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Editorial

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EDITORIAL

Whose Balance-sheet Is It?

One of the vitally important questions of modern accountancy—one upon which there seems to be a distinct cleavage of opinion—is that of the authorship and responsibility for the balance-sheet of any business concern. The word “balance-sheet,” as used here, means not only the actual statement which is known by that name but also the supporting schedules, profit-and-loss account and other statements from which the balance-sheet is derived and by which it is sustained. It is quite a common thing to hear people speak of the balance-sheet of such and such an accountant prepared for the X corporation, and it is equally common to hear of the balance-sheet of the X corporation approved by such and such an accountant. These two methods of expression indicate the sharp difference of opinion as to what the balance-sheet actually is and also whose it is. There was a time when the accountant, so-called, was really a writer-up of books at the close of a week or a month or even a year. He was given certain books of account, most of them quite incomplete, and was told by word of mouth of some of the principal transactions of the period. It was his duty at that time to compile from these uncertain records, both written and oral, a statement showing the assets and liabilities of the concern with the resultant net profit or deficit. When there was no possibility of preparing such a statement from full records of transactions the balance-sheet was in effect the product of the accountant’s knowledge, experience and to some extent his ingenuity. He took what was

really a collection of fragments and constructed with them something which bore the appearance at least of a definitive statement. Today the accountant is not supposed to be a construction engineer. He is an analyst. In most cases the balance-sheet and other statements of the corporation or firm or other business entity are prepared by the concern itself from the books of account, minute books, etc., and the accountant's duty is now to investigate the records, test their accuracy and express an opinion upon the truth of the final statement. By an unhappy turn of fortune the word "certify" has crept into usage and we hear of the accountant certifying that in his opinion the balance-sheet clearly reflects the financial condition of the company. Passing over the impropriety of the word "certify" and its derivative "certificate" we find that the accountant does not make the balance-sheet but merely expresses an opinion as to how it is made and as to the validity of the material which goes into its making. It seems a little like a stretch of imagination, therefore, to describe the balance-sheet as that of the accountant. It is very much like saying that a new play is of the dramatic critic who merely expresses his personal opinion about it. (It would be an unkind punishment of the critic to lay upon his shoulders the burden of blame for all the things at which he has to look.) While admitting, for purposes of argument, at any rate, that the balance-sheet is, therefore, the balance-sheet of the corporation made by the corporation's own servants and that the corporation is responsible for the truth or untruth of its contents, it can not be forgotten that the accountant has a direct moral responsibility—and, some of the authorities would tell us, a legal responsibility—for the accuracy of the balance-sheet and the various items in it. The accountant professes to have the ability to express a valuable opinion upon the merits of systems of accounts, statements and all other forms of financial record. It is this claim that makes his work professional. If no question of opinion were involved the professional attribute would be absent. When the client engages the accountant, therefore, he does so with assurance that the accountant is competent to express an independent technical opinion and he is entitled to rely upon what the accountant says about the accounts. Therefore while the accounts are strictly things of the business concern, the accountant, the moment he passes an opinion upon them, assumes a moral responsibility.

**When Should Changes
Be Made?**

The question then arises how far the accountant may go in changing the form or contents of a balance-sheet which he is reviewing. Remembering that the balance-sheet is prepared by the corporation, it is a very nice point to determine how far the accountant may carry interference with the construction of the balance-sheet before certifying, to use the customary word, that the balance-sheet is correct. Here is where the different schools diverge. There seems to be a more meticulous insistence upon form by some of the smaller accounting firms than there is by the larger. There are many firms which insist absolutely upon adherence to their own chosen order of presentation and will not certify until the accounts have been brought into conformity with their own conception of what is correct. (We are speaking now solely of matters of form.) Some of the larger firms, as well as many of the smaller ones, do not lay stress upon detail and are inclined to accept without much question any method of presentation of facts which is not deceptive. They argue with a great deal of force that the balance-sheet is of the corporation and, if it truly and with reasonable clarity reflects the conditions, they do not feel that it is incumbent upon them to make changes purely for purposes of conformity to precedent. Probably both schools of thought are right. Certainly no one can condemn the accountant who insists upon adherence to the most minute detail of procedure. There is no possible question of the wisdom of such military precision. If it errs it errs on the right side. On the other hand, the more liberal accountant is probably right, but he is in danger always lest, in permitting what seem like unimportant departures from good practice, he may unwittingly allow an arrangement of facts in an order which will not tell the whole truth to the casual reader. Balance-sheets are bad enough at their best. It requires expert knowledge and sometimes a great deal of imagination to know what they really mean. The accountant who certifies is very often misled by his own comprehensive knowledge of the affairs of the company under consideration. Because he knows in his own mind what is back of some of the figures he feels assurance of their accuracy. But the shareholder or investor or any other person less familiar with details of the business is often unable to know what the balance-sheet is all about. Consequently there is a peril in permitting the publication of balance-sheets which wander too widely from established

customs. They may tell the truth but tell it in such a way that no one will understand.

The Test is Absence of Ambiguity

It is generally considered by accountants that they must carefully guard against the utterance of any statements unless convinced that the form of such statements is reasonably intelligible. The accountant who adopts the conservative plan of procedure and insists upon rigorous adherence to form is safer. He can always fall back upon the defense that he has required everything that custom suggests. Many of the fine distinctions which arise will occur to every accountant of experience. The mere matter of order of assets or liabilities, the position of capital stock and many other formal questions will present themselves to anyone who considers the subject. There can not be a universally adopted form of balance-sheet for all concerns. There must be some flexibility—no one could lay down a rule of thumb which would be applicable for all practices—but there has been so much discussion of ownership and authorship of balance-sheets that it seems desirable at times to think about it. Every accountant will have to decide for himself how far he may permit deviation from the beaten path. It is always safest in the middle of the road—unless one happens to be a pedestrian on a motor highway. But there are, of course, many occasions when there must be individual choice of a route to follow. If the balance-sheet tells the truth so that any moderately intelligent person can not be deceived by it, it seems generally wise to approve it. If changes are required in order to meet the purposes of exposition the accountant must insist upon them, and if he signs a balance-sheet which does not comply with these requirements he is culpable. The details, the order, the classification of unimportant items—these things rest with the accountant and his conscience. It would be ideally perfect if every accountant were altogether infallible and if every statement bearing the signature of an accountant were brought into exact conformity with the accountant's own plan of presentation. Perhaps we shall come to those happy days, but in the meantime it is probably well to remember that the balance-sheet, although the property of the client, must never contain anything that could be reasonably misconstrued. Accountants should be on guard against any laxity at all in accepting forms which they do not entirely approve.

Trade-Union Policies Structural repairs and alterations were in progress in a building in the city of New York. Painters, carpenters, plumbers, bricklayers and other artisans were at work. The ceiling of the ground floor had been plastered anew, and from the center of the ceiling was suspended a fragment of electric wire. The owner of the building, inspecting the work, noticed the piece of wire and told one of the plasterers to remove it. The man refused to do so, on the plea that it was work for an electrician and his union would not allow him to touch the wire. The owner reached up, caught the end of the wire and pulled it down easily, as it was not attached to anything. He then instructed the plasterer to complete his work. This is a true story. And it is one of the countless reasons why so many men who are skilled artisans are now out of work. Trade unionism has done much for the working man and for fairness in the relationships of capital and labor, but carried to such silly extremes it has done a great deal to prevent the undertaking of construction and other work. The absurd claims of labor unions have certainly checked building and developments of various sorts, and the country is now confronted with the spectacle of an almost total cessation of many kinds of work where trade unions control, while there is a fairly substantial volume of activity where the open shop prevails.

Unionism Outside the Trades It is the custom of people who are not directly concerned with manual labor to regard the struggles and the absurdities of trade unionism with a somewhat supercilious superiority. Yet there is the same sort of spirit prevailing outside the realm of the artificer. Take the professions for example. Some of them are so dreadfully afraid that there may be encroachment upon what they justly, or unjustly, consider their prerogatives that they would surround themselves with restrictions which will prevent any alien foot from touching even the borders of their territory. Indeed, they go further and construct what seem to be movable fences, which they constantly attempt to push outward so as to enclose a little more territory and to prevent the alien foot. There is, of course, a deal to be said in favor of the theory that the cobbler should stick to his last and that no one who is not a cobbler should profess to be one; but on the other hand there are some things which are regarded as the exclusive right of groups of

men which can not logically be so construed. As an illustration, let us consider a recent enactment of the Alabama legislature defining the practice of law. This act is reported in the *American Bar Association Journal* for February, 1932. The statute reads:

Section 1. Only such persons as are regularly licensed have authority to practise law.

Section 2. For the purposes of this act, the practice of law is defined as follows: Whoever, (a) in a representative capacity appears as an advocate or draws papers, pleadings or documents, or performs any act in connection with proceedings pending or prospective before a court or a justice of the peace, or a body, board, committee, commission or officer constituted by law or having authority to take evidence in or settle or determine controversies in the exercise of the judicial power of the state or subdivision thereof; or, (b) for a consideration, reward or pecuniary benefit, present or anticipated, direct or indirect, advises or counsels another as to secular law, or draws or procures or assists in the drawing of a paper, document or instrument affecting or relating to secular rights; or, (c) for a consideration, reward or pecuniary benefit, present or anticipated, direct or indirect, does any act in a representative capacity in behalf of another tending to obtain or secure for such other the prevention or the redress of a wrong or the enforcement or establishment of a right; or, (d) as a vocation, enforces, secures, settles, adjusts or compromises defaulted, controverted or disputed accounts, claims or demands between persons with neither of whom he is in privity or in the relation of employer and employee in the ordinary sense, is practising law. Nothing in this section shall be construed to prohibit any person, firm or corporation from attending to and caring for his or its own business, claims or demands; nor from preparing abstracts of title, certifying, guaranteeing or insuring titles to property, real or personal, or an interest therein, or a lien or encumbrance thereon.

Section 3. Any person, firm or corporation who is not a regularly licensed attorney who does an act defined in this act to be an act of practising law, is guilty of a misdemeanor, and on conviction must be punished as provided by law. And any person, firm or corporation who conspires with, or aids and abets, another person, firm or corporation in the commission of such misdemeanor must, on conviction, be punished as provided by law.

Laws to Protect Lawyers

It seems that, if this act were administered with literal interpretation it would be illegal for anyone except a lawyer to draw a will or a lease or to prepare an income-tax return. This would indicate that bankers, real-estate men and accountants would be debarred from fields in which they have rendered important service. Apparently no accountant or other person not a lawyer could make a claim for refund or abatement of tax except on his own account unless he were regularly licensed to practise law. The lawyers have always been rather sensitive about their rights and privileges. In some cases they have seemed to think more about protecting themselves than about promoting the welfare of the general public. They have been able to obtain a preponderant representation in most legislative bodies and consequently have succeeded in writing into the laws all sorts of

defensive statutes. Probably any other class of men with similar opportunities would have been quite as selfish. Many accountants are similarly exclusive and would attempt to prevent perfectly harmless activities of persons who are not accountants, lest the sacred precincts be invaded. The medical profession has rather more justification for rigid maintenance of the frontiers, because any encroachment into the field of practice might have serious effect upon the health of the people. But there is in all professions very much the same sort of tendency which induced the plasterer to refuse to remove a piece of loose wire. Quite recently there have been conferences between a committee of the American Bar Association, known as the "committee on unauthorized practice of the law," and representatives of the American Institute of Accountants to consider primarily the attitude of the bar with reference to operations which might by some stretch of imagination be classified as the practice of law. The negotiations between the two bodies were conducted, of course, in the most friendly and helpful way. There was, however, an evident desire to protect the lawyer from any remotest peril of interference with his practice. As always happens, there were two sides to the question and it became apparent during the discussion that there were times when the lawyer displayed an undesirable tendency to wander into the field of the accountant.

Tu Quoque

The representatives of the Bar Association suggested that the Institute should make a rule prohibiting accountants from attempting to practise law. The representatives of the Institute pointed out that accountants have no wish to permit the profession to interfere with legal practice and drew attention to the Institute's rule of conduct which reads, "No member or associate shall engage in any business or occupation conjointly with that of a public accountant which in the opinion of the executive committee or of the council is incompatible or inconsistent therewith." There has been a great deal of argument between lawyers and accountants about practice before the board of tax appeals. Some representatives of each profession would like to restrict to their own profession the right to appear before that board. The ideal arrangement, of course, is one in which the accountant and the lawyer appear together, each presenting those phases of the case which clearly fall within his purview. We think that the lawyers

have been quite unreasonable in many of their efforts to build walls around themselves and we are quite sure that some accountants have been equally unwise, but it does seem a pity that professions, one of them very old and the other very new, whose pursuit runs closely parallel should not be able to carry on without conflict. Both professions have much to do for the welfare of humanity and can help enormously in the restoration of business stability. If only they would forget themselves for a little while and think of the body politic it would be all the better for them and the rest of us. One thing is certain, that the professions so long as they follow the principle of pure selfishness without compensating benefit to the public have no right to look down upon the most ardent advocates of extreme trade unionism.

Professional Accountants Could Assist Railways

In the April, 1932, number of THE JOURNAL OF ACCOUNTANCY appeared somewhat extended editorial comment upon the audit of railway accounts by public accountants. Those notes were instigated by a letter addressed to the shareholders of one of the great railroads by its president, recommending that a proposal to amend the bylaws so as to eliminate independent audit be approved. A correspondent who has had a good deal of experience in the audits of small, short-line railroads, writes expressing agreement with the comments which were published in these pages, and he urges that the question be revived from time to time so that there may not be an apparent acquiescence in the tendency to depart from the principle of independent audit. He says in part:

“People connected with organizations subject to supervision by governmental boards, or commissions, are apt to handicap themselves by too literal and narrow interpretations of the regulations. Railroad records are sometimes arranged so as to facilitate the assembling of data for reports to the interstate commerce commission, and the furnishing of vitally important cost data and other operating information may be overlooked. Perhaps some independent auditors have accepted too readily the established routine and methods, with the result that their work and reports have not been of much informative and analytical value to the railroad executives. It seems to me that railroads should not only have independent audits, but they should be audited with a view to developing more useful and necessary information and such revision of accounting methods as will make the organizations more readily responsive to managerial control.”

**Different Purposes
in Investigations**

There is, of course, a great deal of truth in the argument which our correspondent makes. The investigations which are made by representatives of the interstate commerce commission and other governmental bodies are not intended to produce the kind of information which leads to more economical administration and the attainment of better results. Perhaps the matter can be best expressed by saying that governmental investigation is solely retrospective. There are certain forms which must be followed, certain ways of keeping accounts which must be adopted, and certain statistical summaries which must be prepared, but it is seldom the function of a representative of the government to point out how improvements in service or administration might be brought about. It is well known that the function of the accountant is always to deal with facts, but nowadays it is also the duty of the accountant to report to his client things which he thinks would help the organization toward greater success. Here is one of the most important factors in this whole question, and unfortunately it seems to have been overlooked in almost every case. It must not be inferred that the accountant is supposed to dictate methods of management, but he is supposed to give the benefit of his advice based upon his experience not only in the affairs of a particular client but in the affairs of all other clients in similar business. That is the point which our correspondent has in mind, and it is one that can not be too emphatically stressed.

**Election of
Auditors**

At the monthly meeting of the Chamber of Commerce of the state of New York, June 2, 1932, a report and resolutions submitted by a special committee on "auditors of corporation accounts" were unanimously adopted. The entire report appears in the *Bulletin* of the American Institute of Accountants issued on June 15th, and there is not space available to reproduce the report here. Briefly, however, it discussed the question of adopting the practice (which prevails in other countries) of electing auditors instead of having them appointed by the board of directors or the management. Every accountant and, in fact, every man of business has a vital concern in this important question, and it is eminently gratifying, especially to this magazine which has consistently advocated election instead of appointment

of auditors, that the following resolutions should have been proposed by the committee and should have been unanimously approved:

RESOLVED, That the Chamber of Commerce of the state of New York urges upon the directors of all corporations whose accounting methods are not under federal or state supervision but whose securities are dealt in publicly, to amend their by-laws to require that independent certified public accountants shall be selected by the shareholders; that the reports of such accountants shall be rendered in full to each and every director and be made available for inspection by the shareholders; and that the text of the accountants' certificate be spread on the minutes of the company and printed in the annual report; and, be it further

RESOLVED, That the chamber recommends that all close corporations and firms as well as counties, cities and other political subdivisions which require substantial loans from financial institutions or others, inaugurate the practice of periodical audits by independent certified public accountants.

No doubt this action of the Chamber of Commerce of the state of New York will have effect. It is too much to hope that the entire scheme of things in this country will be changed overnight by any action of any group of men however influential, but it is something to have on record one of the most important organizations of business men in the country as in favor of abandoning the prevailing system and adopting the more desirable plan of election. There has been in these pages so much advocacy of the principle of election as opposed to appointment that it is surely unnecessary to repeat the arguments. All that need be done now is to express gratification.

**Undesired
Publicity**

As we go to press we learn that more than one inquiry has been received by the Institute regarding the ethical aspects of the publication in a recent issue of a magazine of an article dealing with a number of leading firms and personalities in the accounting profession. The criticism presupposes that the article was written with the approval of those whose names were largely featured in it, but we know enough of the facts to be able to state that such an assumption is by no means universally warranted. Indeed, the article bears internal evidence of an absence of coöperation on the part of some at least of those whose names were prominently displayed, the information given in regard to some persons being obviously obtained from public sources and the photographs either snapshots or press pictures. Other persons may have approved the article—all that can be said at the present time is that this is another case in which it would

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be unsafe to generalize. Even in the case of those who actively coöperated it can scarcely be suggested that they acted unethically or even showed a lack of delicacy. When a magazine determines to issue such an article it is, unfortunately, impossible to prevent it from doing so, and an accountant who knows his name is to be featured may think it wiser to coöperate to the extent necessary to eliminate incorrect and objectionable statements. Publicity, whether welcome or unwelcome, is an almost inevitable accompaniment of success.