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Accountant as a Profit Increaser as Well as a Profit Stater

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The Accountant as a Profit Increaser as Well as a Profit Stater*

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The subject of this paper is "The accountant as a profit increaser as well as a profit stater." This subject was chosen on account of the fact that we are being forced in all our present-day business transactions to measure the effectiveness of every dollar spent in terms of what it is producing to help the business to be more successful, this success being usually rated in earnings.

There is not the slightest intention in any way to depreciate the necessity and value of stating profits correctly. On account of the fact that there are so many in this world who will deliberately mis-state facts, there has grown up a well warranted custom whereby certified public accountants should certify to the correct stating of profits, capital value, and everything else in connection with a complete set of statements of everything necessary properly to set forth the standing of any business institution. Anything said in this paper is not intended in any way to minimize the necessity of correct stating of profits and of the standing of a company as to its assets and liabilities. But, like everything else in this life, there is always something else that we can do to make ourselves bigger, broader and better, and it is what public accountants can do to make themselves more valuable that we shall discuss in this paper.

Doubtless many will say that a public accountant is not called upon to comment on organization, personnel, methods or anything of that sort. That might be so, because in most cases a client would not consider that he knew anything about it, and I guess in many such cases the client might be about right. It is for us, however, to discuss how this situation may be changed with profit not only to the clients, but much more so to public accountants themselves.

I want to review five points which, to my mind, have a very distinct bearing on the success of a business.

1. Leadership. No business can hope to be successful without proper leadership. I do not believe it necessary to discuss this point, as I think everyone will agree with this statement. But perhaps some of you may ask what leadership has to do with the

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public accountant. My answer to this is that the accountant can have a lot to do with it. Admittedly an accountant who is a pure dyed-in-the-wool, non-reading figure merchant, will know nothing about what I am saying. But an accountant of the class which I believe is in the majority today is in a strategic position to know a good deal about the results accomplished by the chief executives of the company, on account of the contact which he has at stated intervals with men down the line in the organization. As a result of this he has a wonderful opportunity to judge how the leadership of the chief executives as well as the junior executives is succeeding in preserving and building up the morale of a company.

Furthermore, any outstanding public accountant invariably meets many executives who would, if they could, impose on the accountant a misrepresentation of the affairs of the company. I have known of many executives who have gone to the extreme of trying to induce the accountant to certify to figures to which no upstanding public accountant could possibly subscribe. Of course, outstanding cases of a flagrant nature are few and far between. But there are many cases where, in what might be termed minor situations, executives try to put across things which they should not attempt with a public accountant. In all such cases the public accountant has a wide open opportunity to preach business ethics, to argue with the executive that he can not afford to do such things; that any actions of proposed sort are bound to become boomerangs, even within the executive's own organization, with results which are bound in time to break down the morale. Of course, it takes tact and diplomacy to talk this way to such executives; but it is one of the opportunities for the public accountant to raise the standard of business, in general, and of any company which may have such executives at the top.

Executives of companies are quite justified in talking more confidentially with public accountants than they would perhaps wish to talk with anyone within their own organization. This is brought about by the fact that the public accountant is supposed to represent the *n*th degree of confidence. Furthermore, he is supposed to be in contact with so many businesses that it is natural for executives to talk with him about affairs of many different kinds and thereby obtain a range of thought which may be of value because the public accountant may have known similar circumstances of other companies and be able to contribute some constructive suggestions. This alone is a field for the public accountant already recognized, a field which is limited only by the experience of the accountant himself. By this I mean that an accountant who is thinking beyond the figures themselves, who is studying all the various executives, department heads and everyone else with whom he comes in contact, who goes from one business to another and analyzes in his own mind why this business should do well while another is not doing so well, who studies the effect of the various accounting and control methods used by various companies, who in all ways is constantly searching for the *why* of the results, is the accountant who can be a most valuable consultant to the executives with whom he comes into contact.

An accountant who has studied the effects in various companies of different types of leadership can, with the confidence reposed in him by the executives who employ him, say to such executives many things that no one else can say. Therefore, there seems to be an almost unlimited opportunity for the public accountant to study and broaden his mind in matters of management as well as figures and thereby be able to carry to his clients a fund of experience and advice which will make him worth far more than he is worth as simply a stater of profits.

2. Organization. A good leader will invariably organize his forces in such a way that everybody will know what he is doing and what the other fellow is doing, thereby making certain that every possible thing is done to set up a proper, definite, organized procedure. Many problems enter into this question of organizing the personnel of a company. Engineering departments may be under one executive in one company and under an entirely different type of executive in another company. All the functions of a business, including manufacturing, purchasing, accounting, engineering, selling, traffic, personnel and all the rest of the functions, may be grouped differently with effective results. It is necessary in every business to determine how these functions should be grouped.

In many companies, especially those of some age, where individual men have grown up to large stature in the management of the company, we find organization grouped around these men instead of by functions. This is a dangerous situation as a function lives; but a person dies. Stability for the future, therefore, demands serious attention to the organization of the various functions and the fitting of the personnel thereto.

Here, again, you may ask where the public accountant comes in. I can answer quickly that he comes in to this problem as no one else can. His work as public accountant brings him in touch with the business to such an extent that he is in a position to know exactly what is going on, because he knows how all figures are grouped, and it is within his province to ascertain exactly what is meant by the groupings. As a result of this he is in a position to know how well the business is organized as to its functions and its personnel.

But here, again, comes the problem of the extent to which the accountant can go in remedying or suggesting remedies for conditions which are not healthy. My only answer to this is the answer which applies to anything and everything else, namely, the suggestion of remedies will depend entirely on the extent to which the public accountant has read, studied, analyzed, compared and in all other ways broadened his own mind concerning the conduct of business institutions in general as compared with a statement of how one institution has been conducted.

As the next of the five points we are considering intertwines somewhat with this matter of organization, let us pass on to the next point in order to have a freer discussion.

3. Records to Fit Organization. One of the gravest faults with records of any kind in the past has been the practice of having various expense, sales and other accounts, without a fixed responsibility within the organization for the results shown by the records. To get the best, not only out of the organization, but also out of the records, all records should be set up to fit the various responsibilities which have been definitely fixed by the organization procedure.

Nearly thirty years ago I started to play around with cost records. When I went into professional work in 1903, twenty-seven years ago, I called myself a cost engineer. Almost everybody called me a "nut." But it has always been my principal sport to do things which would bring out such a name. I shall never forget the first cost method that I installed. It was a "pippin." We had the direct labor all right—in fact, very well indeed; we had the material taken care of; and then we took everything else and added it by percentage to the direct labor and material combined. My recollection is that it took only about three months to find out how wrong that was, and then I started adding the burden in manufacturing to the direct labor alone.

From then on came rapid developments with which I have been occupied all the years since.

As we got along into 1910 and 1911, I began to wonder why it was that so many of the perfectly wonderful cost installations which I had put in fell by the wayside. Of course, each installation was perfect. Therefore, something must be wrong somewhere else. Accordingly, I began to make a review of some of the jobs to see what had happened. I found out two things: first, I found in a good many cases that somebody had better ideas about cost accounting than I had; second, and I believe this characterized the majority of cases, stating this with all due modesty, I found that the great trouble with the figures as set up was that they did not relate to any responsibility whatever, and therefore they were interesting to no one in particular and consequently next to useless.

This heading "fitting records to the organization" holds within it a remarkable secret. First of all, no man with a fixed responsibility cares to operate long without knowing how well his responsibility is carried out. Therefore, he demands records. Second, records fitted to these responsibilities give to the general management a fair and square control which means much to the management and to the responsible men in charge of the departments. Third, records built up in this manner are far more accurate than any group method or anything of that sort. Fourth, records set up to parallel and back up responsibilities open up a still more fertile field than anything mentioned yet,—which is covered in the next two points to be discussed.

Therefore, continuing our argument in respect to the relation of the accountant to the organization of duties, let me say that it is beyond my conception how any accountant can contribute much to proper record procedure unless he is thoroughly in touch with and contributes to the organization procedure. In other words, it seems impossible that proper records, other than the old fashioned merchandise account with a couple of expense accounts, can possibly be put into use unless the accountant first becomes acquainted with the organization, the departmentalization of all activities, and knows what it is that should be reflected in the records.

Records, when the accountant understands these things, become of real value. They become not only accurate, but a real control to the business. Such records are sought by the department heads. The controller of a company with such records can be a real, vital helper to the men who are struggling with the business problems in manufacturing, engineering, selling and all the other departments.

It seems to me, therefore, that it is not only the opportunity but also the duty of the public accountant to go into all these matters and make himself of great value in transactions which in the past may have been considered beneath the public accountant's notice but are actually the factors of accounting that make or break a company. In this field the public accountant can contribute to the increasing of profits in a manner which he never in the world can do in simply checking up the vouchers, verifying accounts receivable, analyzing all the debits to capital accounts, and then certifying that he thinks the thing looks all right.

But even at that, we are only looking at the outside of the cocoanut; we have not as yet, except in leadership, got to the real milk.

4. Standards of Performance. If we are fortunate enough to have a good organization and if we are provided adequate records to back up this organization, we are now confronted with the question what we are going to do about it. The favorite custom of altogether too many accountants today is to compare this month's expenses of all kinds with last month's, and the year to date this year with the year to date last year, and all that kind of stuff. That may be wonderful from the standpoint of gratifying curiosity, but in the control of a business it falls short of the requirements.

In approaching this subject of standards I feel that I am going into a field in which public accountants have not taken advantage of their opportunities. And yet there may be a very good reason for that because setting standards requires an intimate knowledge of the minutest transactions in the company, in the manufacturing and selling departments particularly, and most of these problems are handled by the engineering group or by the sales analyst.

But there are two sides of the question. First, I will admit that the setting of standards—an all-inclusive term covering budgets, quotas, direct labor rates, and all things of that sort—is an operation which is far from the usual sphere of the public accountant. Second, there is a possibility that it has taken the public accountant a long time to study these things and to see the great advantages to be gained from the setting of standards.

Let us discuss this matter of standards in order to get a clearer conception of our purpose. Those of us who have been active in the analytical work called, if you please, "costs," found out quite a time ago that the laborious method of charging up to an order number everything that had to do with a certain job was positively ineffective. We found out, as the accountants themselves did years ago in the case of burdens where standard rates by percentage or by hour were used, that the same thing applied to the handling of direct labor and all the materials which entered into the product. Not long ago I was talking with some officers of a company which is still running job-order costs—and I know that they are not alone, there are many thousands of companies doing the same thing today. I asked this one question, "To what extent do you actually use the costs, after they are compiled, which purport to show the cost by operations, by material and by overhead of each run of each part?" Nobody could explain in a satisfactory way what use might be made of these costs except that they were averaged (and I want you to notice that word "averaged") to check their selling prices. In the control of the plant operations, they frankly admitted that when a cost was high they said it was on this account, and therefore would throw it out. When it was low, somebody had made a mistake. And so it would go. The net result was that no real use was made of the records of some thirty thousand open order numbers to which somebody was chalking up charges off and on.

At this point it may be well to mention that the old argument for job-order costs as being the basis of setting selling prices has long since gone into the discard. As far as setting selling prices is concerned, competition is doing that in the great majority of cases. Of course, we must have costs if we happen to be charging on a cost-plus basis, but other than that the one great use of cost figures today is for the control of operations, and this applies just as much to the staff departments and the sales department as it does to the manufacturing department.

Standard cost may be described as the cost that *should* prevail. Let us suppose that a concern is producing some piece on which there should be five operations. On the best type of machine, with the best type of tooling, and on the basis of time studied effort, these articles should cost exactly so much. Each article with a proper waste allowance should use just so much material. For a long time it has been considered that each hour applied to the work should carry just so much overhead. Therefore, we can arrive at a carefully and scientifically studied figure as to just what any one article should cost. It may be a chemical which goes through various processes, or it may be flour which goes through its own peculiar processes, or it may be a textile which goes through all the processes from the raw cotton or silk to the finished product. Irrespective of what the product is, and nowadays irrespective of the quantity in which it is made, standards can and are being set.

Then, with standards set for the whole product we cut out a lot of the detail accounting, the thousands of cost cards, and we work an entirely different plan. Roughly speaking, the plan is to credit each department with the operations it performs, with the material it turns out, at the standard cost on which it is supposed to run, thereby arriving at a group credit against which we have the debits of the total payroll, the total material used in products and in expense items, together with everything else which goes into the expense, and out of this we get a comparison as to exactly how well any department, sales division or any other division of the business has operated as compared with how they should have operated.

Comparisons with the preceding year are certainly gratifying to curiosity. But things a year ago may have been so bad that anyone thinking that an improvement over such conditions is creditable as against a comparison with what they should have been as set up by scientifically figured standards is in a hopeless state. He will be left far behind the procession. There is not time to discuss further the matter of standards; but it is of advantage to remember that within the records which are provided to back up the various responsibilities there must be set up standards of what ought to be done, thereby furnishing each responsible head in the business with a means of control that can be obtained in no other way.

The comparison of actual departmental results, however, with what is allowed at these standards still leaves a vitally important factor, which is probably, except leadership, the greatest thing which has ever come into industrial management. This will be discussed under the next and last number of the five points.

5. Extra Remuneration for Beating Standards. One hears in business a great deal about loyalty. One hears of people with company spirit, esprit de corps, etc., and every one of these elements must be continued. But the fact is that the time has gone by for waving a flag and saying, "Come on, boys," without some incentive other than honor and credit—both of which were often omitted when they could have been given without cost and at the proper time. Titles of "assistant" and "assistant to" and all such titles worked very well in place of a salary increase for many years, but since the cost of living has gone up to its present level, a title does not buy very much in the open market.

Men who have worked their heads off for the success of their companies have suffered many disappointments either through the deliberate failure of management to give them proper recognition in the form of a salary increase or through not knowing who has been really responsible for outstanding results. Therefore, business has become ripe for the institution of some means of extra remuneration which is not only safe for the company but gives each responsible individual employee an opportunity to increase his own income by a share of profits from betterments which he and his organization can effect.

This brought into being incentive methods of extra remuneration. These methods have taken many forms. At present the principal form is probably some kind of profit sharing. Or it may be some form of stock purchase on advantageous terms. One of the most recent and effective methods is "savings sharing" whereby each responsible head may share in the savings over a fixed sum. Savings sharing does not mean just saving money. It may mean spending more money. It does mean spending less money per resultant performance. That is, if $1,000 is supposed to design, or manufacture, or sell 1,000 units of performance, and 1,300 units of performance result at a cost of $1,100, a saving of $200 is made. Or, if 1,000 units of performance result for a cost of $900 a saving of $100 is made.

A standard or bogey, or whatever you like to call it, is set up for each measurable unit of every department. Actual performance is measured by the standard, and a saving or loss results. This I shall regard as sufficient to describe "savings sharing" for the purposes of this paper, as it is not my intention to submit a definite set of specifications for installing such a method.

Savings sharing is superior to profit sharing in that it is applied directly to each definite division which is measurable. What the over-all profit may be means nothing to most "key" men below the chief executives. Even if it did mean anything, what could they do about it more than operate their own departments in a manner to beat their own standards, and thus in their own departments contribute their share to the general result?

It is my theory that every "key" man should receive a salary sufficient to cover his living, with a little allowance for extras but no allowance for what might be called the accumulation of wealth. It does not seem reasonable to expect "key" men to accept salaries which will not guarantee peace of mind, irrespective of business conditions, but it does seem reasonable, and it has worked effectively, for "key" men to take a chance on their wealth accumulation by being permitted to participate in a plan whereby super-effort will result in much larger income. These salaries might be termed the equivalent of a normal return to the stock-holders of say 6% or 7% on their invested capital. From then on the stock-holders may well afford to give to the "key" men a reasonable share of results which are better than the normal results which should be returned for simply a straight salary remuneration.

Most of this might better be on the basis of savings sharing, but certainly part of it should be on the basis of profit sharing, particularly in the case of the higher executives who are responsible for the over-all results.

It is probably obvious that the standards mentioned become the ideal basis for the setting up of savings-sharing plans, with the general profit and loss of the company as the basis of the profit sharing.

And now again we find a fertile field for the accountant, at least the accountant who has the inclination to become a real factor in counselling methods of management which will increase profits rather than simply state profits.

It is perfectly true that the most forward reaching work in this matter of incentives has probably been developed by persons and groups other than accountants. It is quite natural that this would be the case, particularly when groups other than public accountants have contributed so heavily to the development of standard costs and standards of all sorts in all departments.

But this has no bearing whatever on the point that public accountants should use every effort to know and understand all the intricacies of up-to-date and effective incentive methods. It is not enough for anyone, a public accountant, an engineer or any other kind of a practitioner, simply to get a few smattering ideas in respect to these methods and run the risk of destroying his own reputation by finding that he is giving counsel which may be far behind the times when he is giving it. Improvements in incentive methods and the use of standards are coming along so rapidly that it is difficult for anyone not directly concerned in that particular kind of work to keep up with the latest practice. There are two ways, then, for accountants to go. One is to study and follow these methods carefully, and the other is to enter into the research and development of these methods and so become of greater usefulness to the clients they serve.

But here again one may say, "What has the public accountant to do with these detail methods?" My answer to such an inquiry is that there is no money to be made or lost in simply stating profits. The money is made or lost down in the firing line where we find the actual disbursers of the money. We may have so-called disbursing officers, we may have controllers, we may have accountants, we may have a whole array of such officers, but the foreman who is handling the men who are producing the goods is much more the actual disbursing officer than anyone else in the upper strata of the organization.

This whole question of becoming a profit increaser rather than simply a profit stater is wholly within the jurisdiction of each individual public accountant. It is obvious that any man in any walk of life who does constructive work whereby a company may produce better results is worth infinitely more to business than a man who is a pure, out and out checker of what somebody else does. Again I wish to say that I am not in any way minimizing the importance of the verification of transactions. But I do say that there is nothing to be accomplished in the boneyard or after all the meat has been picked off. This expression has been used by many executives. If I may bring you any message today that is worth while it is this: Business needs constructive thinking. Business needs men who are thinking in terms of better conditions. Business needs men to take hold of companies so as to reduce costs, to better the morale of the personnel, to build up men to have a greater interest in the work they are doing, with the result that the future of American business shall be greater in productive value than at any previous time.

We have been going through and are still in troublous times. Business is slack. The wave of prosperity has broken for the time being. Most executives, spurred on by carping boards of directors, have ceased the expenditure of money even against good judgment. There are many constructive things which might be going on at this moment, and yet retrenchment programmes have been carried so that, when business does change, many companies will wish they had taken advantage of the lull to repair their fences, to start up new ideas, and in all ways to be set to go when business starts to return. Many executives cut off here, and cut off there, and cut off everywhere, with no thought for what it will all mean in preparing for the next run of good business. American business has shown for years that it can not be checked permanently. Confidence is unquestionably returning, and as soon as we begin to pick up speed the opportunities for constructive work will come thick and fast.

How does the public accountant regard all these constructive ideas? He has a strategic opportunity to contribute heavily. In his unique position to the management he can talk leadership, organization, records, standards and incentives. All five of these points are extremely important in the setting up of a psychological picture which will be almost irresistible. Think what it would mean if every qualified public accountant in America were fully qualified to advise, if not act, on all these constructive ideas. Think how many weak-kneed executives could be put on their feet; think how many spineless boards of directors could be urged on by advice, counsel or big-stick methods into permitting or perhaps forcing the management of their companies to get up to the line and not remain back with the also-rans.

No one in this whole country is in as good a position as the public accountant to wield a most beneficial influence on the executives of all of our big and small companies. And yet I am frank enough to say that I know personally scores of public accountants who are so out of date and so far behind in their knowledge of things which are absolutely vital to industry that they are nothing much more than high grade clerks. Honest? Most assuredly. Constructive? No—far from it.