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Present Tendencies in Accountancy Legislation

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By Maurice E. Peloubet

Until about ten years ago accountancy legislation in the United States had been substantially uniform in the various states. A certified public accountant certificate was to be granted to men in practice at the time the law was passed and thereafter to successful candidates in examinations. Boards of accountancy to administer the law and set examination questions were created and penalties were set for falsely representing that any person was a certified public accountant when he was not so in fact. The laws contained no restrictions on the practice of accountancy as such.

For a few years previous to the year 1924 there had existed a wide-spread feeling among some members of the profession that the restriction of practice as well as restriction of the use of a state-granted title should be embodied in the law, presumably on the analogy of the profession of accountancy with those of law and medicine. Several states attempted legislation of this character but no law held to be constitutional was passed until 1924. Restrictive laws in general provide that the practice of accountancy may be carried on in a state only by persons licensed by and registered with the state authorities. The methods of administration, definition of accountancy practice and exceptions to general restrictive provisions are dealt with later in this paper. However, the real questions at present in accountancy legislation seems to be whether restriction is desirable and, if desirable, whether it is possible to administer a restrictive law effectively. Most of the writing on this subject falls into the category of controversy rather than that of examination of facts and tendencies.

It is proposed in this paper to avoid, so far as is humanly possible, any attempt to make out a case for either type of legislation in its most extreme form. Enthusiastic partisans of either side will probably be disappointed with this attempted survey of the situation, but this paper is directed more to the man of moderate opinion or of no special opinion than to the strong supporter of either type of legislation.

It might be well, purely as a matter of information, to rehearse the arguments usually brought forward for and against restriction.

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Those who favor restriction contend that the accountancy profession affects the property of citizens and that the ordinary citizen is not usually able to pass on the qualifications of an accountant. Therefore, it is to the public interest to protect the citizens in their capacities as clients or investors from the work of unqualified or unscrupulous practitioners. If every accountant is licensed by and registered with the state authorities a high standard of competency can be maintained and the public will be protected. It is further held that accountancy work arising in or conducted in a particular state should be performed by accountants licensed by that state, for if this is not done the public will not be protected and an injustice will be inflicted on the accountants of that state.

At least one state restricts the use of firm names to living persons and residents of the state, on the ground that it is unfair and misleading to practice under a firm name which includes men who have died years ago or are residents of another state or country.

Most states which have restrictive laws provide in some way for permitting accountants from other states to carry out temporary engagements which have arisen outside the state.

In answer to the contention that some of these restrictions are unduly difficult and burdensome it is frequently replied that they are concessions and not matters of right and that, therefore, the individual state is the best judge of what might be properly conceded.

To sum up the arguments for restrictive legislation we may say that they cover:

1. Protection of the public.
2. Protection of accountants in a particular state.

One of the arguments usually brought forward against restrictive legislation is the difficulty of defining professional public accountancy, as there are many activities which are of a similar or closely related nature, and most of the definitions expressed or implied in the restrictive laws are wide and inclusive.

The opponents of restrictive legislation seem to doubt the effectiveness of the protection afforded the public by licensing all accountants by the state. They seem rather to incline to the raising of professional standards of the certified public accountant and to educating the business and investing public as to the difference between the certified and uncertified man.

The opponents of restrictive legislation do not seem to believe that there is quite the close analogy between law and medicine on one hand and accountancy on the other which forms the basis of so many of the contentions in favor of restrictive legislation. They point out that medicine deals with life and law deals with liberty and civil rights as well as with property, while accountancy deals only with property. They also point out that it is comparatively easy to define the practice of law and medicine but very difficult to distinguish between professional public accountancy and other activities which resemble it closely and are closely allied to it. They further object to the necessity of admitting, under most forms of proposed restriction, a large number of men whose qualifications are clearly and demonstrably lower than those of certified public accountants licensed under the older type of law.

The objection, however, to which the opponents of restrictive legislation seem to attach the greatest importance is the risk of impeding the interstate practice of accountancy through the enforcement of awkward and time-consuming formalities by some states before work arising in another state can be performed and of a possible eruption of reprisal in other states which do not at present have restrictive laws.

There is nothing particularly new nor, I fear, especially interesting in this summary of arguments which have been reiterated with considerable frequency and varying degrees of bitterness for the past eight or ten years. They are presented merely to complete the historical background of the present situation.

I suppose it is inevitable that there should be some subjects on which accounting opinion is divided, but on most of them opinion is somewhat academic and one side is under no compulsion to yield to the opposition. When one side, however, is able to write its opinion into a statute it becomes a matter of importance to the whole profession. To this point has opinion on legislation, particularly in relation to its restrictive or non-restrictive nature, come.

At the outset I must confess to being rather in the dark as to the exact motives and purposes of the proponents of the type of laws involving restriction of accountancy practice. The theory has been argued well and at length without telling us much about motives. As I can add little to the discussion of motives or theory, about all that remains to be said is that we should perhaps inquire more precisely into facts and conditions which may possibly throw some light on the subject.

To summarize such facts and conditions I would say, first, that, naturally, logically and ethically accounting work falls into two main classes—that which extends over several states or even the entire country and that which is local—each distinct and distinguishable by the form and location of the management and financial control. Second, by reason of contact and reputation some of the purely local work naturally flows to the firm with an interstate practice. Third, restrictive legislation is striving for the impossible in attempting to divide the above two classes on state lines. Fourth, the predominant problem of the profession is lack of uniformity—in theory, in practice, in our public pronouncements and in accounting law. Fifth, control of our profession is essential to its health and growth, but that control, whether sought through legislation or through ethical constraint, should strive to regulate—not restrict—our activities.

THE INTERSTATE TYPE OF WORK

We need look back no more than forty years to trace two evolutions of relevance and importance to the subject under discussion: (a) the concentration of single enterprises under one management and one financial control and (b) the wide dispersion of stock ownership.

These forty years have thus seen a vast change in the financing, management, ownership and auditing of business generally. Such sweeping changes have necessarily affected the lives and work of our citizens; and they have been accompanied by constant and drastic adjustment to new conditions. It is one of those inevitable adjustments we are now discussing. In those forty years we move from a situation where there were few American accountants, and business was owned, financed and managed locally, to a situation of many American accountants with the management and finance of business concentrated in the financial centers and ownership spread pretty much over the world.

Accountants have multiplied and demand for their services has increased; but with the increase of mergers and consolidations the sources of such engagements have diminished. Hence comes the firm in interstate practice where partners, managers and seniors, each one capable of running a small local practice of his own, enlist under one banner as individual businesses have done. The accountant follows the business—the big accounting firm is at once the product and the instrument of big business. That is

the first point I wish to make—that restriction must recognize, make provision for and facilitate this legitimate development if much of its opposition is to fall away.

It is useless to oppose a condition which is forced upon us from without. No representative firm wants to take work away from other accountants; but it is obliged by circumstances beyond its control to take work from or to yield work to other accountants when ownership or control of business changes. This sort of accountancy work is of an essentially interstate character.

Significant conclusions may be drawn from this: (a) accountancy is a profession to a large extent brought into existence by and so far as volume of work goes, primarily concerned with, the corporate form of business enterprise; (b) the accountant ordinarily will be engaged by those having to do with the financial management of the corporation; (c) accountants, therefore, ordinarily will become established in a city which is to some extent a financial center; and (d) the client will usually want the accountants to do a complete piece of work for the corporation wherever the company operates.

Furthermore, these tendencies are spreading, and it is natural to think that we are nearing a second stage of development of accountancy in this country. Our country is now financing not only its own activity but to a large extent that of other parts of the world. Our present position is not dissimilar to that of England in the nineteenth century, when she was both a creditor nation and a large exporter. As we are now in much the same position it is inevitable that the greater number of our accountants should concentrate in the cities which supply finances for these various developments.

Our forty-eight states and the District of Columbia may be divided broadly into eighteen industrial or urban and thirty-one not primarily industrial or urban. Of the eighteen industrial five have cities of a million or more population. It is estimated by the American Institute of Accountants that about 14,555 C. P. A. certificates have been issued in the United States, of which 75% have been issued in the eighteen industrial states; nearly 50% in the five "over a million" states and nearly 25% in New York alone. Since these figures are percentages, I think their relation is not much affected by the fact that in some cases certificates of more than one state have been issued to one man and furthermore it is probable that there are more men in practice in the industrial

states than the figures show. This is borne out by the distribution of the membership of the American Institute of Accountants of which over 85% is from the eighteen industrial states, 60% from the five "over a million" states and over 30% from New York alone.

As further indicating this concentration, a recent check of corporation stocks or bonds listed on the New York stock exchange is interesting. It shows a total of 1,056 companies, of which 701 publish accounts certified by 102 public accounting firms or individual practitioners. The points of present interest are that two-thirds of the listed concerns are audited and the head offices in the United States of 58 of the 102 auditors are in the city of New York. These 58 conduct about 90% of the 701 audits.

In saying that we must recognize that it is wasted effort to oppose this natural trend of accountancy to the larger financial centers I must not be understood to imply that we may ignore injustices which arise from or are made possible by that situation. The situation can not be changed but the injustices may be and should be remedied. All I wish to do is to distinguish this interstate type of work and to point out to the proponents of restrictive legislation that while almost any formula or expedient for remedying a wrong can be forced to the front and made popular for a time it will not bring the desired results unless it is on a sound basis. Nothing is ever settled until it is settled right.

Legislation in general should represent a crystallization of general practice or custom rather than an attempt to change conditions which seem to be so much a matter of course as to have almost the force of natural law. We are now at a stage where the finances of our own industries and to some extent those of other countries are provided from our great cities. The profession in this country has entrenched itself firmly in those centers. This, in effect, represents a transfer of professional work from London and the European financial centers to accountants on whom American financiers and investors wish to rely, and correspondingly it is not unreasonable to expect that the future tendency of accountancy work will be to draw away to some extent from the larger cities to the smaller ones as these latter become of more importance in investing and finance. However, the mere fact that a city is a large industrial center will not generally be a sufficient reason for large firms of accountants to be in practice there, as the audits of the local mills and factories will be controlled by the

financial management in another city. If this condition could be changed by legislation there might be reason for discussing such legislation, but it can not be changed and legislative attempts to change it often bring about results which are surprising and disconcerting to the advocates of the new laws.

No matter what we think ought to be the situation or what we think might be desirable, attempted compulsion by legislation or in any other way against natural tendencies of growth in the profession must ever be a losing fight. Business has ceased to be a local affair or a state affair and has become interstate, national or even international, and to keep step accountants must broaden their views and become national as well.

THE LOCAL TYPE OF WORK

As there is a well defined type of interstate work so there is an equally well defined type of local work, of which the first thing to be noted is that it is seldom bounded by state lines but is rather a matter of the territory naturally tributary to any given point. I would say, for example, that Jersey City is in local territory of the city of New York while Buffalo is not.

There is place for the large firm, the small firm and the individual practitioner, and the latter should not forget that he indirectly benefits by all well done accounting work by whomever done.

Let us consider the course of the growth of the profession here. Like many others of our institutions the accounting profession here has its roots in England. The reason for the early presence in this country of the trained professional accountant was the investment in American railroads, and later in other enterprises, of British and European funds. Foreign investors in American railroads and industries naturally wished to know through professional men in whom they had confidence that the affairs of the companies in which their money was invested were being administered worthily and that the statements they received represented the facts in a way lucid to them. For this reason British accountants were first sent to the United States, but the magnitude of those foreign investments and the volume of auditing work entailed soon led the British firms to establish branch offices here. At first these offices were of necessity manned largely by accountants trained in England and Scotland for there were few qualified American accountants in the 'eighties and early 'nine-

ties. It has long been, however, the general policy of these firms to employ as many American accountants as possible and they have aided greatly in the establishment of schools for the professional training of accountants in this country.

The growth and development of these large firms here, originally almost entirely British in personnel and now largely and increasingly American, is a real factor in the history of the profession which should not be overlooked. It is informing to observe the effects of the organization and growth of the British firms here, for it has been marked by an increase in both the number and volume of work of American accountants and American firms much greater proportionately than the growth of the British firms. In other words, the presence of trained and qualified men not only did not retard Americanizing the profession here but enlarged the opportunities of the American accountant both for employment and for practice on his own account, because of the training offered and of the gradual but steady education of the business public in what is to be expected from the services of public accountants.

In spite of the fact that a large proportion of accountancy work in this country is directed from a few cities there is a substantial and growing need for accountancy service which can be rendered as well or better by a local man than by the representative of a firm in some distant city, and this work the local practitioner of right considers his own and need make no great effort to hold.

This has particular reference to the usual business audit and does not apply to certain classes of local work of which an exception must be made. The restriction of some activities to accountants of the particular state would seem logical. For instance proposals to restrict municipal auditing to accountants of the state in which the municipality is located might not be unreasonable; appearance before tax boards might be restricted to accountants of the state, and so also might certain work related to court actions. Any function which is limited to a particular state and in which the local law is involved might be considered as a subject for restriction or limitation. It does not seem reasonable, however, for a client in one state to be forced to employ an accountant in another, merely because the client's property happens to be in that other state. There is no public interest involved, as no report will be made public within the state and no

one in the state could be damaged by relying on the accountant's work.

THE INEFFECTIVENESS OF RESTRICTIVE LEGISLATION

Forty years ago our country was filled with prosperous individual businesses locally owned, managed and financed. There came a time when they were joined and a combination of, say, ten such businesses in ten different states each having a thousand employees and each owned by 100 stockholders was formed. Each state would still have to consider the welfare of its four or five thousand citizens dependent on the local plant but its 100 stockholders would now own only one-tenth of the local plant. Over 90% of its 100 stockholders' ownership the state's jurisdiction would cease.

The state's authority over and responsibility for its thousand workmen and their families will remain unchanged and the state most properly will legislate as to compensation insurance, safety, working conditions, etc., but what can be done by the state to safeguard its 100 stock owning citizens where only 10% of what they own is in the state and 90% of the assets in the state is owned by outsiders with whose welfare the state is not directly concerned?

The state is vitally interested in the success of the combination, for that means the welfare of four or five thousand of its citizens, but it can do little to promote or foster that success, for the management and finance and most of the ownership and assets are outside its jurisdiction. The state is powerless to conserve the interests of its citizens unless the combination succeeds, and even so it is sometimes helpless. There is the classic example of the so-called whiskey trust which took over 81 plants and shut down 70 of them.

The laws of the ten states which attempt to restrict the practice of accountancy have two general characteristics. They restrict the practice of accountancy (as defined in the law) to certain of their own citizens, and they place restrictions of varying character and severity upon the practice of accountancy within the state by citizens of another state. To what extent a citizen has an inherent right to practise accountancy and whether the practice of accountancy is sufficiently affected with a public interest to warrant any restrictions I do not know, but perhaps the framers of these restrictive laws are not greatly concerned with points such as these. Possibly in many cases these general re-

strictions were devised to remedy specific evils and to solve specific problems, so, while we may disagree as to the desirability and effectiveness of the various limitations proposed by the framers of restrictive laws, we must not forget that the really important point to the profession is to discover and to define the problems and difficulties which have brought these laws into being.

We are here on somewhat difficult ground as we are trying to look through the form of these various statutes into the minds of the men who framed and proposed them. Perhaps in some cases the restrictions are dictated by what is regarded as unfair competitive methods of some of the firms carrying on an interstate practice. Perhaps in other cases there is apprehension that accountants from a large city in a neighboring state will obtain practice which it is felt belongs of right to the local practitioner. Perhaps one of the evils against which restrictive laws are aimed is the practice of competitive bidding, and it may be thought that if every acceptable accountant is sponsored in some way by the state and outsiders are prohibited from practising within the state or practise only by permission, the competitive bidding of outsiders will be stopped.

In full sympathy with such objects of legislation, I nevertheless fail to see how restriction can do anything but aggravate the situation. It would still be possible for an outside firm to open offices in the state and, as qualified men, still compete, take local work and underbid. An ethical canon against competitive bidding enforced by a grievance committee of a state society or a state body may work, slowly to be sure, to an effective end, but to get the result by legal indirection is almost hopeless. These are matters which no individual accountant can afford to ignore simply because they do not happen to touch him. If the profession is to advance our brothers' problem is our problem and bad practice anywhere affects us all.

In whatever state an accountant performs work which is an integral part of his practice, such as the audit of a branch store or one of a chain of plants owned outside the state, it would seem to be undesirable and impracticable to put obstacles in his way. This is equally true where investigations are made within a state by outside accountants for outside parties. Work of this nature must naturally be done by an outsider and if not done by an outsider would perhaps not be done at all. It seems undesirable for one state to attempt to prevent a citizen of another state from

safeguarding his interests in such manner as he may see fit, and his accountant's qualifications for work of this character is not a matter of public interest to the state in which the work is done, as no report will be made within the state. On this subject it is well to consider whether the stockholders' interest would be best conserved by having one accounting firm audit all plants and subsidiaries or by having a state licensed accountant audit them in each state.

Of the ten states which have restrictive laws, five have difficult and burdensome requirements which the outside accountant must meet before he can do his work. Some, for instance, provide for registration with the board five days before starting an engagement. Most of us have been called on at times to do work in another state on a few hours' notice. I do not think it would improve the general standing of accountants in the minds of a group of bankers if they were told that their accountants must wait five days before entering a state to carry out an investigation for some proposed financing. Five days is sometimes important in matters of this sort. In cases of financing it is frequently undesirable that the work should be known in advance of the issue. If it is a merger it is particularly unfair to the client in the state where the work is being done, as there is bound to be gossip when it is known that outside accountants are working on the books of the company. It may make negotiations difficult if the combination goes through, and it may react unfavorably to the individual company if it does not. In any case, it seems hardly proper for the accountants to divulge such information even to the board of accountancy of another state.

A student of this question, P. W. R. Glover, said five years ago to the body which is here assembled:

"It would, therefore, seem obvious that legislation for the accounting profession is very much in its experimental stage, and it behooves us to give serious and careful consideration to the subject before we are committed to a policy that might be disorganizing to public practice.

"From an examination of the five restrictive laws referred to, those of Maryland and Michigan appear to be well drawn, but I submit that the two-class basis of regulation, as at present administered, is not yet a solution of our difficulties. The principle of regulating accountancy by law in forty-eight different states, with forty-eight different types of law and administra-

tion thereof, based upon present experience would not give us the kind of regulation I believe we desire.

"One is, therefore, forced to the conclusion that regulation by states, as depicted above, is not altogether desirable unless free reciprocity for the C. P. A. in interstate business goes with it. By free reciprocity I mean that if the holder of a C. P. A. certificate finds it necessary to carry out assignments as a certified public accountant within another state, he should receive by courtesy an equivalent certificate from such state without the necessity of taking further examinations, or that the restrictive laws should be so amended as to permit him to practise as a C. P. A. in states other than his own."

I am not sure we are yet out of the experimental stage but certainly some progress has been made. Only one industrial state has adopted a restrictive law since 1926, although such limitation has been strongly urged in several others. The restrictive laws in force in the three industrial states having that type of legislation have been enforced with fairness to outside accountants, but it is impossible as yet to say whether this is due to the laws or to a fortunate choice of broad-minded men as members of the state boards. The best modern legislative tendencies are, I think, indicated in the recent amendments to the New York law.

While I will not admit that accountants in New York are any wiser or more capable than those of the rest of the country, a consideration of their experience is valuable because they have had more acute and difficult problems to face. There has been agitation for restrictive legislation in New York. This has been due, possibly, to the influx of accountants from all over the country in response to the greater demand for their services in the country's financial center. The New York State Society has made a careful study of legislative trends and tendencies for some years and the members are convinced that restrictive legislation will not give the results they desire; will not bring under control the man who should be legally recognized; will not prevent or punish improper or unprofessional conduct on the part of certified public accountants and will not protect the public against unqualified men.

Instead of throwing open the door to all in practice in order to bring them under control New York state made certain changes in the requirements for the benefit of men who had had a long and honorable experience in the profession but were

unable technically to meet some of the requirements. As a result of this a number of outstanding accountants lately qualified for the New York degree. It was thought better to keep up the standards of the C. P. A. degree in New York and to make clear the distinction between certified and non-certified public accountants in the minds of the public than to attempt to restrict the practice of accountancy.

This theory—that the degree should be safeguarded but that the practice of accountancy should be unrestricted—has been adhered to in the British Isles since the formation of the first Scottish Institute, although it has been repeatedly and severely attacked. This agitation led to the appointment of a departmental committee of the British board of trade under the chairmanship of Lord Goschen, which was charged "to consider and report whether it is desirable to restrict the practice of the profession of accountancy to persons whose names would be inscribed in a register published by law and, if so, to report on the method by which such register should be established and controlled."

This committee's report under the date of July 31, 1930, was well summed up in an editorial in *The Accountant* of August 16, 1930, "After ten meetings and the taking of evidence from seventeen societies of accountants, nine unattached practising accountants and twelve bodies representing other interests, the committee has come to the conclusion that it is not desirable to restrict the practice of the profession of accountancy to persons whose names would be inscribed in a register established by law. The members of the committee were all gentlemen able to take an unbiased view of the realities of the problem, and that they have been able to arrive at a unanimous conclusion is a result which must effectively silence further controversy for a long time to come."

A little book—beautifully written and full of wise counsel and common sense—lately published on *The Ethics of a Profession* has a chapter on branch offices, the pith of which is that it is proper in some cases to establish branch offices but in others it may be quite unethical, the distinction being difficult to define closely but quite apparent to anyone with a developed sense of ethics. I think that here a note is struck which should resound throughout the profession—that the restriction of practice which is needed is a matter of ethics and is not attainable by legislation.

There are many things outside the province of legislation. In a recent speech on public utilities Commissioner Whitsell, of the California railroad commission, recommended the gradual substitution of regulation by conference and agreement for litigation and orders. "In my judgment," says the commissioner, "the remedy to be applied does not lie in the realm of law but in that of human relations and economics."

I hope I am not extravagant in claiming that our profession is perhaps the most ethical in the world today, but neither law nor rules of ethics has brought it about or can keep it so. I suppose no professions are so hedged about by statutes and ethical constraint as law and medicine; and yet we have recently read of lawyers who were content to be ambulance chasers and vice promoters and have heard Dr. Fiske say, at the opening of a hospital in Brooklyn the other day, that "today, when commercialism is dragging the profession into the mire, Kings County hospital stands as a barrier against the destructive menace. Finance has no place in the hearts and minds of those who do the medical work in this institution."

In closing, may I leave these thoughts with you? First, to restrain from practice those who by ability and character are fitted to render good service to the client can benefit no one. Second, while holding tight to the idea of regulation as a means of improving our profession, our minds must be kept open as to what regulation really is. Third, the true professional man is he who loses himself in his work and coöperates with others for common ends.