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Frederick H. Hurdman

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Relation of Client and Accountant *

BY FREDERICK H. HURDMAN

The subject which has been assigned to me for discussion this afternoon covers a very wide field, and I feel constrained to confine whatever observations I have to make to some of the more important phases of the question.

There can be no disputing the fact that in relations with clients the accountant should maintain his independence, and yet some of our best clients are those who depend upon us to a very large extent for guidance in the conduct of their businesses. It requires a very fine sense of balance at all times to preserve that independence and still maintain the closest of business and, perhaps, social relationships.

The same degree of impartiality does not seem to be required in the legal profession where the lawyer is expected to serve and protect the interest of his client generally to the exclusion of every other interest. The accountant, on the other hand, is expected to deal with the facts as he finds them even though a revelation of those facts may appear to be detrimental to his clients' interests.

One thing is certain, however: the accountant must be careful to guard against putting himself in a position where he has difficulty in applying an independent and unbiased judgment to any problem which may be presented to him for consideration.

It will be my purpose to discuss some of the points of danger which, it occurs to me, lie in the path of the unwary accountant. I take it we are not so much concerned about the conduct of our clients as we are about our own, but in the course of this paper I may have occasion to refer inferentially at least to some of the shortcomings of clients.

Let us assume that an accountant is asked to call upon some previously unknown person for the purpose of an interview regarding a prospective accounting engagement. He finds that he has been recommended by a client, a business acquaintance of the man who is to be interviewed. After discussing the nature of the work to be performed and possibly the basis for charge, it would be wise to inquire whether or not any other firm of accountants had served this concern. Should it be found that another accountant numbers this concern among his clients,

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future relations, should they materialize, will best be served by a frank statement to the effect that the accountant in question is a reputable practitioner, in good standing in the profession, and that one prefers to withdraw from any consideration of this engagement so long as a fellow accountant is retained as auditor. This attitude, besides preserving self-respect, will immediately place one in the proper relation should it appear that for good reasons the existing arrangement has been or is in process of being terminated.

By this act one will have not only established independence at the start, but also have placed future relations with the client on a professional rather than a business basis. He is not likely to forget quickly the impression made at this first conference. Many firms make it a practice to communicate with the superseded firm in order that there may be no question concerning the propriety of accepting the new engagement.

Should it appear that the reason why the former arrangement is being terminated is that the accountant refused to concur in some statement which one would hesitate himself to subscribe, that information would be of great value in that it would enable one to establish a definite understanding with the client at the beginning concerning one's own views on this point. The temptation may be great to pick some flaw in the previous accountant's argument and thereby find a way to ingratiate one's self with the prospective client. However, if one values his self-respect it behooves him to make certain that the position he takes is sound, and an application of the golden rule at this point may be decidedly in order.

When it becomes apparent that the fee for the proposed engagement is a major consideration in eligibility, the accountant must be wary indeed lest he find himself in the position of a competitor bidding against a thoroughly reputable firm for an engagement which, if obtained, may be lost next year for the simple reason that someone else has bid lower. In such circumstances, if one feels that he must submit a fee, he should do so only after careful appraisal of the work to be done and consultation with the present auditors, and he should always submit a figure in excess of the fee now being paid. If all practising accountants could be persuaded to follow this procedure the subject of competitive bidding would be a thing of the past and both the accountant and client would benefit.

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Having secured the engagement one must be careful not to permit the client to go too far in laying out the course. Having ascertained from him what is wanted in the way of results, it is largely up to the accountant to determine the amount of work to be done in order to produce that result. Generally one can discourage a client who wishes to direct the scope of audit by pointing out to him what in one's opinion is necessary to be done and stating the qualifications one will be required to make in the certificate or report if one's plan for the audit is not followed. The accountant and not the client is the one who must sign the certificate and be held responsible for the character and thoroughness of the audit.

In the course of audit one will find it necessary to discuss with the client certain points whereon to take issue as to the correctness of the conclusions expressed in the books of account. A restatement of the accounts in a way approved by the accountant may have the effect of producing a more favorable or unfavorable picture of the business or its operations.

Only one consideration need worry the accountant, that is, the soundness of his reasoning with relation to the problem involved. If the result produced by interpretation of the accounts be unfavorable the accountant may meet with hearty concurrence in his views on the part of the management. However, the reverse is more apt to be the case and the accountant will be called upon vigorously to defend his reasoning. If the point involved is not one clearly defined by good accounting practice, one may be confronted with quotations from sundry authors of books or articles on accounting to prove that a contrary view is tenable. These are very difficult times for the accountant. To hold firmly to his views may mean the loss of a client. It is important to be right. If one is sure of his position he can be as firm as the rock of Gibraltar with the knowledge that in most cases he will not only not lose a client but will make a more lasting one. I presume there are few accountants who have developed successful practices who can not recall with satisfaction relations with clients which promised disaster at one time but, because the accountant was right and the client wrong, developed into a complete success.

One must be very wary of expedients in the settlement of differences. In other words, one must not compromise his reputation as a trustworthy and capable accountant. Ways will be

suggested and may very well suggest themselves whereby one may think to relieve himself of responsibility by the manner in which the point under dispute is expressed. In other words, the client wins his point and the accountant's honor is "preserved" by a set of carefully chosen words. I use the word "preserved" advisedly, because that is usually what happens to one's honor; it ceases to develop and becomes a museum piece, good for little else than as a thing to remember. The accountant who yields may find himself called upon frequently thereafter to repeat this performance and may even discover that he is suggesting ways in which the real facts may be obscured.

In a recent celebrated case in the English courts the attorney general stated that the jury would be the more irresistibly driven to the conclusion that the statements in question were intended to deceive someone if they also thought that very carefully prepared phrases were made and used which would allay any suspicion or uneasiness in the minds of the ordinary prudent investor and would conceal from him the true position—phrases so carefully constructed as to enable the defendants to say that the words they used covered what they did. If the jury thought that carefully prepared phrases would prevent the ordinary man's understanding what was being done, then the fact that the phrases were constructed in the way he had indicated, in his submission, forced them to come to the conclusion that there was an intention to deceive.

What has been said about the manner in which an engagement has been secured, the negotiations concerning the fee, the scope of the audit programme and the client's relations with other accountants may have a very important bearing on the adjustments of differences in points of view or treatment of accounting questions as they arise from time to time.

If the client finds that the accountant is endeavoring to conduct himself on a high ethical plane in a distinctly professional way, and that the fee involved is incidental rather than the primary factor in the relationship, the client will exhibit a greater degree of respect for the accountant's views. In other words, through the steps mentioned he will recognize all of the attributes of a professional man. It will then be possible for the accountant, by good judgment and tact, to impress upon him his ability as an accountant.

Another important factor to be kept in mind is independence. The accountant must be free to state what he believes to be the

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facts. This suggests the undesirability of any dual relationships, such as acting as auditor and at the same time holding any position of direct relationship to the client such as a fiduciary office or as a director, officer and, in some cases, even as a stockholder of the corporation audited.

Generally speaking, an accountant should not accept appointment as a director or officer of a corporation whose books and accounts he audits unless the stock of that corporation be privately owned by a limited number of persons and the public, generally, is not affected thereby. Such a corporation might be one organized by a person to control his own estate or one organized by a small group to manage a real-estate venture.

It is difficult to see wherein the relationship is improved by having the auditor also act as a director. If the accountant's judgment is desired, surely it can be obtained when required, even by attendance at directors' meetings if necessary. It is feared that too often the promoters desire the name of the accountant on the directorate to help bolster the credit and standing of the corporation in the community.

In the very nature of his calling, the accountant should command a position of respect. He is at least presumed to be honorable in his relation with the public and to be concerned with facts regardless of their effect. In such circumstances, the client may ask, what could have a more favorable effect upon a prospective investor than the inclusion of the accountant's name in the list of those selected to form the board of directors of a newly launched enterprise in the community where the accountant is well and favorably known?

It may transpire that the accountant-director has very little influence in shaping the policies of the new enterprise. In that event, at least so far as the investing public is concerned, he may find himself held equally responsible with his co-directors for acts which he thoroughly disapproves. While withdrawal from the board in such circumstances may appear to be a perfectly simple and logical remedy, nevertheless, considerable damage may ensue to the reputation of the accountant because of the reliance of others upon the fact that the accountant was identified with the management of the company's affairs, and to some extent they were influenced in the investment as a result of that knowledge.

Bankers have stated that they look with suspicion upon audited statements when it appears that the auditor or some member of

his firm is acting in the capacity of a director or officer of the concern audited. They have stated that it made some difference where the reputation of the accountant involved was of such a high character that they felt reasonably certain the dual relationship did not work harmfully. However, in justice to one's client, one should be careful not to create the slightest basis for any suspicion by the banker as to absolute independence.

This underlying feeling of suspicion apparently is not removed even though the partner in the accounting firm who is acting in the capacity of director deliberately takes no part in the audit programme. That view will be understood when it is realized that the accountant in charge of the audit might hesitate to take a contrary view of some point arising in the audit, if he knew that the director-partner had apparently given his approval at a meeting of the board. In such a case it is highly probable that approval might have been withheld if the director-partner had had presented to him the same set of facts as was discovered by the accountant in his audit. The accountant should not be hampered by any such restriction of his independence.

Even in the case of a privately owned corporation there may be circumstances which will cause the auditor's report to be exhibited to the bank, some creditor or third party interested in investment or purchase. In such a case the preservation of an independent relationship may be quite important.

In Great Britain the companies act, 1929, provides as follows under section 133:

None of the following persons shall be qualified for appointment as auditor of a company:

- (a) a director or an officer of the company;
- (b) except where the company is a private company, a person who is a partner of or in the employment of an officer of the company;
- (c) a body corporate.

The principle behind these provisions is to ensure the independence and personal responsibility of the auditor. Paragraphs "b" and "c" appeared for the first time in the companies act, 1929. Under the 1908 act, the only persons disqualified for appointment as auditors were directors and officers of the company.

I am informed that the exception referred to in the case of a private company doubtless arises because generally the directors, with their immediate relatives and friends, are the sole

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proprietors and there is no market for the shares. In other words, the public interest is very limited or practically negligible.

It would seem to me desirable that the Institute express itself on this point, either by the adoption of a new rule of professional conduct or by resolution of the membership. If the latter method be preferred, I would suggest the following preamble and resolution:

WHEREAS the relation between a client in the form of a corporation and the auditor for that corporation should be one of entire independence, and

WHEREAS it does not appear to be practicable for the auditor consistently to hold a dual relationship as auditor and executive of the corporation, and

WHEREAS the public interest and confidence will best be preserved by a complete separation of these two functions, therefore be it

RESOLVED that the maintenance of a dual relationship as director or officer of a corporation while acting as auditor of that corporation is against the best interests of the public and the profession and tends to destroy that independence of action considered essential in the relationship between client and auditor.

The propriety of an auditor's investing in the stock of companies for which he or his firm acts as auditor is a little more difficult to determine. Generally speaking, it would seem to follow logically that if he is to maintain that relationship of absolute independence he should not become interested in the stock of those companies for which he is acting as auditor.

It may be argued that the ratio of the auditor's investment to the entire amount of stock outstanding would have a bearing, and that in proportion to the size of this investment one might expect to be influenced.

At this stage it may be well to inquire what is the ratio, the amount of the accountant's investment in relation to total capital of the corporation or the amount of his investment in this particular stock in relation to his own total investments in all stocks.

As a practical matter it may be unreasonable to expect that the accountant would be willing to jeopardize his reputation and the consequent valuable goodwill developed over a period of years for the profit he might hope to realize as a result of some decision he was required to make in his audit of a company's accounts.

Certainly the auditor should not take advantage of knowledge acquired as auditor, which the public could not obtain, to secure a more favorable investment for himself. Such opportunities

might occur in reorganizations, underwritings, new issues, stock dividends and the like. Great care should be exercised that the auditor does not place himself in the position of having accepted a favor from the management by being permitted to share in some benefit before a like offer is made to the public.

It would appear that while no fixed rule can be laid down, the accountant should keep in mind the necessity at all times of preserving an independent relationship and so arranging his investments that he does not take advantage of the public nor permit any hoped-for gain in market values to influence in any degree his impartial review and presentation of the facts.

Numerous other factors entering into this relationship between client and accountant will present themselves. It will be obvious that the accountant should be careful about accepting favors from his client in the way of price reductions on merchandise sold to him, gratuities to the staff accountants actually engaged upon the audit or any consideration which might tend to place the accountant under obligation to the client.

Of course the accountant should always be a gentleman. This implies courtesy, tact and firmness. It does not imply that because the client happens to be a boor the accountant should adopt like characteristics. If it develops that the morals of the client are objectionable it may well be the part of wisdom to sever relations even though at some pecuniary loss. An immoral client may be a costly one in the long run.