountants are blind to the fact that nurses are not at liberty to practice medicine, whereas, noncertified public accountants may engage in all fields open to the certified public accountants, but at a lower level of standards. It should be obvious, also, that continued licensing would be an insurmountable barrier to unification of the profession. Finally, continued licensing may involve not only the matter of keeping the door ajar for recruits to the field of professional accounting at a lower level, but it would probably keep the issue of a split board in a state of constant ferment. Accordingly, it seems that we would be well advised to be as wary of continued licensing as of the open pursuit of representation on the state board.

From very inauspicious beginnings in the contest over these issues during the 1945 legislative session, the California Society of Certified Public Accountants and the Society of American Accountants (a strong organization of public accountants in California), succeeded in ironing out differences remarkably well. There were thirteen amendatory accountancy bills before the California legislature in 1947, and on each of these the two groups came to an agreement outside the legislative chambers and succeeded in carrying through their joint aims. The officials of both groups were brought together at special events in Los Angeles and San Francisco, following which there were informal contacts and a series of meetings between the legislative committees and other officials of both societies before and during the legislative session. Out of this has grown a mutual regard which promises to clear up the once lowering atmosphere of distrust and discord.

This brings us rather belatedly to a consideration of ways and means of establishing relationships between the two groups which will promote professional unity, a subject, which seems to have fared no better in the debates which have taken place within the profession than has that of regulation. Cordiality between the two groups cannot flourish so long as there is not harmony on the vital issue of regulation. It is for that reason, together with the conviction that regulation is both logical and inevitable in the development of the profession, that I have dealt at such length with the problem. So long as there are states which ignore or actively resist the regulatory movement, we cannot hope to have unity within the profession. Cooperative efforts by selected states or at the national level will be nullified unless there is at least promise of consistency. And I cannot think of consistency in terms of concerted efforts by the certified group to block or repeal regulation, for on that route lies ruinous internal conflict.

The public accountants are bent on obtaining recognition, and, since regulation is perhaps the most effective means of achieving that end, they are pressing their efforts in that direction with no little vigor. We may expect to see the crusading spirit among them take on proportions in direct ratio to the resistance encountered from the certified public accountants, and any overriding success may be expected to bring with it an uncertain temper. As a matter of prudence and as responsible leaders of the profession, the certified public accountants may be expected to give proper direction to the movement, in cooperation with the public accountants. If we shirk our responsibility, we cannot complain if others move in where we have defaulted. Recent experiences suggest that, unless we assume the initiative and write the regulatory laws, they will be written for us, with possible melancholy consequences. I am quite unimpressed with the judgment of those who find it beneath their dignity to pay a potential threat the respect of precautionary measures. Such an attitude is neither realistic nor constructive, and it certainly ignores the simple lessons of insurance.

As an over-all policy on cooperation, I believe that, for the present, we cannot improve upon the objectives of the Institute, as expressed in the certificate of incorporation, which in part, pledges the members "to unite the accounting profession" and "to encourage cordial intercourse among accountants practicing in the United States of America." This is of necessity very general and must be implemented by measures in the various states to suit local conditions. Density of population and degree of organization among the public accountants will be the two principal variables to which we must accommodate ourselves.

In general, we may say that the extent to which both groups feel the need of cooperation and the methods adopted to bring that about will vary with circumstances, but, so long as the welfare of the profession is the governing consideration, the results will prove beneficial. I believe that it is to the best interests of all concerned that both groups retain their identities by having separate professional organizations. Healthy cooperation between the two groups is most likely where the independent spheres of each are respected. Exception to this may prove desirable in the sparsely settled states where neither group may be large enough to function effectively. There can be harmonious relationship and collaboration, or friendly neutrality, in all legitimate aims and aspirations.

Any workable policy of over-all dimensions must recognize the responsibility of the certified public accountants to exercise constructive leadership, and, above all, it must recognize the personal dignity of the individual public accountant. Students of the labor movement see that movement, not in terms of its less commendable outcroppings, but in terms of human aspirations for equality, or freedom from inferiority. If we can see the movement, which is gathering momentum among the public accountants, as a restless urge to better their station in life rather than a predatory move, we shall have gone a long way toward establishing a sound basis for mutual goodwill and respect.

In closing, I should like to summarize the foregoing remarks. I have stated my belief that regulation is both logical and inevitable in the development of the profession. I have expressed the view that there is but one public accounting profession; that it is not unified; that it cannot become unified without uniform standards; and that uniform standards are not attainable without regulation. I have pointed to the evident desire for regulation at the very outset which was restrained because it was deemed premature, and that partial regulation, in the form of permissive legislation, was adopted as a substitute, seemingly until such time as full regulation became appropriate. I have attempted to distinguish between the waiver plan of installing regulation, which was sought unsuccessfully during the first thirty years, and the licensing (or modern) plan of regulation which has been adopted by eighteen states during the past twenty or more years. I have attempted to unmask the alleged superiority of permissive legislation over modern regulatory legislation in the matter of attacks by those whose scruples have failed to keep pace with their ambitions. I have outlined some of the hazards of regulation and have given it as my opinion that to concede membership on the state board to public accountants or to yield to overtures for continued licensing of public accountants would be fundamentally unsound. I have expressed the conviction that our only choice in the matter of regulation is whether we shall await its imposition or act while the initiative is still with us. I have given it as my opinion that we must be unanimous in our support of regulation, and that we must work out a constructive relationship with the public accountants.

May I say again that unity is indispensable to the orderly functioning of the profession. Progress in the field of professional standards, on which the public welfare rests, can only be secured by recognizing that public accounting is a single profession, and that a house divided against itself cannot stand.

Use of Accounting Data in Economics and Statistics[1]

By Stuart A. Rice, Washington, D. C.

Assistant Director in Charge of Statistical Standards, Bureau of the Budget, Executive Office of the President

The first task of a public speaker is to evoke symbols of interests that he shares with his listeners. If I were able to apply this rule more easily, my acceptance of your kind invitation to address you might seem less presumptuous. I am not an accountant. I have some acquaintance with economics and may possibly be entitled to call myself a statistician, although such mechanisms as examination and certification do not exist in this country for the determination of this question. If there is any justification for my appearance before you it lies in my belief that economic statisticians and accountants should understand one another better and should more effectively inter-relate their activities. I shall therefore begin by discussing the relationships between them.

Relations of Accounting and Statistics

A university colleague once sought to convince me that statistics is a branch of accounting. Another contended that accounting is a branch of statistics. One of my present official associates holds that accountants are in part statisticians, using some of the same procedures and devices; for example, punched-card tabulation.

All of these interpretations agree in the assumption that accountants and statisticians (at least economic statisticians) do have much in common. We place the same value upon "independence" that Mr. Draewell has just expressed. [See page 12.] Our data bear a family resemblance. We often use each others' figures. These figures are viewed with the same combinations of awe, suspicion, disbelief, and ridicule by a public that tends to lump us together and does not clearly understand what either of us is about. The Opinion Research Corporation reported to the Controllership Foundation that large percentages of persons do not know the meaning of such terms as "asset" and "liability." I should guess that even larger proportions would decline to distinguish between "lies, damn lies, and statistics."

My conception of the basic relationship between accounting and economic statistics can be illustrated by a parallel. Before entering government service, my main field of interest was the methodology of the social sciences. Specialists were then as now seeking to establish scientific foundations for their subjects. Among sociologists sharp lines were drawn between partisans of statistical

[1] The writer appreciates assistance received in the preparation of this paper, among others, from the following associates in the Federal service: W. W. Cooper, E. T. Crowder, Paul Green, J. Weldon Jones, Earle C. King, R. W. King, Raymond Nassimbene, Charles Smith and H. C. Walling.

method and "case" method, respectively. I believe that time has healed this breach and synthesized the partisan viewpoints into a broader conception. The study of individual "cases" of whatever character, and the statistical summation of facts uncovered by such case study, far from being alternative methods are now generally regarded as essential parts of the same scientific process.

In like manner accountants have responsibility for determining for individual establishments or companies the value of products and sales; the payrolls, costs of materials, and other costs of production; the value added, etc. Such items are the indispensable starting points for a large proportion, if not the majority of current economic statistics. Statistical aggregates, averages, and distributions for industries, geographic units, and products are derived from the accounting records of individual companies or plants. For an accountant the figure expressing dollar inventory of a manufacturing company may be one of the end products of his labor. For a statistician the same figure may be one observation among others which he bakes together into a "statistic" for the industry. Which is more important, the loaf as it comes out brown from the oven, or the flour of which it is composed? I think the question is meaningless.

In recent years a new type of economic statistics has borrowed concepts from accountancy. The terms "national income" and "gross national product" reflect a desire to analyze the economy of a nation in a manner similar to that of an accountant in the case of a single individual or company. International balances of payment, of much current concern to statisticians, embody the same viewpoint. The extent of this trend is reflected in the statistical economists' talk of "social" or "national accounts" and in the "budget for the nation" discussed in the last budget document submitted by the President to the Congress of the United States.

I think that a thorough survey would lead to the conclusion that both of our professions have increasingly become indispensable to business, industry, government, and each other; and that both have increasingly become imbued with public interest. The last of these points is one to which I wish to return.

In going out to swim with you I have so far managed to avoid the water. Now I must boldly wade into accounting questions with which my acquaintance is much too scanty. I shall not infringe upon your tasks of building accounting systems from their inceptions through the elementary transactions to the significant classifications of the final report, such as the income statement and balance-sheet. My comments will be appropriate to users of your data. These are legion, ranging from the tyro with a casual interest to the skilled investment, business or economic analyst, and I shall speak for statisticians among this diversified army. I will make some mention of cost as well as financial accounting. I shall say little about economics except as statistics based on accounting data can hardly be anything but economic statistics, the service of which to economists will be sufficiently evident. For convenience I will restrict my attention to the official use of accounting data.

The differences between official and unofficial accounting practices and uses would be an interesting topic for separate discussion. One of my associates draws this contrast:

"In the government it is the custom to publish budgets but not the final result of operations. In private accounting the custom is the reverse. I should like to see business firms undertake to publish their budgets as well as financial statements because (1) it will give valuable information to stockholders and enable them to judge the planning ability of their managers and (2) provide valuable information on business plans and business operations (financial statements) for economists and statisticians."

This interesting suggestion, while partially relevant to my subject, I shall pass on to you gratuitously without further comment.

In the federal government there have been three types of uses of accounting information: (1) accounting is used internally for administrative control in a manner similar to that in private business; (2) special administrative purposes require the collection of accounting information from sources outside the government, for example, on income tax returns, applications for price adjustment to the Office of Price Administration or applications for loans to the Reconstruction Finance Corporation; (3) the requirements of broad general policy often lead to the statistical compilation of accounting data collected for purposes of the preceding type, or to the assembly *de novo* of general-purpose data in such inquiries as the Census of Manufactures.

The first type of use presents no features of unusual interest to accountants outside the government. The second type of use may sometimes be of a statistical character, in that it deals with group totals; or it may be non-statistical in the sense that it deals with individual company information. I will direct my discussion to the second and third types of uses, with which my office is especially concerned.

Wartime Experience with Accounting Information

An account of wartime experience will illuminate the government's use of accounting information and reveal some of the problems with which government statisticians have been concerned.

It should be remembered that only a few years ago about one-half of our national output was being diverted into war goods. At the same time wages and profits were paid on war as well as civilian goods. In consequence the inflationary pressure on the prices of things that you and I buy was tremendous. This pressure was held in check by a combination of higher taxes, bond savings, rationing, and price control. At least the last of these, price control, would have been impossible without accounting information. It would be almost impossible to overemphasize the role of such information in the operation of the wartime price control and stabilization programs, hence in the prevention of much higher prices. Cost and financial information served as the primary bases for instituting and adjusting general price regulations of the Office of Price Administration. In addition, all individual cases, such as the so-called hardship adjustments, revolved around the use and interpretation of accounting data.

Use of financial and cost data by the renegotiation authorities of the War and Navy Departments, Maritime Commission, War Shipping Administration, Reconstruction Finance Corporation, and Treasury Department is familiar to most accountants. As the procurement programs of the military agencies developed they depended more and more on accounting data. I refer not only to the cost-plus contracts which were common in certain fields of procurement, but also to fixed price contracts. The taxpayer was spared billions of additional debt through the use of accounting information.

The uniform provisions and procedures of the contract termination program revolved around data supplied by accountants. Again this story is so familiar to you that I need not dwell on it except to point out that contracts were terminated and plants cleared with a minimum of dislocation to private industry and with virtually no unemployment. Accounting facts helped to make this achievement possible.

In all of the preceding types of wartime experience it was frequently difficult to distinguish between accounting information obtained as a basis for statistical aggregates and that obtained for non-statistical purposes. Frequently the same information served both types of purpose.

Early in the war it became apparent that the government would make extensive use of accounting information. In the middle of 1942 the Director of the Budget requested the creation by American industry of an Advisory Committee on Government Questionnaires to consult with the Bureau. To this Committee (now the Advisory Council on Government Reports) my office turned for accounting assistance and advice. A standing subcommittee on financial reports was appointed; and in addition, special subcommittees and panels from time to time handled more specialized accounting problems. Other consultations with business controllers and accountants were arranged as occasion warranted. The men on these committees and panels gave unstintingly of their time and energy to the problems pouring into my office. Theirs was an objective, patriotic service to industry, the government, and the nation, of which the accounting profession can be proud.

May I explain that the Division of Statistical Standards administers the Federal Reports Act of 1942. We do not ourselves collect statistics; but under the Act, with certain exceptions, we must review and approve all questionnaires and schedules to be returned by ten or more respondents before they may be issued by other federal agencies.

In retrospect, the government's difficulties in using accounting data as the basis for wartime statistical controls appear relatively slight. Solutions satisfactory to all concerned were in most cases found. We took the view that the primary function of accounting was to service individual management. On the other hand, there was need for standard forms and procedures. These had to be clear, understandable, and flexible enough to fit a great variety of accounting situations. They must not work undue hardship on any respondent or result in the collection of misleading or inaccurate information. Finally, they had to be drawn in such a way as not to obstruct or subvert the standards which the accounting profession had itself developed over the course of years.

The accountants on our committees were ingenious in finding solutions of problems within these terms of reference. Where practice and variations from practice were fairly standard it was possible to design the questionnaires so that alternative methods could be applied and adjustments effected during the process of review and editing to reduce the data to comparable bases. When variations from general practice could be expected in a small percentage of cases, the form was designed so that questionable items would be "flagged" for further attention. Correspondence or personal conferences with company representatives could then produce the necessary adjustments. In general we tried to avoid the use of ancillary schedules for companies with peculiarities in their accounting.

As far as financial data were concerned we found it relatively easy to devise standard forms and general instructions which were widely applicable, easily interpreted by respondents, and which confined variations to a tolerable range and pattern. It was frequently possible to use mail questionnaires with a resulting saving in time and money, both to government and respondent.

Where cost data were to be secured, however, it was virtually impossible to obtain reliable data through the use of mail questionnaires. Variations in cost procedures and terminology were so wide as to necessitate the use of extensive field investigations in virtually all cases. These were costly, time-consuming, and imposed such strain on a limited personnel that it was impossible to obtain the extended coverage needed. As a result, the government was sometimes forced to rely on inadequate or obsolete information with resulting inequities to persons affected by government decisions.

It was nevertheless possible to use standard forms and procedures in these cost surveys, and hence to achieve the uniformity necessary for statistical aggregation, but only when field representatives were present to study, interpret, and classify the information preparatory to completing the forms. This suggests that the necessary core of uniformity and comparability among the companies in particular industries already existed, but that it had not yet reached the stage of development achieved in general financial reporting. Moreover, the forms and procedures used in a wide variety of studies display a considerable degree of uniformity from industry to industry, at least at the primary level of accounts (labor, material, overhead, etc.) in which the government is most interested for purposes of economic analysis.

The Government's Normal Use of Accounting Information

Quite apart from the war, accounting information serves many special administrative purposes of the government that may be included in my second category of uses. It plays, for example, a leading role in the establishment of rates by regulatory agencies. Since government regulation of business seems to be on the increase in the United States, regardless of the party in power, this use of accounting data appears to be showing a long-term upward trend.

Even more striking are the broader contributions of accounting information falling into my third category of government uses. In the Division of Statistical Standards we think it important that forms and procedures which will increase the costs of business should serve as many legitimate statistical and analytical purposes as possible. Of the statistics employed in the government's over-all policy-making, the greater part are derived from data gathered in the first instance for particular administrative purposes.

It is obvious, as already indicated by my review of wartime experience, that the harmonization of a plural number of objectives in the preparation of a single report form is sometimes difficult. Flexibility must be allowed to fit details to individual situations; but a minimum standardization and uniformity are essential if there is to be sufficient comparability to permit meaningful statistical aggregates. To fail in the reconciliation of objectives is to invite duplication of reporting requirements which result in extra costs to both government and business. We regard unnecessary business burdens in such cases as indefensible.

The multiple use of a single report may be illustrated by an income tax return. The primary use of the data reported is for tax collection purposes; but in addition they contribute to the compilations published annually by the Bureau of Internal Revenue in the volume *Statistics of Income*. These compilations are vital for the study and reformulation of tax policy. They are also one of the important bases of the national income series. The latter, with other statistical information of broad character, are among the determinants of government policy respecting expenditure and borrowing.

The estimation of the national income by the Department of Commerce is a formidable task. In accounting language it includes the preparation of a consolidated statement of income and expense for all manufacturing companies, in which all duplications are eliminated. But the statement must be extended beyond manufacturing to other types of industries, finally including not only agriculture but also government. The accounting data upon which the national income series rest are collected almost entirely for administrative purposes by other agencies.

This all-inclusive series, the revision of which has recently been completed after five years of work to cover the years 1929 to date, is an indispensable tool to such groups as the Federal Reserve Board, the Council of Economic Advisors to the President, and others within and without the government, who deal with major policy issues. The wide use of the series by businessmen, labor groups, research foundations, etc., is a demonstration of the fact that government and private enterprise, like accountants and statisticians, have many of the same common interests.

Standards of Presentation

I doubt whether the safe utilization of accounting data presents problems for the statistician very different than for any other intelligent user. His prime requirements are a reasonable degree of uniformity, in order to permit the grouping of like items; a disclosure of all relevant facts; and a technical language sufficiently simple, standardized, and well-defined as to be intelligible. His interest in accuracy I shall discuss in a moment.

It was a common complaint a few years ago that the government did not adapt its reporting requirements to the books and accounting procedures of business companies. Government agencies were perforce compelled to answer that whenever the books and accounting procedures of different companies should follow or set an industry pattern, the agency would be happy to adapt its requirements to them. So far as the complaint continues and has merit, I believe that the solution of the problem is as much a responsibility of the accounting profession as of the government statistician.

I have no desire to see American accounting strait-jacketed into uniform inaccuracy. Any such imposition would in my opinion be a great mistake. There must be flexibility to adapt accounting procedures to individual situations. As a matter of fact the statistician can stand fairly wide variations in accounting practice. For example, it is well known that statements designed to reflect statutory taxable net income may differ widely from prepared statements for other purposes. Such studies as we have been able to make, however, show that in certain key items such as net income after taxes the divergences in the aggregates between tax reports and corporation reports, except in the case of certain industries with large amounts of wasting assets—are not statistically significant. Some items showed more and some less of such divergence. In general, categories on the balance-sheets were in closer agreement than items on the income statement.

It is obvious, however, that wide variations in accounting may produce distortions in the aggregates. A reasonable degree of uniformity and adequate disclosure are thus highly essential and should not prove impossible. The field of cost accounting may be ripe for developments in this direction. The coming three-year study of the concept of business income by the American Institute of Accountants is clearly in the right direction. I am told that the work of the Institute's committees on auditing procedure and accounting procedure is effecting greater uniformity in practice. The SEC, working in close cooperation with practicing accountants, has also played an important part in achieving a greater degree of uniformity in industry reports.

In the matter of disclosure, the accountant is called upon to show his independence, good judgment, and courage. The pertinent facts must be brought out and properly labeled. This is one of the points at which the statistician and the general public are completely dependent upon the accountant.

One of the principal problems faced by the statistician is that of preparing comparable statistical time series covering a period of years. Aside from the problem of uniformity, there is the problem of segregating recurring and non-recurring items. Failure to disclose large non-recurring items may seriously distort time series comparisons.

Another problem is that of attempting to build up group totals without duplication, in order to ascertain total value added. Essentially, it is the problem of consolidating profit-and-loss statements applied to an entire industry or group of industries. Obviously this can be done only if accounting reports segregate the more important internal and external items. Thus, in the profit-and-loss statement, unless costs of materials and supplies are shown, it is not possible to construct an approximate non-duplicated total of industry costs and income. Most accounting reports today do not present a profit-and-loss statement which will permit the grouping of non-duplicate costs and income.

I will say nothing more concerning the technical language of accountancy, since I anticipate that Mr. Caffrey will touch upon this question in his address. [See page 31.]

As to accuracy, the statistician is broad-minded. He is usually concerned with group totals and does not need the degree of accuracy required in an accounting-for-funds statement. His primary interest is in the first three or four significant digits. Ordinarily, for example, he is not disturbed by an inaccuracy of 0.1 per cent of the total. If all the group figures are in millions, his totals may be shown only in millions or tenths of millions. The statistician is vitally interested in the substance of the account. Furthermore, he is interested in obtaining the information at the earliest possible date. Consequently, he is willing to sacrifice a relatively small inaccuracy for more prompt reporting.

The conclusion of the matter for the statistician, it seems to me, is that the accountant on his own initiative, or in response to other public pressures, may be expected to develop satisfactory standards in respect to adequacy of disclosure. This will occur in other particulars as well. The statistician's interests may warrant his most frequent intervention in connection with the establishment of minimum bases of uniformity in accounting practices. For without such minima, in respects which the statistician may be in the best position to specify, the construction of statistical aggregates from accounting information may be thwarted at the start.

Both of our professions are affected by trends which bring our work increasingly within the spotlight of public interest. Our products have graduated from the luxury class to the class of essentials; but we have reached our recognized positions after long hard struggles. We are now called upon increasingly to show what illumination our techniques can throw upon the nature and workings of the national, and indeed of the international economy. We must not fail or shrink from an unaccustomed public inspection, or recoil on the basis of conservatism alone from assignments that do not conform to the accustomed categories and tenets of our thinking. It behooves us both to keep our prejudices in suspense, our armor spotless, and our white plumes held high.

Plain Talk in Accounting

BY JAMES J. CAFFREY, PENNSYLVANIA
Chairman, Securities and Exchange Commission

I BRING YOU greetings on behalf of the entire Commission and of myself. We wish you a pleasant and fruitful meeting. We would all like to be with you, but since that is impossible I have accepted your invitation as an ambassador to a group with which we have worked closely, amicably, and effectively for a long time.

This is my first address to a professional group of accountants; and, I understand, this is the first time a chairman of the Securities and Exchange Commission has addressed the Institute. It is a perfect occasion for high-sounding phrases. But I would rather use it to do some plain talking. I do that because plain talk is the substance of my message to you.

I cannot afford the luxury of either a personal or professional bias on accounting problems. Although I am a lawyer I do not view accounting with the squint-eyed hostility of some lawyers. Although I like to speculate about technical accounting, I have no technical axe to grind. My position requires me to bear in mind the needs of investors, to think in practical terms of the effect of regulation on company managements and on those who render professional services to companies, to make decisions based on legal considerations and to reach judgments based on accountants' presentations. I discovered early that there were two important things I had to do: think straight and talk plain. Out of the welter of complicated legal, accounting, analytical, and other elements that enter into our deliberations, the challenge is to find the issue reduced to its simplest form and to state the conclusion in the plainest way possible.

To my mind the accountants' job is very similar. Out of the welter of raw elements that go into the making of a financial statement, he must find the simplest and most sensible rules of order and he must state his conclusions in the most understandable form possible. The single, most important challenge which faces the profession is, to my mind, the challenge to talk plain. I do not by any means underestimate the extent of that challenge.

Perhaps the most striking thing about your profession is the enormous change that has taken place in the position of the accountant. From the simple scrivener tabulating receipts and disbursements, with limited functions and limited responsibilities, he has become the processing plant through which the raw data of finance must pass before it can be compiled in the vast financial encyclopedia of our time. To the terminology of receipts and disbursements he has had to add a language to describe newer concepts; within the framework of the balance sheet and income statement he has had to find a place for items of multiple, complex, and ambiguous character. To the simple dimension of income and outgo there have been added new dimensions in which to reflect spending not yet done and receipts not yet in hand.

Further, the accountant for the large enterprise is often called on to account for the operations of an "entity" only in the bare legal sense. Within a single corporate framework there may be divisions, each one of which represents an enterprise almost independent in its organization and operation. The holding company system has, on the other hand, required the development of techniques of combination and consolidation to account for a diversity of corporate entities in reality joined in a common economic enterprise.

To these difficulties have been added many others. Not only is the imagination staggered by the growing size and complexity of what the accountant must account for, but it is not always clear even for whom accountants account. The single enterprise is no longer the personal concern of one owner or a small group of owners. Its ownership is likely to be spread among vast numbers of security holders, aggregating into a mass of conflicting legal and economic interests in the single business unit. In any given situation the exercise of an accountant's judgment may vitally affect the ownership interests of one competing group of security holders as against another.

History seems to have an endless storehouse of burdens for the accountant. His presentation must also satisfy the regulatory agencies interested in the operations of the economic enterprises for which he accounts. One group in government is charged with protection of the revenue, another with the protection of security holders, another with the protection of rate payers, another with the protection of employees, and so on. Each of these bodies may approach the balance-sheet or the income statement with a different emphasis, and may read it for a different message. Nevertheless, the accountant is expected to produce one single adequate, truthful, and understandable statement.

History has thus thrust the accountant into a crucial role. Management, labor, conflicting groups of investors, potential investors, and governmental interests make vital decisions based on the story told by the accountant. Yet the accountant is no mere reporter who sits by the sidelines giving a play-by-play description of the business. Save in the simplest kinds of business, he has been given a task which embraces interpretation as well as mere recording; judgment as well as mere tabulating; art as well as science.

What does this add up to? Perhaps the simplest way of putting it is to say that the accountant's position has become a position of power. In this regard history has an even hand; with power she doles out responsibility. The full measure of that responsibility is a full bible of accounting. I have neither the time nor the ability to cover that much ground. I would like to touch briefly on some problems that, with the layman in mind, strike me as basic and perpetual.

An accountant necessarily deals with the terms of art. But those terms have popular meanings to the non-professionals who read and rely on accountants' statements. While I might be ill at ease in technical arguments about the full implications of such words as "profit," "income," "surplus," and "depreciation," when I read an accountant's statement I have a very well-defined reaction to these words. I assume that the character and quality of these accounts are the same for different statements of the same or different businesses. I assume that the accountant has told me how much the business made or lost during the year and how much it can pay out without impairing the investment. I expect the statement to be complete: if it covers income and outgo, I feel entitled to believe that charges and credits have not been tucked away or placed anywhere else. If there are necessary qualifications to what I read in the figures, I assume that these will be flagged for me where they are most pertinent and will be stated in such a way as to permit me to appraise the statement intelligently.

These are the things a layman expects. In my opinion these expectations are the core of accounting. They are the common ground upon which the public and the profession communicate; they are the only source of vitality for accounting concepts; they define ideals—vague and difficult as they may be—toward which the philosophy and language of accounting must move to be vigorous and meaningful. When accounting terminology loses touch with common meanings, it becomes at best a verbal exercise and at worst meaningless double talk. As necessary as it may be for the accountant to choose between alternative theories or alternative applications of theory in the course of making his statement; as multiple and as complex as may be the elements that go into the achievement of the net result, it must mean pretty much what the layman thinks it means or it has no public meaning at all.

Thus, there are necessary limitations to the art of accounting. It cannot be permitted to take the accountant so far afield that his language loses its essential touch with reality. The common man's understandings of accountants' words are heavy anchors against drift in representation of financial facts. They must form, in all statements, for all companies, and wherever used, the essential content of accounting terminology.

Every generation brings with it those who strive for certainty, and it brings also those who insist that certainty is a will-o'-the-wisp. Of course, absolute certainty in accounting is not now, and may never be, an achieved fact. But it is nonsensical and dangerous to deny its validity as an ideal. Your profession has in the past decade made many improvements in that direction. They are palpable evidence that we can go still further.

There is a vast premium in continuing efforts to achieve certainty, comparability, and rigid independence in accounting. We must remember that an accountant's presentation is, to most people who read it, like a mariner's compass in the fog. It is all they have to go by. If the guide fails they are lost. They cannot trace back the method of arriving at the statement. They do not have the skill to temper their reading with sophisticated judgments about diversities in accounting treatments. They have no choice but to assume that the accountant's presentation means what it says and that it tells the whole truth, on the basis of an independent and thorough survey of the facts.

Full respect for the stewardship inherent in the position of the accountant requires more than conscientious performance by individual practitioners. Who is to blame if the balance-sheets and income statements of the X and Y companies certified by different firms, are found to use the same language, within the scope of accepted or acceptable accounting principles, to describe different things? There may be excellent arguments to justify both presentations and both may have been conscientiously certified. However, if they use the same words to describe different things, even an experienced investor who makes a comparison between them has been seriously misled by a dangerous though honest falsehood. Each statement, telling the truth in its own way, is justifiable. Put together they distort each other.

It is here that the Institute has done much in the past and can do more in the future. Individual practitioners, working alone, cannot reduce their concepts to generally applicable formulas. Comparability, which is one of the vital elements of meaningful accounting, presupposes broadly applicable standards, so concise and well-defined that variability is eliminated or reduced to an insignificant minimum.

How can we do this job best? First I think it obvious that we must preserve and improve the close cooperation of the past between the SEC and the Institute. Accounting standards cannot be improvised or manufactured in a vacuum. The Commission needs the benefit of the close touch with facts and practice which the profession gives us in talking our rules over with us. Only in that way can we be sure of vital and meaningful standards. On the other hand, accountants need our continuous support. What is inevitably a part-time effort of busy members of the Institute and its committees is a full-time effort of the Commission. What, in the end, the Institute can only suggest to the profession, we can require.

I cannot stress too strongly the importance of keeping and improving our cooperative relations of the past.

The American Institute of Accountants and the Securities and Exchange Commission have been partners in a common endeavor. We at the Commission who have worked with you know how much the public owes to accountants who have devoted so much of their time and effort to bring about improvement in accounting standards and accounting techniques. You have shown your deeply felt responsibility in many ways; you have given unstintingly of your time and skill in reducing ideals to workable formulas; you have been an important vehicle in transmitting the benefit of new developments to the accounting profession in general, to the businesses for which you account, and to the public which depends so vitally upon your efforts. Because of this, you are much more than an association of professional practitioners devoted to your own interests—you are a means of safeguarding and transmitting the heritage of your art and science.

We at the Commission know, too, how important the Institute has been as a standard bearer in its field. So-called "regulation" of accounting by the Commission has not meant policing a beat. Because of the high ethical sense of the profession, it has involved, most pertinently, a *legislative* job; it has meant mutual effort in the development of a rational code. Once you and we have agreed on the general acceptability of an accounting principle or practice, whether it is promulgated by you or by us, we feel reasonably sure that the profession will obey it. What in some other fields is done largely through coercion and discipline is done in the accounting field largely through voluntary adoption of, and voluntary adherence to, professional standards. We have through this valuable partnership built an enviable record of progress. We do not dare do less and the public looks to us to do more.

Lastly, I wish to stress the importance of *scope* in any program to improve the adequacy and comparability of financial statements. Among those whose interest is served by such improvement, the investors stand prime. They are, in the classical sense, the owners and creditors for whom accountants account. At the very least any program of improvement should embrace all companies in which public investors have an interest. The Commission had this in mind, among other things, when it recommended to the Congress that the Securities Exchange Act of 1934 be amended to make it applicable to some 1,000 companies—each having at least $3,000,000 in assets and 300 security holders—not now required to file financial statements with the Commission because they do not happen to have securities listed on a national securities exchange.

To the members of your group—those who know best what sound accounting means for investors and the public generally, we shall look for help in framing workable and intelligent legislation. We have no unalterable, preconceived ideas about how the law should read, or about what the extent of its coverage should be. You gentlemen would have much to do with translating such a law into action. Your voice should be heard in the councils of deliberation.

Our direct interest in these matters is limited to businesses in whose securities there is a public interest. But you have no such limitations. Financial history seems to indicate that any business may be a candidate for development into a corporation with a wide public interest.

The transition accountingwise would have been eased in many cases which have come to our attention if the guiding hand of truly independent accountants working with sound principles and procedures had been applied earlier in the life of the business. Most of you, I suspect, literally have grown up with many of your principal clients. This process will continue. Failure on your part to maintain a progressive and constructive attack on accounting problems on a broad front can only lead to a usurpation of the field by others. With proper foresight and a cooperative attack upon new problems of accounting as they arise in the future, conflicting procedures will be avoided and your profession will retain the confidence of clients and investors alike.

Accounting Services to Management

By Eric A. Camman, New York
Member, American Institute of Accountants

In approaching this subject this morning, let me take you back briefly, some thirty-five or forty years ago and trace a bit of the history of what we now call industrial accounting. You all remember that in about 1909 or 1910, Frederick Winslow Taylor startled the industrial world, and really started an industrial revolution, by the paper that he read before the American Society of Mechanical Engineers. It had to do with some remarkable experiments that he had carried out, which were really the beginning of the time and motion study method of analysis of industrial operations. He began, I think, at the Midvale Plant of the Bethlehem Steel Company, and made an analysis of one of the most elementary operations in that plant, the loading of pig iron from a pile onto a freight car. The operation required no particular intelligence. It required strength, and that is about all. He studied the operation, studied the types of mentality, the types of physical build, the type of psychological approach to the job; also, the relation between effort and fatigue, and he found out that the men who were loading pig iron (one pig weighs 92 pounds), lifting the pig from a stock pile and carrying it up an inclined plank and putting it on a freight car, could load 12-1/2 tons of pig iron in a day, for which they were paid, $1.15 an hour.

He was successful in selecting certain types of men to try his experiment, which was simply to do exactly what they were told as to alternating periods of lifting and resting, and he had it figured out in percentages how much rest time there should be to overcome the fatigue of this heavy work. He produced the astounding result of loading 47-1/2 tons of pig iron per man per day through that simple analysis —four times as much. The men were paid $1.85 an hour, if I remember correctly.

He did the same thing with other operations. I will not go into many of them. For instance, shoveling. He studied shoveling. There were 600 men engaged about the plant in different kinds of shoveling work. He found that they used shovels of all shapes and sizes, and that the loads ranged from 3 pounds to 40 pounds, but that the average load that a man could carry, making due allowances for effort and fatigue, was about 21 pounds, depending upon how high it was lifted and how far it was tossed. He also found that the size and shape of the shovel had a great deal to do with this work, so by a simple planning arrangement of having a tool for each job, a man was taught how to use that tool, and by measurement of the effort involved and the fatigue allowance required, again Mr. Taylor achieved startling results in production.

That, very briefly stated, was what he called scientific management. His book on the subject came out in 1911 and was titled, *Principles of Scientific Management*. Out of that came the tremendous industrial growth in production methods that has followed in manufacturing operations in our generation.

At about the same time there also came a great stimulus to cost accounting in America. All the progress that we have made in cost accounting has been made in thirty-five years. Of course, evidences of cost accounting can be traced farther back. Cost accounting can be traced back, I think, to the 14th century, but the real development of it that we have seen has been since 1912. Following Taylor there was quite a group of scientific management engineers: Gantt, Leffingwell, Emerson, Carl Barth, Mr. and Mrs. Gilbreth. Following them in turn were others, engineers and accountants, who went into the cost accounting complement to this development in manufacturing operations: Hamilton Church, in his study on machine rates; Clinton Scovill in his book on "burden" and on interest in costs, you will remember, which started a long series of discussions. At this time also the theory of normal capacity for application of overhead expenses (burden) on an equalized basis over the production cycle of a year was developed. And also at this time we had the beginnings of what we now call standard costs.

G. Charter Harrison was the first one to come forward, following the principles outlined by Frederick Taylor and his successors, in the development of the procedure we now know as "standard cost accounting", which has branched into a number of practices, and has been widely recognized and adopted.

With these developments, particularly the development of standard cost accounting related to operating results, came a change in objective in cost accounting, from that of mere ascertainment of costs to the more important ones of furnishing operating controls for aid in running plants, operating controls for rewarding efficiencies, and operating data for use in administration to formulate the policies. These became the first in order of importance in industrial accounting, and they are today.

It is this broad field of industrial accounting that I should like to talk to you about now. While accountants have played an important part in this movement, so have industrial engineers, and it seems to me the day is coming when the industrial engineers will take over more and more of it, because accountants are too busy with other branches of their profession to take the lead that they should in developing the work of the industrial accountant, the man who is in the works and really is the source of all the data that you later find and deal with in the operating statements and balance sheets.

I cannot go into all the types of services that we can render to management; time will not permit. I intend to touch upon a few only. Last May I gave a talk at the Ohio State University. There was not time to prepare a paper, so I just made an outline (which was published in *The Journal of Accountancy* for July 1947, p. 29). The secretary of the American Institute of Accountants was there. It was an outline showing, on the one hand, the eight major departments of management in any manufacturing enterprise, and then on the other I tried to set down, just as they came to mind, the types of services which accounting can render in these areas of management. Before long, I had listed twenty-one major types of services, and I know I did not get them all down. So there is a vast field here that we should not overlook.

I will take time to give just a few illustrations of types of accounting services to management, say one or two in the department of administration, one in production, one in distribution, and one in employee relations.

Accounting can very definitely help in running a business. Everyone knows that keeping books of account is necessary in the conduct of business affairs, but many persons do not know how much can be done through accounting to help in running a business. This phase of accounting goes beyond the keeping of accounts, into the art of actually making use in management of the procedures which have to be followed in order to gather the figures, and to use them in such a way that they can be of aid in guiding management.

Great progress has been made during the last twenty-five years in developing the art of useful industrial accounting as an important arm of management. Much has been said and written on the subject, so much that a student now pursuing a course in industrial accounting may get the idea that the field has been pretty well covered and there is little left to be done. This would be very far from the truth. The field has been pretty well covered but in practice a great deal remains to be done.

Notwithstanding the advances which have been made and the extensive reference material which is available in modern books and publications, the actual use made of accounting in management falls far short of the possibilities. The greatest number of business concerns are still being run with less help from their accounting departments than could be made available rather easily. It is continually surprising to an accountant in public practice how often this is found to be so, and the cases are not all small companies, either.

There are two reasons for this condition. One is that the men who make up what we call "top management" frequently have no knowledge of accounting. Their abilities lie in other directions. These men have little patience or time for figures and statistics. Most of them would deny it if you told them that they were not sold on the importance of accounting. Yet in too many cases the kind of information furnished is of the least practical use to them, and it should cause no wonder that they are skeptical. Somehow, accountants make it as hard as possible for other men, men who are not "figure minded," to understand what they are trying to say and to make use of the information they can provide.

That brings us to the second reason for this condition. It is that the accountant does not think enough in terms of top management problems and speaks too much in the language of accounting, which is a strange dialect. Anyone who has sat in a conference between accountants on the one hand and shop men or salesmen or businessmen of whatever occupation who are not accountants on the other hand, will know that this is so. It takes a long time and a lot of talk for either side to get its meaning across to the other. This difficulty of expression is becoming recognized. Prominent examples can be found today of attempts to prepare annual reports in a manner so that they can be understood by employees, stockholders, and the public. Since accountants are in the minority and since the effectiveness of their services depends greatly upon how they present the information they have to transmit, it is up to them to overcome the difficulty.

The remedy for the two conditions is that the accountant should learn to think and speak in the language of those to whom he devotes his skilled services, and top management and the public in turn should give the accountant the recognition, the means, and the encouragement to do so.

Today I am happy to have the opportunity to talk to you on the philosophy rather than the technique of industrial accounting, to which so many meetings have been devoted, especially in cost accounting circles. I intend to talk about the "why" rather than the "how." The latter—the technique—deals with the details of procedure and with accounting principles. I shall talk very little about these. I shall devote the time instead to the philosophy which underlies all our efforts, and the objectives or ends toward which we should aim, from the viewpoint of business management rather than of accounting. If we can keep these objectives and ends clearly in mind and apply our abilities in their direction, the results of our work are bound to be of greater constructive value. If they are lost to sight through obsession with technique, the objectives may never be reached and the ends may never be realized.

This has happened time and again. The consequence has been that executives despair of getting the help they need through accounting channels and seek it by other means. The impression has been created that accounting is necessarily cumbersome, involving a lot of system and too much red tape, the less of which the better. Too often this impression has been justified through overemphasis upon technique.

I do not mean that technique is not important. It is. The methods must be economical and efficient; the procedure must be sound and the figures must be correct. The point I wish to make is that these features alone are not enough. They are of the greatest use if they are directed to the major purpose of solving the problems and lightening the burdens of management.

In the dictionary, philosophy is defined as "the love of wisdom as leading to the search for it." This definition comes nearest to expressing what I have in mind in talking about the philosophy of industrial accounting. In business management questions continually arise for decision. Many things enter into the making of wise decisions, but a basic one is reliable and timely knowledge of the facts and factors.

To give you an example of an application in the field of administrative decision, a conversation I had some years ago with the vice-president of a large steel company is recalled vividly. We were engaged in setting up a budget and planning procedure, striving for a certain profit position over a period of years. In discussing the program, the vice-president told me frankly that he had no great faith in paper planning and budgeting, that in the last analysis the attainment of the profit position sought depended upon the judgment of men who knew the steel business and upon their guessing the right way at the right time. He said if they guessed wrong, all the budgets and accounting in the world could not alter the result.

I agreed with him that knowledge of the steel industry, experience and ability in the management of his business were paramount. But I asked him whether he believed that if capable executives were furnished with accurate, factual data a month or six weeks sooner than they now were able to obtain them, in such a way that they would make a right decision when otherwise they might have made a wrong one, and if this happened a number of times throughout the year, might this not amount to saving many thousands of dollars in each case and perhaps a tidy sum in the aggregate? He agreed that this might well be so. And so it turned out to be. His company reached the goal set, and accounting helped in bringing this about.

Again in the field of administration, the presentation of data is of cardinal importance, and I think the force of that has been overlooked, or has not been fully appreciated. I think we all learned during the war in renegotiation proceedings how important a factor presentation was, because many a good case was jeopardized by poor presentation, and, on the other hand, good presentation facilitated the settlement of many cases.

In industry, you all recognize that it is important to know where we are, how fast we are going, in what direction. and whether a change in rate or direction is desirable. Forms of accounting reports and statements which merely show the current position are not of much aid in management. Reports which show the position now in comparison with the position at another time (such as this month in comparison with last month, or this year in comparison with last year) are somewhat better, but still quite inadequate for the needs. Such comparisons are meaningless—indeed, they may be positively misleading—unless and until they are analyzed and interpreted. The reader must first make mental reservations in the figures before him to eliminate the effect of altered conditions. These do not appear on the surface but are reflected in the figures. The reader must make such reservations both with respect to the present position and to the previous position. This is truly a laborious task, for which the executive has not time or inclination. And I might add here there is an additional factor present now in the rapidly changing value of the dollar from year to year.

Recognition of these difficulties has led to the presentation of data in the form of trend summaries. In this type of report, figures on the same activities are set down for successive periods. For example, if the figures are weekly, they are set down side by side for each week for a period of, say, thirteen weeks. If the figures are monthly, they are similarly set down side by side for a period of twelve months. If the figures are yearly, they can be set down in the same way for any number of years.

In this arrangement it is possible to read almost at a glance the rate and direction of the trend in any activity. It is immediately seen whether the progress is good or bad, and whether it is very good or very bad. When such figures are read in conjunction with others, representing the budget or expectations on the same activity, the picture is even more complete.

The performance and the trend on one activity can be seen and measured against those on another. Maybe they should run together or in parallel. If rates of pay go up, it seems logical that labor effectiveness should also go up. Often it does not. In running a shop department the rate of spending (for departmental expenses) should normally tend to be within the rate of running (production load). If the rate of spending goes up and the rate of running goes down, high costs or losses are inevitable.

Control in management is largely a matter of maintaining the proper proportions between numerous activities all going on at the same time. The use of trend summaries can be of great help in achieving such control.

Now, in the field of production, production control is not recognized at first glance as a part of the accountant's activities, yet, as a matter of fact, it very much is a part of his sphere. Industrial accounting is an important factor in production control. It is a kind of specialization which has undergone a rapid advance with the development of cost accounting. One of the directions in which great gains can be made is that of inventory control, production planning, and production control. These are interrelated and are comprised in the general term "production control." In many cases high costs and low output are caused principally by poor planning, poor scheduling, and poor physical control. Indeed, I have seen cases in which the word "poor" would be euphemistic and the words "inept" or "chaotic" would more properly describe the lamentable lack of production controls.

One of the most immediately effective ways of offsetting higher costs arising from increased prices and increased wages is to step up production. The greater output must be brought about not by hiring more men or buying more machines; it must be done by turning out a greater volume with the same number of men and the same equipment, if costs are to be brought into line. To accomplish this, we must make use of all possible means of smoothing out and expediting the flow of production.

Such a program calls for long-range procurement planning and production control. Procurement planning means purchasing foresight. Production control means having balanced inventories, advance planning for manufacture, scheduling for machine and assembly loads, and dispatching for uninterrupted flow of materials and parts.

Without these essential features of control, efficient manufacturing and assembling are impossible and labor is indeed laborious. Products cannot be produced for lack of missing parts. Parts cannot be furnished for lack of balanced inventories. Balanced inventories do not exist because of inadequate procurement or production methods. Then in desperation resort is had to the deployment of a large force of stock chasers to hunt for missing parts and to push them along so that assembly can be completed. Hurrying these parts along pushes others back. The inevitable results of this vicious cycle are utter confusion, excess inventory, low production, and high costs.

The industrial accountant can do a great deal to remedy such situations. Planning is part of his work. So also is the devising of ingenious forms and practical procedures for keeping the necessary records. The process is merely accounting in another form. Instead of keeping books and ledgers, it deals with orders, cards, charts, and records kept in quantitative terms of hours and pieces, requirements versus capacity to produce. A variety of office machines and devices are obtainable. The accountant can combine his procedural abilities with the technical knowledge of the engineer and the production know-how of the shop man. The three together can bring order out of chaos, or come pretty close to it. It has been done.

In cost accounting, the ascertainment of the cost of an operation or a product is a relatively minor feat. To tell an executive or department head how much a cost is does not suffice. He wants to know why. Why is it so high? The answer probably is that among other things material has gone up, labor has gone up and overhead has gone up. But this answer is no answer at all. He knows that these things have happened. The real question in his mind is: What can we do about it? To find out we must get at the underlying causes, and for the time being lay aside the language of figures.

Is our manufacturing management efficient? Do we have the right tools and equipment? Enough factory space? Where are the weak spots in our organization? Some of the difficulties encountered today are attributable to the aftermath of the war: Material scarcities, increased price levels, higher wages, high indirect expenses, production slow-down, etc. Some of these are extraneous conditions and others are due to habits and changes in attitudes which have grown out of the strain of the war years. We cannot do much about the extraneous conditions, but we can turn our attention to many other things within our reach about which we can do something to improve operations.

It may strike you at the moment that the things I have been talking about are not accounting at all, and in one sense that is so, but they are the problems of management and there is a very definite accounting avenue in reaching a solution to these problems along which the accountant can be of use. The accountant shouldn't run the plant, but he should help the men who do.

Just a short word of reference to the field of labor relations and labor effectiveness—employee relations. Very far off from accounting, isn't it? Well, as a matter of fact, as Donald Richberg told you the other day at lunch, it isn't very far off from accounting, it is very close to it. Our accounting should be very close to employee relations. Had industry in labor struggles in recent years been as well equipped with statistical and operating data as labor was, there would have been a more even battle across the bargaining table and labor might not have gotten away with quite so much in the use of information favoring their own side and perhaps not presenting a complete picture. And don't overlook the fact that the men on the labor side of the table are able men; they have able accountants who are studying their problems.

Employee earnings should be regarded in conjunction with labor effectiveness. I might add that in consideration of the inter-relationship between productivity and earned pay, the full cost of employment should be taken into account. The full cost of employment comprises expenditures other than the dollars that actually go into the employee's pay envelope for the work he does. These expenditures are for social security taxes, vacation allowances, welfare expenses, sickness, accident and health provisions, compensation insurance, and pension plan allotments. When such items are counted up they may run as high as fifty cents on every dollar of wages paid. They are definitely as much a part of the cost of employment as wages, and should be so regarded and treated in the accounts.

The subject of labor effectiveness is a delicate one. It enters upon the field of human relations in industry. It deals with incentives, with performance, with pay and with facilities, and as well with health, comfort, welfare, safety, and congeniality. All of these and more enter into labor effectiveness. The abilities of the accountant can be brought into constructive use in this important concern of management. I do not mean that the industrial accountant shall become a personnel director. He is, however—if he is not, he should be—in reasonably close touch with the employees in the shop who make up the group we refer to as "labor." He keeps their time, he makes up their pay, he reports upon their activities and productiveness. Perhaps he has a hand in setting the basis upon which their earnings are calculated. Indeed, the effectiveness of the accountant in industry depends in no small degree upon recognition of this human relationship.

According to the newspaper headlines, rates of pay are set by collective bargaining. Collective bargaining seems to consist of demanding certain hourly pay and perquisites in exchange for a number of hours of work. The productivity of the work and the effectiveness of labor are submerged in these headlines, most of the talk being about a decent wage, cost of living, security and working conditions. Yet in the final reckoning there must come about just proportions between rates of pay and labor effectiveness. It is vital for management and labor to find out what these proportions are, and to reach and uphold them. And I should like to direct your attention to the fact that the accountant has a very important function in this area.

Now, let us take a short excursion into the field of distribution, which ordinarily is not regarded as accounting. Take the field of market analysis.

The accountant is an analyst by training. The study of markets, where customers will buy our products, which customers will buy the most, which will keep on buying and what kinds of the things we make will they buy, are subjects for analysis which can lead to marked improvement in accomplishment. Market analysis can point the way to the most effective application of sales effort and expense. Who is better qualified than the industrial accountant to participate in this study and to gather the necessary data from which to reason the answers to these questions, and other questions? For instance, assuming we are a manufacturing concern, what are the channels through which we should distribute our products? Should we sell wholly through distributors? Should we sell partly through distributors and partly to retailers? Or should we sell to distributors, to retailers and enter the retail field ourselves?

There are companies successfully dealing through all three channels. Other companies find it better to confine their sales through certain selected channels. These are questions of policy with which management must deal. They are also the questions which the accountant who would serve management must keep prominently in mind in gathering his information.

The problems of pricing are many and varied. Prices are subject not only to economic forces of supply, demand, and competition, but also to federal and state laws. The cost of the thing we make to sell is only one factor among many which enter into the fixing of a price. I do not mean that costs are not important. In the long run, we must recover costs and have a profit left over. But cost alone is seldom the determining factor. If it were, small customers could not buy our products except at high prices.

The price structure as between customers must be carefully set so as to avoid discrimination under the Robinson-Patman Act. It may be desirable sales policy to grant lower prices to customers who buy large quantities, but any such scale must be set so that it will not work out to unduly favor one customer against another who may be in competition with him.

Another price problem is, where is our breakeven point? What is the level of volume which must be reached under a given price schedule before all costs can be covered and profits can begin to be earned for keeps? The three factors of price, volume, and cost are interrelated. If they are held in the right proportions, profit ensues. The problem is to find and maintain these proportions.

The accountant can render able service in this area of management. He can compute tables of discounts in such a way that discrimination is avoided. He can make calculations showing the probable outcome of any given combination of the three factors of price, volume, and cost. He can tell where losses end and profits begin. He cannot make dreams come true, and he cannot secure profits. But he can be of material help in their realization by computing the likely results of alternative courses to guide the making of decisions.

You may ask, "What has this to do with the province of the public accountant, the professional accountant who is engaged in public practice?" In many cases these areas do not enter into his immediate concern. He is more occupied with balance sheets and income statements, taxes, and matters of general accounting practice and auditing procedure. Yet I believe that here is a very important branch of the profession in which he must take a lead. The profession should lead industrial accountants in the development of this art. The industrial accountants look to the public accountants for such leadership and if they cannot get it, they will turn away disappointed, and they will turn to other leadership.

I was very much impressed—I was aroused, as a matter of fact, and wrote to the American Institute of Accountants on the subject—by an article which appeared in May in the *Wall Street Journal,* a front-page, right-hand, full column and a half on this subject, under the title, "Business 'Doctors.' Management Engineers Are Swamped by Calls for Cost-Cutting Ideas."

The article describes the services of management engineers to industry. There is a caption, "Most Industries Call in Engineers." Throughout the article not less than six prominent firms of management engineers, reputable firms, are mentioned by name and some of their accomplishments are detailed. The nature of the services they render is described, and in the description occurs this sentence: "The staffs of the big firms include specialists on such topics as labor, production, marketing, chemistry, and accounting."

I know it is so; I know that management engineering firms have certified public accountants on their staffs. Then it also goes on to say, "The services of management engineering firms do not come cheaply. Fees usually range from $65 to $150 a day for each man assigned to a job." Then it goes on to point out that very often the costs of the services are well worth while and are recouped by the benefits obtained.

The article is disturbing to me because here, in a public medium, is a call of attention to the services available by "management engineers" in the field of accounting aids to management—and that is what these are, largely; they are not talking about machine construction or plant erection here; they are not talking about factory layout. They are talking about management policies and operating controls, in which the accountant can play so important a part. I feel that they are encroaching upon the accountant's legitimate field of service, and that if the accountants do not step forward and take their right part in it, accountants are going to lose out to this growing profession of management engineering through sheer lack of interest.

My alarm was somewhat tempered, I will admit, by a part of the article which describes what makes a management engineer. It says:

"What makes a management engineer? Old-timers in the business say aspirants to the profession should have a formal engineering education and have served in industry in a top position, say, as a chief engineer, or a production vice-president.

"Some engineers contend that when a man breaks into the business he needs about ten years of training before he is ready to handle an assignment on his own."

Then the article goes on to say, "Firms Increase From 2,000 to 15,000." It says that before the war there were 2,000 firms; now there are 15,000. This means that in a period of about six years there was an increase of 13,000 such firms. The article implies that an average in size of such firms might be, say, ten men, because they range from small to large. So if there are 13,000 new firms at an average of ten men, somehow we have found in the period of six years 130,000 trained engineers with more than ten years of management experience. I don't think it is true. However, my purpose has been served if I have called to your attention—or recalled to your attention, because you know that what I say is true—this very important part of the services of the accountant to industry, in industry, and to management.

The Federal Tax Outlook

By Roswell Magill, New York

Attorney

To speak with assurance about problems of domestic tax policy these days involves a degree of omniscience that few of us possess. There was a time when a speech on tax policy could be introduced merely by a paragraph on federal expenditures. That paragraph stated that if expenditures could be brought under control, particularly WPA expenditures, and the federal budget balanced, then taxes could be revised and reduced. It is still true that if expenditures could be brought under control, taxes could be greatly reduced, but the problem of expenditures has become much more complicated. Today the demand for relief expenditures comes not from our own citizens, but from across both oceans, and it is fantastically greater in amount than ever Harry Hopkins dreamed. In addition, every day's events witness the pressures of many other insoluble problems that vitally affect the American budget and tax picture. How much of an Army and Navy can we and must we maintain? How much can we and should we pay down the federal debt? How long can we expect the present unprecedented levels of employment and national income to continue?

A tax lawyer is no expert on world politics. He strains his capacities when he discusses tax economics. Yet some premises about items in the budget have to be laid down if questions of tax policy are to be discussed at all. I shall make mine explicit, even though I cannot debate them with you here.

Actual federal expenditures for 1947 were $42.5 billions, and we wound up the year with a net surplus of $753 millions, about the same as the surplus in 1929 and 1930, the last preceding fiscal years in which the budget was balanced. The President recommended budgetary expenditures of $37.5 billions for 1948, and retention of present taxes, which he estimated would produce (with other miscellaneous receipts) $1.3 billions more than enough to balance the budget. The Congress trimmed the budgetary expenditures somewhat; indeed, the Appropriations Committee of the House did a much more careful and thoughtful job of analyzing proposed expenditures by each department and bureau than it has been given credit for. Nevertheless, the President has recently stated that expenditures in the current fiscal year will probably be around $37 billions. Receipts may total $42 billions, leaving around $5 billions for debt reduction or tax reduction. The President includes $3.6 billions for "international affairs and finance."

It is evident that if Federal expenditures can be further reduced, as they certainly should be, money will be available for such other purposes as debt reduction or tax reduction. We must not let ourselves become complacent about present federal budget levels. Not only are expenditures four or five times what they were in the thirties (and the thirties was not a period notable for rigid economy), they are far above what fiscal students have estimated to be necessary.

Several studies came out a few years ago, forecasting federal budgets of $15 to $22 billions, with $18 billions as a general average. Tremendous production, full employment, and unexpectedly great national income have combined to make present federal budgets bearable, but can we count on all three factors to continue for the indefinite future? I have not seen an investment advisor who thinks so. Therefore, we should be well advised to continue to trim federal expenditures all we can, to get the budget down nearer to a level we can afford in an average year, not merely in an unusually prosperous one. A $20 to $25 billion budget is certainly possible for a normal year, without undue curtailment of proper government functions.

The federal budgetary expenditures present to a layman an immensely complicated maze. If ever there is justification for a citizen leaving the subject to the experts, there is here. Yet it must be evident that we must not leave the determination of the size of the budget merely to federal bureau chiefs. Any bureau chief shares the natural human desire to make his bureau bigger and better, to improve his staff, to advance into new fields. Therefore, he just must have more money. We all witnessed a demonstration last spring of the intense unwillingness of the federal bureaucracy to cut expenditures, of the propagandist appeals that can so readily be developed against any cuts. We are, therefore, very fortunate in having vigilant congressional appropriations committees, well-staffed to search out and to find the soft spots in departmental budgets. As citizens and as professional guardians of the profit-and-loss statement, we owe the country the duty of assisting intelligent supervision of the budget in every way we can, and of supporting efforts to bring it under control.

We need not despair of the practicality of cutting the total of expenditures. We need a strong army and navy, certainly; and we want vigorous and effective government departments. Experts tell us that we can have them within a $20 to $25 billion budget. Therefore, let us strive to that end, for if we can attain it, crushing tax burdens can be eliminated. On the other hand, if we cannot get our expenditures under real control, the prospect for tax reduction, for a continuation of present business activity, for economic health here and abroad, is not bright. Finally, one way to get expenditures down is to reduce taxes so that the money is not there asking to be spent.

I

Three items—debt reduction, tax reduction, and expenditures abroad—offer the major competing claims to any excess of federal receipts over expenditures. My premise is that a budgetary surplus should be divided among the three; that the excess of receipts should not be devoted solely to one or even two of the three.

Humanitarian motives combine with good judgment in favor of help to European countries which will do their best to help themselves. We certainly do not wish to play Santa Claus to the world, but we do want to preserve, if we can, a democratic civilization in which we may hope to live at peace.

If widespread starvation in Europe is to be avoided and if its economy is to be revived and restored, aid from us appears to be essential. With the best will in the world, Europe cannot restore itself to physical and economic health.

We certainly have our own domestic problems to consider, as well as the world's. We are one of the few remaining countries in which a free private enterprise system persists. Our domestic health, as well as our aid to foreign countries, depends entirely upon the vigor and vitality of that productive system. We must continue to produce and produce mightily, for it is goods and not merely dollars that are in great demand today.

Since taxes always operate as a brake upon the economy, and our individual taxes remain at almost the war peak, it is especially necessary both to reduce the over-all tax burden, and to remove the tax injustices that have grown up through the years by the rigid and rigorous application of the revenue laws. We cannot expect men indefinitely to work harder and to produce more, when the government gets more than they do out of their additional earnings. We need a more favorable tax climate in the interests both of satisfactory production and of satisfactory Treasury receipts.

Finally, the debt ought to be paid down a few billions. We ought not, I think, to devote excess revenues merely to debt reduction, and to refuse to reduce individual income taxes at all. Paying down the debt alone will not remove any brakes on the economy. It will not cause men to produce more, nor will it increase anyone's incentives. Moreover, in the past, we have found that an intelligent reduction of tax rates may result in more revenue than the previous high rates did. It is quite likely that the same result would be produced today. We will have the revenue to pay off enough of the debt to demonstrate that we regard the debt as a real obligation which we mean to discharge; and also to give all sorts and conditions of working men the incentive of more pay to take home after taxes.

II

If you have followed me thus far, you can join with me in filling in the details of my tax proposals for the federal government. Whether or not a tax program of any kind, or such a tax program as you and I regard as wise, can be put through in a presidential election year, is a nice question. Certainly none of us would choose such a year as the best time for calm consideration of individual income tax rates and exemptions, nor of technical amendments. Nevertheless, there is clearly a strong will in Congress to do the job in 1948. Since revenue revision is badly needed, you and I ought to do what we can as citizens to bring it about.

It is likely that there will be two revenue bills in 1948—one dealing primarily with rates and exemptions; one primarily with amendments to the tax structure to remove injustices and restrictions upon the proper functioning of our economy. Probably tax reduction will largely be limited to the individual income tax, plus perhaps some of the excises. The corporation will only benefit from the adjustments to the tax structure. Such a program is justified because corporations have had a major tax reduction since the war, the repeal of the excess profits tax, and individuals have not. The tax reduction bill will, of course, have more political repercussions than the revision of the Code; and I enter with great misgivings into this field of political prophecy.

HR 1 and HR 3950, both vetoed by the President last spring, were attempts to reduce the tax burden on individuals by a more or less flat percentage cut in rates across the board.

The reduction in dollars for the big income taxpayer was thus much greater than the reduction in dollars for the small taxpayer, but only because the former started off with a much heavier tax burden than the latter.

An alternative method of income tax reduction would be an increase in exemptions. The effect of such a procedure would be first to eliminate millions of taxpayers from the tax rolls, and thus from direct tax responsibility to the government. Second, the revenue cost of even a slight increase in exemptions is great, for all taxpayers are affected.

With government costs what they are now, and are going to be for sometime to come, we cannot afford to reduce income taxes much. Moreover, since the great bulk of the income stream flows to taxpayers with net incomes under $5,000, we cannot afford to increase exemptions much, at least if the income tax is to continue to be the mainstay of the federal revenue system. In a democracy all able-bodied citizens may be called upon to fight to support and maintain our government in time of war. Should not all citizens with incomes, at least above a minimum subsistence level, pay direct taxes to support and maintain our government in times of peace?

The fact is that exemptions have been severely reduced and rates severely raised during the war years since 1939. Previously, during the thirties, exemptions were not much changed, but rates were steadily raised. Hence, in beginning an approach to a more normal peacetime tax system, it would seem just and wise to raise exemptions a little and to reduce rates a little.

In my judgment, the whole surtax rate schedule should be revised, if we still believe in the old American dream that a country boy can work his way to the top, and that he should be encouraged to do so. The present scale is so steeply graduated and the rates are so high that added work and accomplishment are not much rewarded. The surtax rates on the higher incomes produce little revenue, but they do discourage risk-taking and endeavors to advance in the business world. In general there is much to be said for the proposition that, in normal times, a man should not be asked to do more than share his income equally with the government. A thorough revision of surtax rates perhaps cannot be done in 1948, but surely a start can be made by some percentage reduction of surtax rates.

Another plan to increase the equity of the individual income tax is to permit husbands and wives in the non-community property states as well as in the community property states to compute their respective taxes by first dividing their total incomes evenly between themselves. Surely there is no sufficient reason for taxing a man earning $50,000 in California or Texas $6,194 less than a man with the same income in Illinois. With tax rates so high, injustices of this sort are intolerable, and there is every reason to believe that they will be remedied next year. Since the dollar benefit of the change would flow mainly to persons earning incomes in excess of $5,000, the adoption of such a plan will doubtless be accompanied by a reduction in rates or an increase in exemptions that will be beneficial primarily to persons with incomes under $5,000.

III

So much for the income tax reduction bill, which may be the first revenue act of 1948. The second bill, in which we are more interested as tax practitioners, may be the bill to improve the structure of the revenue act, to eliminate injustices, to enable business and the tax administration to function more smoothly. A vast number of amendments of this sort have been proposed by individuals and professional organizations. They have been widely discussed and thereby perfected; and a large measure of agreement upon them has been reached by the proponents, the staff of the Joint Committee, and the Treasury. The great problem is to consider, sift out, draft and enact these so-called technical amendments. There are dozens and even hundreds of them. Many of them present debatable questions of policy. Many of them are hard to formulate.

The Committee on Ways and Means and its staff consequently confronted a very formidable task. It decided to accept it and perform it, not to lay it over for the indefinite future. Hearings have been going on for months. Volumes of testimony and of briefs have been submitted. The Committee does not lack for data, but the job of sorting out proposals and drafting the actual revenue bill is a staggering one. The Committee and the staff have done valiant work to accomplish it.

Last June, Chairman Knutson, Congressman Doughton, senior Democratic member, and the Committee asked a group of ten men to help out. That group, called the Special Tax Study Committee, has just made its report to the Committee on Ways and Means. I shall not go all over the detailed recommendations with you here, for I hope you will each read them for yourselves. Let me emphasize rather our general purposes.

First, the Committee decided to make no recommendations on such major policy questions as individual income tax rates and exemptions. The Committee on Ways and Means and the Congress are charged with the duty of determining national policy on these matters. The relevant data is readily available, and the Committee and Congress are better informed than we are on the considerations pro and con.

Our Committee thought we could perform more useful service by reviewing and reporting upon major structural amendments. We have made recommendations on about 50 major topics, many of them with several subdivisions. Our basic purposes were largely two-fold. The Treasury and to a degree the whole world is greatly dependent upon the active functioning of our economy. We need to produce more than we have ever done before. Therefore we need to eliminate those provisions of the tax law which tend to make it difficult for business to function at its best. Our recommendations relative to depreciation, Section 102, and pension and stock purchase plans are examples of our attempt to carry out this purpose. Second, we wanted to eliminate serious inequities and injustices. The tax load will continue heavy for a long time to come. Therefore we must use our best endeavors to distribute it fairly. So we have made recommendations to improve the taxation of family income, to eliminate the double tax on corporate income distributed as dividends, and to ease the tax on small corporations. We hope that another result of our recommendations will be to reduce controversies with the Treasury and litigation in the courts.

Many difficult problems, both of policy and of draftsmanship, are presented by any project to revise the revenue laws. There are several possible ways, for example, to alleviate or eliminate the double tax on corporate dividends. Which shall be adopted? One is a variation of the old undistributed profits tax—let the corporation deduct dividend distributions as well as interest payments, and itself pay a tax only on such income as it retains. Another is the British scheme—treat the tax paid by the corporation as a payment on behalf of the stockholder, withheld at the source. Thus the amount of the dividend which the shareholder must return is the amount he received plus his portion of the income tax paid by the corporation.

The simpler plan which our Committee recommended harks back to that embodied in the revenue laws from 1913 to 1936: let the stockholder take credit at the initial rate of normal tax and surtax for the tax the corporation has paid. At present this would mean a 19 per cent credit for a 38 per cent tax. The ultimate goal of this plan would be equivalency between the starting rate of tax applicable to the individual and that applicable to the corporation. Some day we may reach that Utopia. In the meantime, the credit is reasonably fair; and it is more intelligible and practical than either of the other two plans.

Much of the trouble the practitioner has confronted in recent years is really due to court decisions that seem unreasonable and, at any rate, are very hard to live with. Why should a foreclosing mortgagee be taxable upon interest he didn't receive, merely because he bid the amount of principal and interest for the property? He made the bid of interest because it cost him nothing; and in all probability he really had a loss, not a realization of income, on the whole deal. Why should the essential elements of a recapitalization or a reorganization be shrouded with so much judicial mystery, when it is plain that Congress intended to and did embody in the law the complete catalog of specific technical requirements for a reorganization? When a sale of property is in fact made by corporate stockholders personally after a liquidation, why should the sale be taxed as having been made in substance by the corporation? How can anyone know what "substance" is, when we know that it is not fact?

Our Committee has tried to correct each of these difficulties. The last two presented serious problems for the draftsmen. We have recommended that Congress state expressly that the conditions, qualifications, and requirements set forth in Section 112 are all that are to be applied, unless the Commissioner shall prove, by a clear preponderance of the evidence, that the principal purpose of the plan of reorganization was tax avoidance. We realize that the proviso perpetuates uncertainty, but could we reasonably give the Commissioner less? We have further recommended that the gain on a sale of corporate property, whether preceded or followed by a liquidation, should be subjected to only one capital gains tax, thereby eliminating entirely the materiality of the issues of fact which the courts have been trying not very happily to resolve. We have great hopes for both changes.

The amendments I have outlined, plus the fifty others we have recommended to the trust provisions, the pension provisions, the estate and gift tax sections and so on, do not involve much revenue. The ordinary layman would not regard them as major matters. Yet you and I know that the smooth functioning of the revenue laws, indeed their utility and efficiency in raising billions of dollars fairly, depends upon the justness and decent operation of just such sections as these. Our revenue system could break down because of recognized overcomplexity and inequity; and it is approaching unpleasantly close to that situation today. The Committee on Ways and Means deserves a very good mark for recognizing the need of a thorough-going revision of the Code, and the possible utility of a citizens' advisory committee to help out. I know you join me in hoping that the effort for sound basic reform of the revenue laws will actually be successful.

One word more. Some of our recommendations go a long way toward sustaining the taxpayer's accounting practices and business decisions, unless the Commissioner proves him wrong. Thus, the burden of showing that surplus is improperly accumulated for Section 102 purposes is put on the Commissioner, as well as the burden of showing that the taxpayer's method and rate of depreciation are erroneous. Both provisions reverse the former presumptions. These provisions will only work well if taxpayers in general make honest, defensible business decisions. Our Committee has based its work on the premise that the great bulk of taxpayers are honest businessmen. If we are shown to be wrong, the country will be in for another decade of tax evasion investigations, witch-hunting and loophole closing. You public accountants can take a great part in seeing that business plays the game fairly according to the rules.

The perfection of the revenue laws is probably a never-ended task. Many wise men have worked at it—men like Cordell Hull and George May and Arthur Ballantine and A. W. Gregg and Randolph Paul, to name only a few—and yet so much remains to be done. Accountants and lawyers are key men in the process, for we see the system in action every day, and we know what the actual impact of each section is. Our Committee earnestly hopes that our report will appeal to such men as yourselves, that you will find its recommendations technically sound, and that you will work for its adoption. The Code will not be perfect, even if all our ideas are embodied in it. But if you agree with us that it will be greatly improved thereby, and will make your endorsement known, we ought to be able to make a long step forward in 1948.

Relation of European Conditions to Our Budgetary Problem

By Richard B. Wigglesworth, Massachusetts

Member, Committee on Appropriations, House of Representatives

I am more than happy to be here with this able and distinguished group. I am happy to be here with my colleagues in the Congress; with the chairman of the Appropriations Committee, John Taber; with Joe Hendricks, with whom I have worked so closely over a period of years; and with George Smathers, the Representative of this District. I am particularly happy to be here because of a deep sense of obligation that I feel towards some of the outstanding members of this organization by reason of the help and counsel that they were good enough to give me and other members of that Committee during the recent session. I believe that the Congress and the Nation owe them a debt of gratitude for their contribution.

It is a great temptation to talk at length to a group like this, but I have promised to be brief, and I am not going to deal with the over-all budgetary picture in Washington. I know you want to hear from Chairman Taber in that connection.

I am going to confine myself to the European picture as I see it, and its relation to the budgetary problem of this country in the light of a trip to Europe from which I have just returned. And I want to say at the outset that what I say at this time, I say on my own responsibility. I am not speaking for the chairman; I am not speaking for the Committee; I speak only for myself.

This trip to Europe was of six weeks duration. It was a trip taken by the four senior members of our Appropriations Committee, three of us being together throughout the trip, the fourth member being with us about half the time. It is amazing what can be done with the aid of an airplane and a carefully planned program.

We visited nine different countries, including Turkey, Greece, Italy, Trieste, Austria, Germany, France, Belgium, and England. We conferred in the countries visited with practically every prime minister, foreign minister and finance minister, with other ministers, heads of banks of issue, other bankers, industrial leaders, and labor leaders. Also, of course, we had the benefit of all the facts made available by our diplomatic staffs and by our military staffs.

In Rome we were honored by a private audience with the Pope and we talked also with others high in the clergy, both Catholic and Protestant. In Germany, it was possible to talk directly with workers in the coal mines, with workers at the blast furnaces, with their wives and children in their crowded housing facilities, with workers in domestic service, and with people in a great many walks of life.

I have been in Europe many times in days gone by. At one time I put in four years there as assistant to S. Parker Gilbert who, as Agent General for Reparation Payments, represented twelve nations, including our own, creditors of Germany's as a result of World War I. I felt that I knew Europe pretty well in those days, particularly Germany and France. I had not been there, however, since the day World War II broke out, and my impressions are necessarily against the background of the prewar Europe that I knew.

I am frank to state that my impressions are very grim impressions. They are grim in the terms of actual war destruction, which in certain places, even to an old soldier, seems almost indescribable, although it is two years after the fighting finished. They are grim in terms of the economic and financial problems confronting the countries that we visited. They are grim also in terms of the political problems confronting those countries.

I suppose nine out of ten people, in most of the countries we visited, if asked what is the primary need in their country would answer, "Food." I think there is a great need of additional food in Europe at this time. There is great undernourishment. The average loss of weight in Germany since V-E Day is reported to be 26 pounds per individual. I do not believe you are going to get essential production without more food. As one worker at a blast furnace expressed it—"It is too little to work on and too much to die on."

Fuel is also in imperative demand all over Europe. In England and Germany coal production is only about 80 per cent and 60 per cent, respectively, of prewar production. There are other needs, but food, fuel, and perhaps fertilizer are the most vital needs of the moment.

In the financial field there is great need for reform. Budgets are out of balance, and banks are confronted by the greatest difficulties. The currency picture in some cases is absolutely fantastic. In Germany, for instance, where there are seventy billion reichmarks in circulation as compared to the prewar level of five billion, the reichmark is literally worth nothing in terms of other currencies, and it hasn't much internal value because of the limits imposed on purchasing.

The incentive essential to necessary production in Germany and elsewhere is destroyed by the fact that money earned can buy little or nothing.

On the political side, country after country is confronted by the threat of Communism, either within the borders of the country or just outside the borders. Russia is today purging, Sovietizing, making a police state out of each of the so-called satellite nations that she has taken over. I met a man who had held a very high position in the service of one of those countries, who had taken his life in his hands by leaving that position to go to a western country in the hope that he might help the general picture. He told me that every small government job, every policeman, every attendant at a theater in his country was now manned by a Russian. He told me that all opposition was being purged, both actual and potential. He said to me "Congressman, if this thing goes on four months longer, the country that I knew and loved will simply be gone."

Outside the "iron curtain," it is perfectly apparent that Russia is pushing all along the line, economically, financially, politically in terms of propaganda, always with the threat of the mailed fist behind it. And if we accept at 50 per cent face value the figures that were given us, Russia is arming and preparing for war at a rate which is alarming.

Generally speaking, in most of the countries we visited there is a vicious circle. On the one hand, economic and financial difficulties; on the other hand, political difficulties, the existence of each making a solution of the other extremely difficult. For Turkey, for instance, the threat from Communism comes from outside the country, a threat which compels the government to use some 50 per cent of its total expenditure in the maintenance of a standing army. For Greece the threat comes also from outside the country from the Communist trained and supported bandits. We were told that these bandits are often better equipped than the Greek forces. When we asked how this came about, we were told, "Oh they have lend-lease equipment from Uncle Sam by way of Tito."

In Italy, the Communist threat is from within the country. The last day we were in Rome we saw thousands of Communists marching along the street to a central gathering place where, the papers said, there were anywhere from eighty to a hundred thousand Communists demonstrating, demanding more food, demanding the overthrow of the government. In France, the threat of Communism is also from within the country. We were advised that the Communists there control at least 26 per cent of the popular vote.

In all four countries there is the vicious circle.

Speaking for myself, I believe that America must help and help promptly. I do not think we can afford by inaction to aid the aggressive drive of the Kremlin throughout Western Europe, a territory with a population of 260,000,000 and a prewar productivity in excess of that of America. Having made that statement, I want to qualify it, because I think determining that we must help is one thing, and determining the amount of help and the method of giving the help is another thing, and almost as important.

The amount of help can only be determined in the light of all the evidence, including not only the stated European demands, but also an appraisal of all available assets, both in this and other countries outside of Western Europe. I hope the so-called Harriman report will be helpful in the latter connection.

Obviously, we must not attempt to do more than we can, in fairness to this country and the rest of the world. Nothing could be more disastrous. In my opinion, we must even guard against holding out the hope of doing more than is practical under the circumstances, because to hold out a hope and then fail to make good on it is destructive of morale overseas and of the prestige and influence of this country.

What we give must be so controlled as to give the maximum assurance that it will be spent effectively; that it will not be diverted or thrown down some political drain pipe, as has been the case so often in recent years. What we give must also be given on a cooperative basis, and must be dependent on a showing by those we seek to help that they themselves are putting their backs into the problem and contributing the maximum, under present conditions, to essential production and to putting their financial houses in order.

In a word, I believe we must help, and help promptly, but with proper safeguards. A declaration to the world today that no help will be given by this country would, in my opinion, extinguish the spark of hope in the hearts of Western Europe, destroy the principal psychological barrier confronting Russia at this time, and pave the way for the arrival of the "iron curtain" at a not too distant date on the shores of the Atlantic Ocean and the Mediterranean. The decision, of course, is in the hands of the American people and of the Congress as their representatives.

If help is given, as I believe it should be given, that fact emphasizes the compelling necessity of eliminating all non-essential expenditure from our domestic picture. If we must help abroad, it is more important than ever that every cent of non-essential domestic expenditure be eliminated. We can no longer continue to spend billions of dollars in some forty-three different countries of this world. We must husband our resources, decide how much we can do and where we can do it most effectively, and then do it under proper supervision.

I think the Congress of the United States took a long step in the right direction at its last session. I do not know whether you have seen an observation by David Lawrence in this connection about the time of the close of the last session. "The greatest achievement of the 80th Congress," he said, "has been its courageous reversal of the tide of spending, which for nearly fourteen years has been regarded by too many officials as the primary objective of government, as if our taxing power and our financial resources were inexhaustible."

The figures indicate an improvement in the budget presented by the President for the fiscal year 1948 amounting to over 4,480,000,000 dollars, in addition to 2,684,000,000 dollars of recisions not recommended by the President which might have been spent.

We are facing a new session; in fact, two of them. Speaking as one member of the Committee on Appropriations, I can say, and I am sure it goes for the other members of the Committee, that I would welcome at any time any helpful suggestions that members of this organization may be good enough to give.

We need expert assistance. Given that assistance, I am confident that the Appropriations Committee and the Congress as a whole will continue along the trail that was blazed at the last session doing its utmost to reduce expenditure, to reduce debt, and to make possible a reduction in taxation in the interest of essential production and the elimination of nationwide suffering for the people of this country.

The Government of the United States

By John Taber, New York
Chairman, Committee on Appropriations, House of Representatives

It is a real privilege to have an opportunity to come to Miami. It is more than that to be asked to come to meet with as fine a group of men as are gathered here today.

When I went into the office of Chairman of the Appropriations Committee (and I am saying this without criticism of anyone who has gone before), I found, more or less by happenstance, that the clerk of the Committee and some of the principal members of the staff were about to move out on us. I practically had to reorganize that staff. We seemed to be in a kind of hot spot, and it was necessary to build up the regular staff —and I think we have made very marked progress with it and have a younger and more aggressive staff than we had before. But I took advantage of the provisions of Resolution 50 of the 79th Congress, which was incorporated into the Legislative Reorganization Bill and which allowed us to set up an investigatorial staff and to make surveys and investigations of the various departments of the government so that we might do a little better job.

I contacted a group of the very best accountants in America, members of your organization and some of the members of governmental research organizations throughout the country who had been accustomed to operate on municipal and state governments. I found a most ready response. As a result, we were able to put capable men into many of the organizations. Your chairman today was one of those fine men. As was stated, there are eight others here who participated in that operation.

By dint of the hardest kind of work that that Appropriations Committee had ever indulged in, I got the reputation of being a mule-driver. I think we had hearings lasting longer by 50 per cent than hearings of that Committee had ever lasted before. As a result of that operation, we were able to make savings to the federal treasury of $4,470,000,000 one way or another. Of that item, $3,200,000,000 were direct cuts in dollar appropriations. Now, that was not so much in itself—only 12 or 13 per cent of the budget estimates; about 10 per cent of what was expended by the federal government in the fiscal year 1947—but it was a start in the right direction.

Every agency that a dollar was taken away from made the wildest kind of statements. They told the people that we were wrecking the structure of the government. I will give you an illustration of the way that worked. We made a cut of about 35,000 employees in the Bureau of Internal Revenue and the Treasury Department, and I am not going to stand up and tell some story that my own investigators have found, but I am going to give you the picture that the investigators of the Bureau of the Budget have found within the past thirty days.

That cut, instead of being applied to the employees who were not needed, was very largely applied to employees who were useful and were producing results, but by methods decidedly antediluvian. An investigator arrived in Denver, one of the most progressive towns in the country, and found men drawing eight and nine thousand dollars a year adding up long columns of figures by hand instead of by adding machine. That is just a sample of the sort of thing we found in every agency of the government, and it is not so difficult to follow but that an ordinary layman can understand the situation. In other words, if they had applied that cut honestly and straightforwardly, by getting rid of the men who were drawing large salaries and not producing, and put in better methods of doing business, they would have had no difficulty getting along on the amount of money provided for them.

Now, we must recognize that such outmoded methods exist everywhere in the United States in governmental activities. As an example, in the Veterans' Administration I found one case that had stood six months after it had been submitted to the review board in the district office for rating. They had taken it up time after time. They had papers submitted to them galore. It was a perfectly simple case of service-connected disability. It took them six months to make a decision that didn't need over three or four simple little papers and ten minutes' time.

Many of those fellows are afraid that if they do their job they will kill their job. What the Veterans' Administration needs is more efficiency in getting out its work. Every time veterans run into such a thing as that they become discontented. The government loses the standing with its citizens that it should have, and the whole economic picture of the government of the United States is held up to public ridicule.

That is the kind of thing that we in the Appropriations Committee are trying to get rid of. We appreciate that we are not the executives; nevertheless, it has been possible for us, with the cooperation of the agencies that are willing to cooperate, to cut down a great deal of the governmental expense. We are getting through with the immediate war period and the backlog of expenditures that have to follow that sort of thing, but it is a very, very difficult task. It is hard to separate a man from the federal payroll, especially when he has had a soft snap. Now, the fellow who is working and trying to do his very best is not worried, and he is really an asset to the government of the United States, but the fellow who is warming a chair and trying to kill time in the old-fashioned way thinks he is terribly abused. We have run up against that. That problem is going to be especially difficult in the next two or three years. I am hoping that we will be able to get some of the best people in the United States to help us with that work.

Perhaps a few things in the nature of figures might be interesting to you. I have here a copy of the Treasury statement that comes out every day. This one is for October 28. The first of January that statement didn't reflect anything. By looking at it you couldn't tell the slightest thing about what was in it. I had the Assistant Secretary of the Treasury, who has charge of that operation, up; I went over the situation with him, and have tried to correct a lot of things, but the statement does not reflect their expenditures. For instance, in the item of expenditures under Agricultural Department, is shown Farmers' Loan Administration, $14,566,000, with an "a" in front of it. You look down to see what "a" means, and it says, "Excess over savings." Those receipts should be carried in the Treasury statement under receipts, and the expenditures should show just what they are. That is one of the difficulties we have in trying to keep up to date and keep track of it. I intend to follow them up to see if we cannot break that disgraceful habit.

Our expenditures for the first four months of this fiscal year are practically an even $12,000,000,000. I should think that if we had any kind of management and did not have too large foreign expenditures, we would be able to get by with three times that figure. It may be that it could not be done, but I think if we were careful, it could.

The receipts are running at a higher rate than for last year, but last year there was a very large item carried as a current receipt which was a recovery of surplus property, so that when you got all through and used the Treasury statement and the balances that were left, if we had used the $2,800,000,000 of receipts from surplus property, if we had taken that out of the receipts instead of showing a surplus of $700,000,000, we would have shown a deficit of a little over $2,000,000,000. Now, that is the picture that the government's financial statement is presenting here.

True, those items should be used and ought to be used in so far as they can be to reduce the public debt.

I want to call your attention to the foreign relief picture. Last year we had something like this: loans to the United Kingdom, $2,050,000,000; UNRRA expenditures, $1,500,000,000; Bretton Woods, the international balance, $1,436,000,000; Export-Import Bank, $325,000,000; military expenditures for relief, $700,000,000; State Department expenditures, a little over $100,000,000, making a total of upwards of $6,100,000,000.

This year, to date—and we have gone four months—our expenditures run something like this, and I can't give you accurate figures because of the jumble in the Treasury statement:

United Kingdom loan, $1,300,000,000; UNRRA, approximately $300,000,000; the military relief, $500,000,000; the State Department, approximately $312,000,000; the Export-Import Bank, $112,000,000, a total of approximately $2,500,000,000.

Frankly, I would expect those expenditures for the last eight months in the fiscal year to run very close to $4,000,000,000—it may be a little more. I do not know what needs to be done, but I do know we have got to go a long way to keep our governmental house in order. None of us knows just what we have to face.

That statement of Mr. Wigglesworth on the foreign situation was fine; it was complete. It indicated a broad approach to the problem. We must do what we can to stop Communism; at the same time we must not wreck the economy of the United States.

Our State Department and its agencies, including the Federal Surplus Commodities organization, which has charge of selling our property abroad, must move in one direction. Let me say to you that in the month of May, last, over 3,000 tractors were sent into Yugoslavia out of the United States by UNRRA behind the "Iron Curtain" at a time when the "Iron Curtain" was a menace to the United States. Let me say to you that this surplus commodity set-up turned over to a corporation organized by the Soviet in Italy all of the surplus property that we had there, including cars and tanks and that sort of thing, which, instead of being used for the benefit of the Italian people in their transportation and on their farms, is being used especially for Soviet propaganda against the United States and against the freedom of the world.

Those things must stop and we must move in one direction. I am willing to go just as far as we need to go to protect the interests of the United States. It is possible that we will have to do some things with reference to the military that have not been done; it is possible that we will have to do a great many things with reference to some of our allies across the water; but now is the time for those governments over there to realize the situation they are in. If they would stand up today and look Mr. Stalin in the eye and tell him it was time he ceased to disturb the peace of the world, I believe it would have a wholesome and favorable effect upon the peace of the world. Unless Russia is ready to make an immediate peace in Germany and Austria and throw the economies of those countries into one zone where they can be operated for the benefit of the German and Austrian peoples, and let the middle part of Europe become stable and self-supporting, we must organize the three zones in each of these countries that we control and put them in shape to do business and get on their feet. That is the only way we can make progress.

We are all facing a difficult problem, we in the Congress just as much as anyone else. We must face that problem square-toed and without the slightest thought of what effect it will have on our political future. We won't have any political future unless we do.

We in Washington are going to face the most serious problem. We must have the machinery of government in Washington running on a business basis, running along progressive lines, and for this reason we need the best kind of advice from accountants of experience, from business leaders, from business analysts, and from governmental analysts. But we must do all this on the basis of governmental efficiency, and we must do it courageously and without regard to where the axe may fall. If we can have the cooperation of the Administration in bringing about these results, I believe that we can go so far in the session to come as to put the government's house in order and even have a modest tax reduction, and at the same time have something left of a substantial character to make a sizable payment upon the public debt and to meet every obligation that we will owe to the peace of America.

Case Studies on the Natural Business Year

By L. C. J. Yeager, Kentucky
Member, American Institute of Accountants

The program of this meeting of the Institute has been aptly designated as "Challenges" and when I was assigned the subject of the natural business year, I was given the one which probably represents the greatest challenge to our profession.

I am sure that nearly all of you have noticed the obituary columns recently in the magazine, *The Certified Public Accountant,* and no doubt you have further noted that the average age of certified public accountants, according to the statistics, is somewhere in the low fifties. This fact has been further brought home to me since three accountants in my own city have died in recent months, all of whom were under 50 years of age.

Insurance companies have in many instances designated certified public accountants as "preferred risks." It is possible that the new group insurance plan now being promulgated may dispel this illusion. Be that as it may, it now appears that the life expectancy of the average certified public accountant is alarmingly short, and until investigation has been made into the causes of this condition your guess is as good as mine. But I *will* take the liberty of stating that, in my opinion, the greatest contributing factor is the tension caused by meeting deadlines and the physical and mental strain caused by our so-called "peak season," or to state it more simply, just plain overwork.

To get down to the meat of the situation, this matter of overwork is a life-and-death issue with us. Analyze the causes of overwork and the principal one must inevitably be the "peak season" caused by the press of work due to the use of the calendar year for determining profits. Therefore, the natural business year concept is not just a theory to be weakly expounded, but is, as I said before, a matter of life and death to you and to me.

In the over-all picture, much progress has been made in recent years, although some ground has been lost. For example, the withholding of taxes works a hardship upon the individual on a fiscal year basis if he has any income subject to withholding, since the credit for taxes withheld is based upon calendar year withholding regardless of the tax year of the individual. Another instance is the fact that one of the large motor car producers is now insisting that all of its dealers make financial reports on the calendar year basis, even though the dealer has established a fiscal year corresponding to the "model-year" of the motor car dealers.

A government agency is in some instances a thorn in the side of the accountant who is attempting to get the client to adopt a natural business year. Take, for example, the Interstate Commerce Commission, which requires all annual reports to be made on the basis of a year ending December 31. Better still, look at the Federal Communications Commission. The rules and regulations of that body contain the following:

"A licensee of a broadcast station shall file with the Commission on or before April 1 of each year a balance sheet showing the financial condition as of December 31 of the preceding calendar year and an income statement for said calendar year."

Thus we see that the Federal Communications Commission specifies that the calendar year be used. That is where *our* work is concerned, but let us turn to where *their* work is concerned and investigate the regulations of the Federal Communications Commission. Under the section of the regulations dealing with the renewal of broadcast licenses, which are now issued over three-year periods, we find that broadcast stations have been divided into 12 groups and applications for renewals of licenses are distributed over a three-year period variously expiring February 1, May 1, August 1, and November 1. Thus we see that the Federal Communications Commission, having the power to do so, has distributed its own work in license renewals, but where our work is concerned they have arbitrarily fixed December 31.

Since the formation of the natural business year committee and due to the efforts of its members over a period of years, a great deal of educational work has been accomplished. There are two ways in which this problem of education can be effectively approached and let us for the purpose of this discussion refer to them as the top and the bottom ways. From the top the natural business year committee can continue to press its program of education and can continue its advocacy of the theory with trade associations and governmental bodies. But the real work of conversion must be done from the bottom. It devolves upon the individual practitioner in each case to sell the theory to his individual client. It is my experience that few business executives advocate a change in fiscal year without strenuous urging from the accountant.

In connection with the problem of selling the client on changing to a natural business year—and it is a *problem,* as anyone who has tried to sell such a change knows—we should mention the fact that it is difficult, if not impossible, to sell a product or an idea in which you yourself do not believe.

Along this line I recall a meeting of the board of directors of our state society held a few years ago. We were discussing the mailing of a pamphlet on the subject of the natural business year and somehow the question arose as to how many of the firms represented by our board had adopted for their own operation a year other than the calendar year. A poll of the nine members present indicated that seven of the firms were still on the calendar year. Don't you believe it would have been a little difficult for some of those seven to convince a client that a change in the client's year was advisable when he himself did not believe in the theory enough to apply to his own business?

Long ago realizing that the spread of work throughout the year was possibly the most important administrative function in the office of a certified public accountant, I have given much thought to the arguments for the adoption of the natural business year, with which arguments all of you are undoubtedly familiar. I have used them on client after client and it has been my personal experience that in most instances the client was not sold. As a result, I have come to the conclusion that the most moving argument an accountant may make is to put the problem on a purely personal basis. After all is said and done, if your client thinks enough of you personally to want you to handle the important work for him that you do, he thinks enough of you personally to be interested in your welfare and well-being, and in most cases where we have changed the client from the calendar year to the natural business year, the clincher, no doubt materially aided by the reasonable arguments, has been the necessity and convenience to the accountant.

If you personally had a serious operation to be performed in your family, would you knowingly entrust the matter to a surgeon whom you knew to be practically punch-drunk from overwork? Or, if you had an important law case, would you care to entrust it to an attorney at a time when you knew him to be so busy that he could not perform his best work? Naturally, these questions appear almost silly, and yet it is exactly what we as a profession are permitting our clients to do, largely because we have failed to have a frank and honest discussion of the subject with them.

There is now available a considerable amount of material regarding suggested closing dates for various types of businesses and it is possible that many of us may get into the rut of thinking that only one date, other than December 31, in each specific case would constitute a desirable natural year closing. For example, many years ago the Comptrollers Congress advocated January 31 as the desirable date for department store closings with the result that this is generally spoken of as being THE natural fiscal closing for department stores. Nevertheless, R. H. Macy & Company, one of the greatest of them all, makes its annual report on a year ending July 31. While often for a particular type of business, one particular month-end will seem to be far the most desirable, in most instances there is a reasonable amount of latitude as to choice of dates. For example, the automotive dealer group: in the years in which the new models appeared about October, certainly either August 31 or September 30 would be fairly acceptable.

While in a large number of business classifications, a natural business year other than December 31 is obvious, there are many in which this is not the case. In this latter group one month-end is just about as good as another, and it is with this group that the certified public accountant is enabled to do his best work in balancing his practice throughout the year. Here also argument on a purely personal basis for a change is most necessary and effective. The following are months on which we have succeeded in placing the closings of businesses of the types numerated where no particular month-end is indicated:

January—
- Whiskey wholesaler
- Storage warehouse

February—
- Drilling contractor
- Plate glass contractor

March—
- Wholesale auto accessories
- Electrical contractor

April—
- Distributor restaurant equipment
- Dealer in antiques and novelties

May—
- Member, New York Stock Exchange
- Finance company
- Retail furniture company

June—
- Wholesale drugs
- Processor of dairy products

July—
- Hardware dealer
- Processor of dairy products

August—
- Broadcasting station—in spite of the F.C.C.!
- Scrap material yard

September—
- Broadcasting station
- Retail furniture

October—
- General insurance agency
- Manufacturer of valves and fittings

November—
- Broadcasting station
- Laundry

However, some businesses have such a production or sales cycle that it is obvious that a particular month-end is indicated. Such a situation obtains in the following case studies:

Case Study No. 1

Some years ago my firm was employed by a manufacturer of topcoats and overcoats. The business had been established some 15 years earlier. At its inception the calendar year had been adopted. Yet we found that in each of the years it had operated, the plant had been closed for at least two weeks in May, and in most years for the entire month of May. Their business practice was to start the production of coats for fall delivery sometime during the first week in June. Deliveries would commence during the latter part of August and continue until April. During the latter part of April and early part of May, only a few sample garments were produced. New woolens to be put into production were ordered for delivery starting with June 1. Here was a clear-cut case of a year ending May 31, and yet it was with the greatest of difficulty that we persuaded this particular company to change its fiscal year from the calendar to that date.

Case Study No. 2

Another case study concerns a holding company operating 18 wholesale grocery houses. It had been their practice for years to close with the calendar and yet here was a business dealing primarily in food products and in actual practice they commenced the marketing of the current crop and pack during July of each year and continued the merchandising of said crop until June of the following year with the result that they were closing their accounting year in midseason with the attendant large inventories and employment of credit. Inventories on December 31 had to be taken usually in cold warehouses and by employees who probably were less efficient due to the festivities of the holiday season. After two years of discussion with the management we were finally able to convince them of the advantages of changing to June 30. They have since been quite pleased with the change as it is no longer necessary for one of the officers to delay his winter trip to Florida!

Case Study No. 3

Some years ago we were employed by a firm distributing school supplies of all kinds, whose operations covered about three states. In prior years they had closed their books on the calendar basis. Here was an instance of a company having a definite cycle ending about June 30, since their big selling season started during July and continued until the latter part of November. On December 31, the company was employing nearly its maximum credit usage, whereas the June 30 liabilities were at their lowest, inventories were at their lowest, and most of the business functions were at the lowest ebb of the year. Despite the fact that a June 30 fiscal year was obvious, it was only with the greatest insistence on our part that the management acceded to the change. Now that the accounting has been put on the natural business year of the business and the management has seen it function for three or four years, they are delighted with the adoption of their natural business year.

It cannot be too strongly stressed that the struggle to balance an accounting practice is never ended. As hard as we try to get businesses off December 31, nevertheless that date seems to fill up again, because invariably new business is on a calendar year basis.

We have recently analyzed the business of our own firm to ascertain the distribution of our work based upon fees received. While our fiscal year closes August 31, the analysis is presented on a calendar basis. We have distributed fees to the month used by the client as his fiscal closing. The tabulation which is not distorted by so-called monthly jobs as only 3 per cent of our gross fees were from this source, presents the percentage of work distribution for the past year in comparison with what it would have been if all of the clients we have moved off the calendar year were back on it.

For months having less than 1 per cent, zero is used:

	Is	Would have been
January	1%	0
February	3%	2%
March	3%	0
April	1%	0
May	6%	2%
June	24%	4%
July	6%	1%
August	12%	6%
September	2%	1%
October	5%	4%
November	4%	1%
December	33%	79%

In closing, it has been our experience that those clients whom we have persuaded to move from the calendar year to an accounting period closing on some date other than December, once they become accustomed to the change are extremely pleased with the change.

Accountants' Liability

By Norman J. Lenhart, New York

Chairman, Committee on Accountants' Liability and Liability Insurance, American Institute of Accountants

I believe it is unnecessary to dwell on the variety of claims to which independent public accountants are subject. It is a source of worry to all public accountants that no matter how hard they may try, they may be subjected to claim and suit with the resultant publicity which is often more damaging than the suit itself.

We all hope to see the day when accountants may be in the same situation as lawyers and doctors. The shyster lawyer and the unethical physician certainly should be subject to claim or suit, and likewise I think the accountant who is guilty of dishonesty, or who deliberately fails to do what he considers a good job, should be subject to claim and suit. But the lawyer who exercises reasonable skill usually is not sued for what may turn out to be poor judgment. The physician is not sued for a poor diagnosis if he exercises reasonable skill. We all feel that the accountant should not be subjected to claim and suit if he does the best job of which he is capable and follows reasonably good practice.

For a good many years Lloyd's of London have issued insurance policies which insure against most of the claims which may be made against independent public accountants. These policies have been issued in amounts running into the millions. For a while, Lloyd's cut down the amount of insurance they would write for public accountants, but within the last year or so, Lloyd's have again increased the limits. Just what their present limit is, I do not know, but I know they now write policies of several million dollars each.

There are two American companies that have written accountants' liability policies for some years. Those two companies are the American Surety Company and the Indemnity Insurance Company of North America. In most respects the policies now written by American companies are like the ones written by Lloyd's, that is, the provisions are substantially the same. The amounts, however, are very much lower, running from $200,000 to $250,000 maximum. It is of interest to note that both the American companies restrict the policies they issue to members of the American Institute of Accountants or to members of state societies of certified public accountants. They very carefully investigate any applicants for these policies. I am told that as the number of policies increase, the limits will increase. If the American companies write liability policies for a limited number of public accountants the amount of each policy that can be written is less than could be written if more accountants carried such a policy.

For quite some time (a matter of some years), the committee of which I am now chairman has been negotiating with the companies writing fidelity bonds in an effort to minimize the publicity resulting from the claims such as have been made from time to time by certain of these companies against accountants for failure to uncover defalcation or fraud. A few of the surety companies have taken the position that the accountant, by failing to discover a fraud, has permitted the amount to be built up and that the accountant should be liable not only for the amount of defalcation that may have existed at the time he last made the audit, but the amount to which the defalcation may have grown before it is discovered.

As a result of negotiation, twenty-three of the surety companies signed a letter in which they said that as to members of the Institute, if they think they have a claim against an accountant they will discuss the matter with a three-man committee, and a hearing will be held by such committee in such manner as the committee thinks best. The surety company will not sue the accountant if the committee says that, in its judgment, the surety company does not have a fair claim. We feel this is quite a step forward because it may prevent suits being brought that should not be brought, and we think that by and large it should reduce to a minimum the publicity resulting from such claims.

A letter was sent out to all members of the Institute, dated December 1945, which listed twenty-three of the surety companies that had signed the letter in question. Since that time, twelve more companies have signed, the latest company being the Indemnity Company of North America, one of the two companies that writes accountants' liability policies. We are hopeful that the remaining surety companies will eventually sign this letter. There have been no cases brought under this new procedure, which speaks well for everyone. Apparently there have not been any cases that surety companies thought involved claims.

I hope all of you have read the article by John L. Carey which was first printed in *The Controller* for March 1947, and reprinted in *The Journal of Accountancy* for April 1947 (p. 353). This article stressed the relationship between internal control, fidelity bonds and audits.

I have been impressed in my talks with the surety companies by the importance they place on the adequacy of internal control. They apparently feel that they would be happier if all of their policyholders had good systems of internal control than if they could increase their business substantially without improving the internal control existing in most of their policyholders.

Apparently an important way in which the public accountants can improve relationships with the surety companies is to keep trying to get their clients to improve their existing systems of internal control. Surety companies tell me that by and large they do not believe most policyholders appreciate what constitutes an adequate system of internal control and the advantages that would result therefrom.

I should like to mention one other matter. I have just learned that two disturbing questions have come up with regard to accountants' liability policies carried by a member of the Institute. I understand this member had a claim made against him for which liability was denied by the company writing his accountants' liability policy, for the reason that the policy ran to the firm and the suit was brought against the individual partner. That does not seem very reasonable to me and I should like to look into it. Certainly most of us might be in a bad spot if a partner can be sued and have no protection merely because the liability policy runs to the firm of which he is a partner.

The other matter is not so surprising. One of the insurance companies has expressed doubt that it will pay the costs of defending a suit for fraud, which suit evidently was without merit. The accountants' liability policy does not insure against dishonesty, but suits are brought alleging dishonesty. On trial, however, the accountant may be found not guilty. I am under the impression that one of the companies (I am not sure which one) has changed its accountants' liability policy so that the accountant will be defended against such a suit even though the insurance company would not be liable if the accountant is found guilty.

If it develops that there is anything of particular interest to members of the Institute on those two points, notice will be given to the membership.

Incentive Pay Plans Applied to Accountants' Offices

BY RALPH B. MAYO, COLORADO
Vice-President, American Institute of Accountants

"INCENTIVE PAY" is a method of compensation which rewards superior performance. It increases in proportion to measured results. It gives those who work a financial interest in the product of their efforts. It is designed to encourage excellence so that motive springs from within and no external urge is required. It offers the staff member opportunities for development and permits continued growth and expansion, limited only by the individual's own abilities.

Such objectives are obviously highly desirable. How they may be achieved at least in part is a problem which cannot be fully answered but will be discussed (1) as to staff members and (2) as to partners.

Staff Compensation

The quality of the staff is of utmost importance to every accounting organization. It determines the quality, growth, and achievement of the firm. The building of a good staff depends on many factors, the most important of which are (a) wise selection, (b) thorough training, and (c) adequate compensation. As stated, this discussion deals only with compensation which is in the top bracket of importance in producing an organization which will be interested in results, loyal to the best interests of the firm, and grow in stature.

The typical accounting organization, in addition to principals, may be roughly divided into (1) seniors in charge and supervisory accountants, (2) juniors or assistant accountants, and (3) stenographers, bookkeepers, and clerical assistants.

Seniors

Attention will first be given to *senior and top-flight accountants*. Having advanced this far they probably have embraced professional accountancy as a lifetime career. Furthermore they presumably have been with the firm long enough to be accepted as permanent members of the staff. They themselves will have formed a genuine feeling of "belonging to" the organization. There will have developed strong bonds of mutual allegiance and esteem. This being true, it is proper and fitting that they should be offered the top contract. All that can be done should be done to give them as many as possible of the essential characteristics of a joint venture short of an actual partnership. The usual flat salary and even the occasional bonus, no matter how generous they both may be, fails to satisfy this test fully.

Every ambitious young man in the public accounting profession looks forward to the day when he will have a practice of his own. It is desirable, as nearly as possible, to satisfy this natural and proper aspiration and to encourage his growth with the present firm with whom he has cast his lot. There follows an extract taken from a "percentage" contract designed to accomplish a true sharing arrangement:

Employer agrees:

(a) To pay said employee for his services, compensation to be computed as follows:

(1) .... per cent of net fees earned by the employee, and chargeable to clients by the employer (after giving effect to all adjustments of such fees as

may, in the judgment of the employer, be necessary), plus .... per hour for time spent on "non-productive" work, or

(2) A minimum annual salary of .... Dollars ($......................).

(b) The employee will be credited with his earnings as computed under (a) (1) above at the end of each month, and at the end of each fiscal year his earnings will be computed under each of the above methods of computation, and his compensation for the year will be whichever of the above computations produces the larger amount.

(c) Payments on account of compensation as computed above will be made to the employee as follows:

$...................... on the sixteenth day of each month and

$...................... on the first day of the next month.

Any balance due the employee at the end of the fiscal year, as computed under (a) and (b) above, will be paid sixty-five days following the close of the year.

The first essential of the above contract is that the senior staff member will receive an agreed percentage of the fees which he earns. (50 per cent is the most used rate but cases are reported of 60 per cent.) This requires a careful record of fees earned. In those cases where it is possible to charge the client more than the stated per diem, because of good results or other reasons he shares in the write up prorata with all who worked on the engagement. This frequently occurs in tax engagements. Where it is impossible to charge the full accumulated cost on a per diem basis, the charge-back likewise is prorated and the senior accountant bears his share. This places on him the responsibility to see that the character of work performed can be fully charged for and collected. Obviously if the going rate of charge for his time is from $30 to $50 per day, his earnings will be (on a 50 per cent basis) $15 to $25 plus such additional amounts as may be justified by excellence of performance. This percentage of fees earned plus an agreed hourly rate for non-productive assignments (not including unassigned time for which no credit is given) should be credited to his salary account monthly.

The second essential is to agree on a proper annual guarantee which will provide a sense of security and measure the semi-monthly payments. This should be large enough to cover reasonable living costs and avoid anxiety, and low enough to be attainable and permit the accumulation of a substantial credit balance. After the close of the fiscal year this credit balance is paid to him in one lump sum, which experience has shown is helpful in the individual's savings program.

The above sharing plan may be supplemented by offering inducements for attracting new clients. In one instance this takes the form of a bonus of 10 per cent of all fees charged to such new client (and collected) during the first twelve months and 5 per cent thereafter.

The contract used here as an example contains the following provisions relating to sick leave and vacations:

After the first year no reduction of the minimum annual salary computed under (3) (a) (2) will be made for unavoidable absence of the employee on account of sickness not in excess of two weeks in any fiscal year, but reduction will be made ratably for absence in excess of two weeks on account of sickness, or for any absence for other reasons.

After the first year a vacation of two calendar weeks in each fiscal year will be given the employee, at a time to be selected by the employer, without reduction of guaranteed minimum salary computed under (3) (a) (2).

It is obvious that under the above provisions the senior accountant who has accumulated a credit balance from the percentage of his fees actually is taking such time off at his own expense because no further credits are being made while no fees are being earned.

The employment arrangement may also provide additional perquisites such as:

1—Annual or Christmas bonuses.
2—A retirement plan.
3—Group insurance covering life, health and accident, Blue Cross, or other hospital and medical benefits.

Juniors

Turning now to the matter of compensation of junior accountants on the staff, a somewhat different problem is presented. The men usually will have been in the profession and with the firm a relatively short time. They are probably just starting their career, perhaps just graduated from a university accounting course and with little or no experience. Very properly they are more interested in securing training than in compensation. From the firm's standpoint, as well, there is no basis for a generous rate of compensation, as considerable time and effort must be devoted to staff training and intensive supervision, in addition to time lost in inefficiency.

The most used basis of pay is a standard monthly salary which carries through winter and summer. In some cases, no additional amount is paid for overtime, but such hours of overtime may be used to offset unassigned time during dull seasons or perhaps may be added to vacation allowances. This or similar methods offer no rewards for effort beyond the stated hours nor inducement for devotion to service. Perhaps the springs of ambition within the energetic young man should be sufficient to assure a cheerful response to overtime assignments. However, a tangible showing of appreciation on the part of the firm will be a great encouragement.

Obviously there is no reasonable justification for a sharing or percentage contract such as the one discussed above for senior accountants. In fact, such would be unsound and unwise. The most that can be done is to pay an additional amount for overtime. One plan calls for a contract which (1) sets a basic hourly rate, (2) guarantees a minimum weekly salary, and (3) provides the hourly rate to be paid for time over 40 hours within any calendar week. For example, if the hourly rate is $1.00 or $1.25 then the guaranteed weekly salary is $40 or $50, respectively, which is forty times the hourly rate. Since in the lower case the staff member cannot qualify under wage-and-hour rules as a "professional employee" (basic compensation is less than $200 per month), overtime is paid for at time and a half. In the higher case he technically is a "professional employee" and therefore overtime can if desired be paid for at the basic hourly rate (in this case $1.25). This overtime pay provides the beginning accountant on the staff an opportunity to accomplish extra earnings if he is sufficiently devoted to his job.

Obviously no credit balances are built up against dull periods. The firm must take this risk itself in order to provide security and encouragement to the young man entering upon an accounting career. Since the minimum guarantee must be paid in dull periods, it is desirable to keep a separate expense account to which may be charged the portion of such guaranty payments which are not earned. If a reasonable trial period indicates that the man is to be a permanent member of the staff, then other inducements and perquisites may well be granted such as some of the standard ones presented above for seniors including (1) vacation with pay, (2) sick leave with pay, (3) annual or Christmas bonuses, (4) retirement plans, and (5) insurance benefits.

Compensation for other members of the organization, including stenographers, bookeepers, and clerks, may properly be discussed under this head-ing. Their compensation may well be patterned after the junior accountants' plan just presented. That is a basic hourly rate, weekly guarantee, and time and a half for overtime, together with the usual extras. Although these persons may not be directly productive of revenue for the firm they are, nevertheless, vitally important to its success. They should be treated and compensated in such a manner as to encourage in them a feeling of being an essential part of the whole machine, and not let develop a sense of being separate and apart from the productive staff. Obviously, percentage arrangements are not possible but overtime pay and bonus are proper and desirable.

For all members of the organization on an "hourly contract" a weekly or bi-weekly pay period is desirable. It simplifies the computation of time over 40 hours (or other basic time) per calendar week. Monthly or semi-monthly payrolls complicate this determination as the pay period usually includes parts of three calendar weeks with carryovers from former payrolls and forward into the next. The good old wage-and-hour law has brought this development. The pay period here discussed is in contrast to the monthly or semi-monthly payments under the percentage contracts where an annual guarantee is provided.

Partners

A discussion of partners' compensation may appear out of place here as there should be ample incentive for superior performance in the share of profits which each will receive. This hasty conclusion, however, is not necessarily valid, for the reason that partners are human like members of staff and are influenced by the same motives and incentives. The more directly the partner's share of profits is geared to his individual performance the more the incentive for personal achievement. On the other hand, if his share of profits is a predetermined amount or percentage, then the direct motive for production is missing.

There are so many methods of dividing profits which are meritorious that this discussion will be limited to the statement of a few basic principles and the description of one example.

The first fundamental to note is that the practice of public accountancy is strictly personal service. All revenue flows from services performed by members of the organization for clients. Capital is not an income producing factor, although a reasonable amount is required to operate. The best potential revenue producers in the group are the partners. It is their personal services that the clients seek and are willing to pay premium rates to secure. It therefore follows that the partner should be encouraged to keep his time productive and be compensated accordingly.

The individual partner then makes three contributions to the partnership results (1) his services, (2) his investment, and (3) his share of clients and business attracted to the firm. To recognize these three elements the partnership agreement may provide for the following division of profits:

1—A salary to the partner.
2—Interest on his investment.
3—A credit for a stated portion of the net profit (or loss) after deducting salaries and interest paid to partners.

As to partners' salaries, many firms use a flat monthly or annual amount. As previously pointed out, however, it is important to provide incentive in the salary plan. One example follows the principles of the "percentage contract" for senior accountants previously discussed. This includes:

1—A monthly credit to the partner's salary account of a percentage (for instance 50 per cent) of fees charged for his personal services. This would include regular per diems with prorata write-ups where possible in billing and any write-downs required.

2—A monthly credit to his salary account based on hours devoted to activities for which no charge can be made, including executive functions. The hourly credit rate should not exceed and may be less than 50 per cent of regular per diems in order to place no premium on non-productive time.

These provisions require, of course, that the partner devote time to the partnership and that he produce fees. Under these rules, likewise, a retired or inactive partner would receive no salary credits.

The next factor is interest. So long as capital invested by each partner is in proportion to his interest in profits, it is immaterial whether interest is credited or not. Since there is usually some difference in net capital on account of variations in drawings rates by various partners, it is desirable to make an interest adjustment. This may be accomplished either (1) by crediting each partner with an agreed rate on his net monthly investment balance or (2) by crediting interest on such balances in excess of the basic capital account of each partner or charging interest on any overdrafts. The rate of interest may well be the going bank rate, so that the interest adjustment will be equivalent to the cost of securing similar amounts by bank borrowings.

Profits remaining after deducting partners' salaries and interest as expenses is usually divided upon an agreed proportion or percentage. The only special problem met here is as to the treatment of retired or inactive partners. Some firms require the partner who wishes to retire to sell his interest to the others and if he wishes to materially reduce his time devoted to the firm, his share of profits may be reduced under a sliding scale. The theory followed in such cases is that the profit is derived by personal services and only active partners should share therein. Exception is usually made for prolonged illness, military service, or other agreed leave of absence. It is believed that most partnerships require the estate of a deceased partner to sell his interest to the continuing partners.

This discussion cannot be considered complete without some consideration of retirement provisions. A partner's interest in a firm may be terminated by the following events:

1—Withdrawal from the firm for personal reasons, such as removal from the city, disagreement, etc.
2—Retirement because of age or health.
3—Death.

It is quite usual under any of the above situations to require that the terminated interest be sold and that the remaining partners agree to buy. There are exceptional cases where the business may be divided or liquidated. In case of purchase and sale between partners it is necessary that valuation formulas be agreed and stated in writing so they may be applied impartially to any interest affected. The elements of valuation are obviously (1) net tangible investment, and (2) goodwill. No consideration will be given here to the many interesting income and estate tax questions. Ordinarily the net tangible investment is easily handled. The largest item is accounts receivable from clients. As to these, settlement may well proceed as collections are made. Furniture and equipment may by agreement be valued at book value or be appraised. Life insurance division should be clearly provided in the agreement.

Valuation of goodwill is the most difficult. As stated, a formula should be stated in the contract. For instance, it may be a percentage of annual volume of fees. Rates which have come to attention range from 50 per cent to 100 per cent. Other plans have been mentioned involving results after the event, such as a percentage of fees earned in the next year, or all the profits earned on the clients existing on the basic date, over a period such as three years. There are many terms to be used in such provisions which should be clearly defined. For instance, should typing fees be included; should large and unusual fees be excluded; if profits are the measure, should partners' salaries be considered as expense, and how is overhead to be computed?

Conclusion

Incentive-pay plans, to which attention has here been focused, involve rewards for personal services which recognize both the time devoted and the extent of the results accomplished. The dual objective is that those who serve shall give of their best and receive a fair share of their product. It is a modern application of the golden rule, the reward for merit, and the profit motive, which have been economically and morally sound through the ages. If accountancy is to be a great profession, it will be because of the caliber and devotion of the men attracted to it and because of the quality of their achievements.

Basic Information Concerning Candidates Writing the Uniform CPA Examination

By Norman Lee Burton, New York
Educational Director, American Institute of Accountants

For many years the fact that the ratio of the number of persons who pass the CPA examinations to the number of those who take them appears to be smaller than corresponding ratios based on similar data in other fields of professional examinations has been a matter of comment, both oral and written. Various explanations of this phenomenon have been offered. A common one is that accounting is just naturally harder than such professions as law or medicine, for example. Another is based on the belief that the certified public accountants try to keep the profession small by failing the great majority of those who take the examinations. In some states the profession has been accused of predetermining the percentage of candidates their boards will pass.

It is not my purpose to discuss any of the foregoing suggestions nor to introduce a new one. That not one of those made, however, is the result of a sound and careful analysis of all the factors involved needs little demonstration. How does the preliminary education, for example, of the candidate for an examination for admittance to the bar or for a license to practice medicine compare with that of the candidate for a CPA examination? To what extent are the questions asked in the bar examinations and in those presented to candidates for medical practice of a sort which can be answered purely from a study of standard textbooks and published reports? Do the examinations in law and medicine presume a period of practical professional experience? How do the answers to the last two questions compare with the answers to similar questions pertinent to CPA examinations?

As a step in an attempt to learn the reasons for results obtained by candidates for CPA certificates who take the uniform certified public accountant examination prepared by the American Institute of Accountants, the Institute asked the various state boards of CPA examiners to give it certain basic information regarding the candidates who sat for the examination given in November 1946.

These questions related to the age, education, and experience of the candidates and the number of times successful candidates in each examination had attempted to pass it. To simplify the work of the boards in compiling the data requested, the form of the questionnaire was such that most of the data required could be indicated by check marks. Thus, the section relating to a candidate's age was divided into six blocks, headed, respectively, "Under 25," "25-29," "30-34," "35-39," "40-49," and "50 and over."

In this effort to accumulate basic data regarding aspirants for CPA certificates, twenty states co-operated and provided information relative to exactly twelve hundred candidates. Almost every section of the country is represented and the group includes those with very few as well as those with a large number of candidates. Of the states and territories in which the examination was given, 41 per cent sent information relative to 35 per cent of the number of persons who were examined in November 1946.

Certificates were issued to 232 or 19.3 per cent of this group of 1200. An additional number of 46, or 3.8 per cent, completed their examination requirements, but had their certificates withheld for some statutory reason, such as a lack of the required number of years of public accounting experience.

Of the 1200 candidates, 72, or 6 per cent, were under 25 years of age; 313, or 26.1 per cent, were from 25 to 29 inclusive; 293, or 24.4 per cent, were between 30 and 35 years old; 215, or 17.9 per cent, were in the 35 to 39 age group; 236, or 19.7 per cent, were between 40 and 50 years of age; 51, or 4.2 per cent were 50 or over; and for 20, or 1.7 per cent of the total, no age was reported. From this it will be seen that slightly more than half of the candidates were between the ages of 25 and 35, while nearly 40 per cent were between 35 and 50 years of age. While the heaviest concentration is in the age group of 25 to 35, as might be expected, it is highly significant that such a large proportion of accountants over 35 feel the importance of obtaining a CPA certificate. Perhaps it is merely the result of taking something which, spelled backwards, means something else.

What kinds of educational advantages have been enjoyed (or suffered) by the 1200 candidates for CPA certificates?

The Institute's questionnaire provided blocks for checkmarks applicable to six categories, as follows:

- High school, or equivalent
- College incomplete
- College graduate
- Technical accounting school
- Graduate of college, with accounting major
- Graduate of graduate school of accounting

Filling out this section of the questionnaire presented some difficulties. To aid the boards in deciding under which classification a candidate belonged, it was suggested that only the highest school attended be indicated. Thus, a candidate who had had college training could be assumed to have had a high school or equivalent education. But what about the boy who had had three years in college which he had followed with two years in an accounting school which he could have entered directly from high school? In such a case should the "college incomplete" or the "technical accounting school" be checked? Some boards checked both categories, leaving it to the Institute's analyst to select the one he wanted. In other cases the boards made their own selections, based, presumably, on their knowledge of the facts in each instance. It might be assumed, for example, that a candidate who had abandoned college at the end of the first semester of his freshman year in favor of a technical accounting school qualified to give good training but no degree, and had completed a two-year course in the latter school, had experienced his highest education in the technical school. On the other hand, a man who had had four years of college, involving no technical training in accounting, without obtaining a degree, and had followed that with a year of work in an accounting school, might be identified in the "college incomplete" section. The sections designated "college incomplete" and "college graduate" were intended to relate to the sort of education emphasized in a typical "college of arts and sciences," whether or not in the course of his curricular work the student was exposed to some principles of accounting. The "technical accounting school" is fundamentally a post-high-school, but non-degree granting, institution, usually operated on a commercial basis, the curriculum of which is limited to courses in accounting, business law, business English, business methods, etc. Correspondence courses were included under this category.

A candidate classified as a graduate of college and an accounting major probably received a bachelor's degree from a recognized school of business administration (most likely a member of the American Association of Collegiate Schools of Business) where he took all, or most of, the accounting courses offered. A graduate of a "graduate school of accounting" is presumed to have received a master's degree from such a school.

In classifying candidates' educational backgrounds some errors of judgment have undoubtedly been made. The quality of the work done in schools cannot be measured by such an analysis as was called for by the questionnaire. The effect of his outside interests, the nature and extent of his extra-curricular reading and the state of his health, while factors in his educational preparation for professional life, are not reflected in this analysis. With all its limitations, however, it is important in shedding some light on results obtained in the examination room.

Of the 1200 candidates about whom information was furnished 93, or 7.7 per cent, were reported to have had only a high school (or equivalent) education; 233, or 19.4 per cent, had had some work in college, but had not graduated; 213, or 17.8 per cent, were listed as college graduates, without accounting majors; 299, or 24.9 per cent were deemed to have had their highest schooling in a technical accounting school; 290, or 24.2 per cent, were college graduates who had majored in accounting; 49, or 4.1 per cent had received degrees from graduate schools where they had specialized in accounting. With respect to 23, or 1.9 per cent, of the group, no report regarding their educational background was received.

This summary suggests that the present-day candidates for CPA certificates recognize that mere graduation from high school supplemented by home study and work in an accountant's office is not the preferred way of preparing for the professional examinations. Not one of the twenty states reporting the data from which these percentages were obtained requires that a candidate for its CPA certificate extend his formal schooling beyond the fourth year of high school. Yet less than 8 per cent of the persons who sat for the uniform examination in the 20 states reported an educational preparation so limited.

On the other hand, more than 46 per cent of them were college graduates, of whom three-fifths had majored in accounting. In addition, approximately one-fourth of the entire group had had formal instruction in accounting, though not in so-called accredited colleges or universities.

While aspirants for the CPA certificates have recognized the need for post-high-school education, particularly of a technical or professional character, much of the credit for this attitude probably belongs to those professionally established, who not only have encouraged members of their staffs to take regular courses in accounting and allied subjects, but have given employment preference to college graduates and particularly to those who majored in accounting. The demands upon the profession have increasingly called for men not only well trained in the technical phases of professional activity, but in the broader fields of knowledge and in the art of thinking to which the college-educated man has been exposed to a greater degree than his less formally educated brother. The need for men who can develop in professional practice rapidly and who can quickly learn to assume responsibility for assignments with a minimum of supervision has led public accountants to build up their staffs with college trained personnel. This, in turn, has influenced the young people with an inclination toward accounting to prepare themselves academically as adequately as possible before identifying themselves with the profession of accounting.

Of the 1200 persons included in this study who sat for the November 1946 uniform CPA examination in 20 states, only 49, or 4.1 per cent, admitted having had no accounting experience. One-third of the entire group, or 401, however, had had no *public* accounting experience. This suggests, or perhaps confirms, the idea that many accountants seek the CPA certificate to provide evidence of their accounting proficiency rather than for the primary purpose of qualifying them for professional practice. Of the 719 candidates who had had public accounting experience when they took the November 1946 examination, 140 (11.7 per cent of the total of 1200 sitting for the examination) had had less than two years of such experience; 273 (22.7 per cent of the total) had had from two to four years of public accounting; 164 (13.7 per cent of the total) had had from four to six years of public accounting; and 142 (11.8 per cent of the total) had had more than six years of public accounting experience. No experience data were reported for 31 candidates (2.6 per cent of the total of 1200).

Clearly a majority, though not a large one, took the examination after they had gained some experience in the office of a public accountant. For 441 of the candidates their respective state laws required it, the amount of such experience ranging from a minimum of six months in one of the states to as much as four years in another. Of these states in which public accounting experience is a prerequisite to qualifying for the examination, three years of such experience was required of 269 candidates. It would appear from the figures that a substantial proportion of the candidates in those states apply for the CPA examination as soon as they have met the experience requirement.

The chart which has been distributed presents an analysis of the basic data relative to those who received passing grades in the various parts of the November 1946 uniform CPA examination. Since each of the 1200 candidates regarding whom basic information was provided did not take an examination in every subject, and the number of persons who took each examination was not furnished, certain interesting and perhaps important ratios relative to the number who passed in each subject are not here available. It may be noted in passing, however, that if each of the 1200 candidates had taken each part of the examination in November 1946 the ratios of the number who passed in each subject to the number sitting would be, respectively, as follows:

auditing, 45.8 per cent; commercial law, 57.6 per cent; theory of accounts, 58.5 per cent; accounting practice, 39.3 per cent. Since the denominator in each case is less than 1200, the actual ratios were somewhat higher. Nevertheless, the chart [Exhibit A] provides as many interesting figures as one might expect to see on Miami Beach, though perhaps the points of interest are not so apparent at first glance.

One matter of interest that cannot be gleaned from this chart is the fact that of the 1200 candidates, information regarding whom is the subject of this analysis, 92 passed all four parts of the examination at their first attempt. Of these, 13 were under 25 years of age; 45 were in the 25 to 29 age group; 19 were from 30 to 34 years old; 7 were over 34 but under forty; 6 were between 40 and 50 years of age; 2 failed to report their age. As to education, 5 reported no formal education beyond high school; 8 had attended college but had not graduated; 23 were college graduates without an accounting major; 14 had attended technical courses in accounting; 35 were college graduates with accounting majors; 7 had post-graduate degrees with accounting specialization.

The experience report of these 92 candidates shows that 4 had had no accounting experience, while 35 others had had no public accounting experience. One failed to report the character of his experience, and of the 52 who had been engaged in public accounting, 13 had had less than 2 years, 25 had had from 2 to 4 years, 9 had had from 4 to 6 years, while only 5 had had more than six years of such experience. If there is any moral to be derived from these data, it would seem to point to the importance of youth and education as factors in passing the CPA examinations, with public accounting experience as of secondary significance.

As to those who passed the several parts of the November 1946 examination, it was the first attempt for 308, or 56.1 per cent, of the 549 who were successful in auditing; for 442, or 64.0 per cent, of the 691 who passed the commercial law; for 403, or 57.4 per cent, of the 702 who received 75 or more in theory of accounts; and for 242, or 51.3 per cent, of those who received passing grades in accounting practice.

Second-timers who passed in the various subjects were as follows:

Auditing	114	20.8% of 549
Commercial law	129	18.7% of 691
Theory of accounts	158	22.5% of 702
Accounting practice	109	23.1% of 472

The persistence of many others, who had appeared for similar examinations two, three or more (in at least one instance as many as 17) times before, in an effort to qualify for the coveted CPA certificate, was finally rewarded in November 1946.

If the November 1946 examination is typical, it would appear that the chances in favor of a person's passing the CPA examinations in no more than two attempts are at least three to one.

Of the successful candidates in each of the November 1946 examinations those under 35 years of age were in the majority, moderately so in the tests in auditing, commercial law, and theory of accounts, but rather strikingly so in the accounting practice examination, where of the number who passed, 67.4 per cent were under 35. In all of these examinations the predominance of the younger element among those who were successful in their first attempt is still more evident. In auditing, commercial law, and theory of accounts approximately two-thirds of the successful first-timers were under 35, while nearly 80 per cent of those who passed accounting practice were in this group.

Of those under 25 who passed the various examinations first-timers are rather heavily in the majority. Witness: in auditing, 25 out of 38; in commercial law, 32 out of 36; in theory of accounts, 35 out of 46; and in accounting practice, 26 out of 37.

The educational background of the successful candidates in each of the examination parts in November 1946 follows much the same pattern, with the man with no formal education subsequent to his secondary school work distinctly in the minority. The largest single group consists of college graduates who have majored in accounting, either as undergraduates or in preparation for a master's degree. On a consolidated basis, considering the four tests together, the non-technically trained college graduates, the candidates trained in technical accounting schools and the college men who failed to graduate and who claim no specific technical training, vie with each other for second place. These three groups together are approximately twice as large as that of the college graduates who majored in accounting, which represents approximately 30 per cent of the total. The percentage of these college graduates in the various groups of successful first-timers is slightly higher than in the groups of all successful candidates, but no marked difference in the ratio is to be observed with respect to the various first-timer groups.

The experience classification provides some interesting material for consideration. Of the successful candidates in auditing, 17 admitted to no accounting experience of any kind. In commercial law, theory of accounts, and accounting practice similar admissions were made by 26, 26 and 12 candidates, respectively. This does not mean that 81 persons who passed one or more of the November 1946 examinations had had no accounting experience, for several persons are included in more than one group.

It is also worthy of note that the majority of these candidates without accounting experience were among those who passed the examinations at the first sitting. To be sure, the number of successful candidates without experience is very small. That there should be any is a matter of some significance.

Another significant fact is that in each examination the largest individual group of successful candidates consisted of those who had had no public accounting experience. The proportion of this group for each part of the examination was as follows:

Auditing	36.1%
Commercial law	34.2%
Theory of accounts	33.6%
Accounting practice	40.9%

Were it not for the statutory requirements in many states it is not unlikely that these ratios would be higher. The fact that public accounting experience is a prerequisite to admission to the examination in many states tends to reduce the number of candidates who appear without that type of experience. The number of years of public accounting experience required for admission to the CPA examination also has a bearing on the number of candidates included in the various experience categories. Observe, for example, that of the 549 persons who passed Auditing in November 1946, 112 had had from 2 to 4 years of public accounting experience. Is there any significance to the fact that of the 549 persons who were successful in the auditing examination, 105 were from states which require 3 years of public accounting experience as a preliminary to admission to the examination? Comparable figures relative to the other examinations are as shown in the tabulation which follows.

Subject	Number	2-4 yrs. of Pub. Acctg.	Number passing from states requiring 3 years Pub. Acctg.
Commercial law	691	145	117
Theory of accounts	702	148	132
Accounting practice	472	91	78

How many of these persons with from 2 to 4 years of public accounting experience would have been included in the 1 to 2 year class, if it had not been for the 3-year experience requirement?

The permutations and combinations that can be developed from the data relative to 1200 candidates provided by 20 state boards of CPA examiners are more numerous than can be obtained from a deck of cards. Many merely provide data for problems in pure mathematics. Others have a practical significance which should not be overlooked.

But data applicable to the participants in only one examination are not an adequate basis for the establishment of long range policies. Such fundamental information with respect to the candidates for each examination should be supplied by every board twice a year for several years. The results of analyses of the figures furnished must be tentative until they are confirmed by the experience of years. The conclusions based on the analyses of such figures accumulated over a period covering several examinations should lead to the establishment of sound policies relative to the administration of the uniform CPA examination, or to the confirmation of the soundness of existing policies.

This report, incomplete though it is, was made possible through the cooperation of 20 state boards of CPA examiners, which deserve the gratitude of the accounting profession for providing the Institute with the basic information concerning CPA candidates in their respective areas. Forms have been prepared for the accumulation of similar data in connection with the May 1947 uniform CPA examination. It is hoped that many more than 20 boards will submit the information requested on these forms. In so doing, each will be participating in a study, the value of which to the profession of accounting can hardly be estimated.

EXHIBIT A

BASIC INFORMATION CONCERNING CANDIDATES IN TWENTY STATES WHO PASSED VARIOUS SECTIONS OF THE UNIFORM CPA EXAMINATION IN NOVEMBER 1946

		AGE							EDUCATION							ACCOUNTING EXPERIENCE						
	Number of Candidates	Under 25	25-29	30-34	35-39	40-49	50 & Over	No Report	H.S. or Equiv.	College Inc.	College Grad.	Tech. Sch. of Acctg.	Coll. & Acctg. Major	Grad. Sch. of Acctg.	No Report	None	Other than Pub.	1-2 yrs. Pub.	2-4 yrs. Pub.	4-6 yrs. Pub.	Over 6 yrs. Pub.	No Report
Auditing																						
First attempt	308	25	95	82	47	43	9	7	22	56	69	47	90	20	4	12	93	50	80	33	33	7
Second attempt	114	9	24	32	23	18	6	2	12	28	26	20	22	4	2	4	47	9	19	17	15	3
Third attempt	62	3	11	14	13	16	2	3	2	17	8	18	13	1	3	1	29	5	8	9	5	5
Fourth attempt	19	0	5	5	4	3	1	1	0	5	4	4	5	0	1	0	9	0	4	4	1	1
More than fourth attempt	46	1	3	12	13	10	5	2	2	12	2	15	10	3	2	0	20	2	1	2	18	3
Total	549	38	138	145	100	90	23	15	38	118	109	104	140	28	12	17	198	66	112	65	72	19
Commercial Law																						
First attempt	442	32	148	111	74	60	11	6	24	69	101	87	130	28	3	21	147	80	103	46	35	10
Second attempt	129	4	28	28	25	37	6	1	14	35	17	31	28	3	1	4	54	9	24	19	17	2
Third attempt	68	0	7	14	16	22	4	5	2	20	8	18	13	2	5	1	24	6	12	9	6	10
Fourth attempt	28	0	4	9	4	6	3	2	1	7	2	12	4	0	2	0	7	2	5	6	5	3
More than fourth attempt	24	0	1	7	8	5	3	0	1	6	1	12	4	0	0	0	4	2	1	4	13	0
Total	691	36	188	169	127	130	27	14	42	137	129	160	179	33	11	26	236	99	145	84	76	25
Theory of Accounts																						
First attempt	403	35	145	92	64	55	8	4	29	61	93	75	117	24	4	19	125	65	101	51	36	6
Second attempt	158	8	34	42	34	30	9	1	12	40	28	40	33	3	2	6	59	21	36	16	16	4
Third attempt	56	2	9	15	15	9	4	2	4	12	5	18	14	0	3	1	24	2	5	12	8	4
Fourth attempt	41	0	5	13	11	8	3	1	4	16	3	12	4	1	1	0	17	3	4	7	9	1
More than fourth attempt	44	1	3	9	11	12	3	5	1	10	6	16	7	0	4	0	11	3	2	7	15	6
Total	702	46	196	171	135	114	27	13	50	139	135	161	175	28	14	26	236	94	148	93	84	21
Accounting Practice																						
First attempt	242	26	97	64	30	20	3	2	12	25	55	56	78	16	0	7	94	28	64	36	12	1
Second attempt	109	8	35	30	17	18	0	1	7	26	19	30	23	2	2	5	47	13	16	14	9	5
Third Attempt	48	1	9	16	13	5	3	1	4	10	9	14	9	1	1	0	22	3	5	10	6	2
Fourth attempt	25	1	4	9	6	3	2	0	2	10	0	7	5	1	0	0	14	2	2	3	4	0
More than fourth attempt	48	1	4	13	9	14	5	2	1	17	4	16	8	1	1	0	16	1	4	7	19	1
Total	472	37	149	132	75	60	13	6	26	88	87	123	123	21	4	12	193	47	91	70	50	9