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Editorial

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A. P. RICHARDSON, *Editor*

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EDITORIAL

Why Contingent Fees Are Condemned

Ever since 1919 when the American Institute of Accountants adopted its rigid rule against the acceptance of so-called "contingent fees" there has been a certain amount of restiveness both within and without the Institute, originating largely on the part of accountants engaged in tax practice. These critics of the rule have frequently expressed the opinion that much of the work devolving upon accountants as a result of the enactment of the federal income-tax laws was of such a nature that the acceptance of contingent fees appeared to be practically unavoidable. They seemed to feel that many just claims for refund or abatement would never be presented at all unless the taxpayer were assured that in the event of failure to obtain satisfactory results he would not be liable for any additional expense. The rule, however, has endured and probably will endure, because the great majority of professional men are firmly convinced that any fee which is solely dependent upon results over which they should be able to have no control is repugnant to the whole spirit of professional life. Furthermore, the accountant is of necessity never an advocate. If he accepts contingent fees he is prejudiced at the outset—he becomes a partner of the taxpayer and therefore not entirely impartial. Recently, however, there has arisen some inquiry as to exactly what does or does not constitute a fee contingent upon results, and therefore it may be desirable to explain briefly what we believe to be the true professional sentiment on this vexed problem.

**Doctrine of Quantum
Meruit**

There is a fine line of distinction, often difficult to ascertain, between a fee which is properly describable as contingent and one which is based upon something other than the actual time involved in the work. As one eminent member of the profession recently expressed it, there is abundant precedent for a professional fee which takes into consideration not only the amount of labor but in addition the amount of skill. The old story of the watchmaker who charged \$10 for a minor repair is appropriate. The owner of a watch complained because the charge was \$10 and he pointed out to the watchmaker that the labor involved could not be worth more than \$2. The watchmaker thereupon amended his bill to read, "Time on repairs, \$2; Knowing how to repair, \$8." The same principle applies to professional work. It would be absurd to say that an accountant should always govern the extent of his fees by the actual hours and minutes employed in performing a given task. It is right that he should charge also for the ability, which he has acquired or inherited, to do the work in a satisfactory manner. In other words, the fee may properly be based to some extent upon the doctrine of quantum meruit. Let us suppose for the sake of argument that an accountant obtains for one of his clients a substantial refund from the government. His acquaintance with the affairs of the client, his intimacy with the accounts and, above all, his general knowledge of the requirements of the law and their application can not be measured in terms of time. He may charge, it seems to us, a fee taking into account two great factors—the first, the amount of time, and the second, which is the more important, the amount of skill. It would be ridiculous to assert that every accountant should charge the same fees for his services. That would place the entire profession on the basis which is supposed to underlie trade unionism, where all men in theory are of equal ability. If a citizen be assessed what seems to him to be an unjust and excessive tax, he may call to his assistance a practitioner who has had little experience, and he may expect to be charged a fee of a very low amount, because the practitioner will exercise only such abilities as he has and the results may be highly problematical. On the other hand, a man who is familiar with tax practice and has great aptitude for the correct interpretation of law may devote less time than the incompetent novice but accomplish much greater results. No one

could argue seriously that the proficient man should not charge a higher fee.

Fees Based on Two Factors

This is not to imply that the fees charged may be governed in advance by any percentage of the amount to be recovered or abated. It is here that the fine line of distinction lies. Where is the point at which what may be called a quantum-meruit fee becomes a contingent fee? It seems to us that the point is discernible if the practitioner carefully avoid anything in the nature of percentage or commission. We do not believe that the accountant should govern his fee at all by the amount which is ultimately credited to his client. Indeed, we would go further and say that whether success or failure attend the efforts of the practitioner, his fee should still reflect the two elements (time and skill) which we have mentioned. Whether he win or lose his suit the accountant devotes an equal amount of time and effort to the task in hand. He will do his best to succeed and therefore is entitled to a fee which is sufficient. The ideal condition to which every accountant looks forward but does not often discover is that in which no question of fee arises during the negotiations with the client. Physicians, surgeons, lawyers and many other professional men who have reached the higher planes of their professions will not set any definite price upon their services. At the conclusion of an engagement they render a bill, often without detail of any kind, which represents what they believe to be the fair value of their service, taking into account both time and skill. Sometimes these fees, particularly in the case of lawyers, seem to be exorbitant. The client's recourse in such an instance is to protest according to law or in future to engage some more reasonable advisor.

**Different Accountants,
Different Fees**

At the beginning of the professional career of accountancy it seemed to be necessary to adopt the per-diem basis of charges; but those days are past and we are coming, it is hoped, into a time when the fee will be a secondary consideration. The first thought will be to secure the assistance of the most competent man available. We should like to see a change in the basis of charging and to have accountants render bills for professional

services, which, of course, could be supported by computing the amount of hours spent on an engagement and the amount of technical skill required. If the accountant were to render a bill "Professional services, \$10,000," he should be prepared upon request to supply the client with a schedule of the number of men and the hours of labor, which would support the time factor in the account, and a statement of the value which the accountant placed upon ability to do the work. Naturally, if this were the custom, the fees charged by men with small experience would be comparatively modest, and in the case of accountants whose standing, reputation and general ability were greater the fees would be much higher. It were folly to contend that there is no difference in the value of the services rendered by one accountant and another. We do not mean to infer that a client should be expected to pay for a name, but he may quite reasonably be expected to pay for the skill which made the name conspicuous in the profession. This, it seems to us, is the whole principle involved. The high prices paid by connoisseurs for the paintings and sculptures of the great masters are not attributable only to the fame of the artists. They are chiefly due to the fact that the work of those artists stands out high above the productions of less talented men. Before leaving the subject let us repeat that it seems to be the common opinion of the better informed practitioners in all professions that the question of fees should never be contingent upon results. Fees may be and should be contingent upon the ability of the professional man, whether he succeed or fail in any given case.

**Profession Not Subject
to "Code"**

We are living in a day of codes, potential and existent. Every business and industry is being subjected to extraordinary regulation or is threatened with it. No one knows whether this regimentation of human activity will redound to the advantage of the people or not. There appears to be a great deal of merit in the attempt to prevent unfair competition. Probably when the period of experimentation is over we shall have gained lasting benefits from the experiences and perhaps something from the accomplishments of the present day. But it seems to be quite clear, even in the minds of the most vehement proponents of codes, that certain walks of life must be left open to free will.

Chief among them are the professions. No code can be written or enforced to govern the practice of medicine, the law, the church, and we believe that this is equally true of accountancy. Indeed, excellent legal authority supports the view that accountancy is not and can not be made the subject of a code of fair practice. The profession itself will see to it that the practice is fair. In spite of this evident truth, we are informed that four or five codes of accounting practice have been prepared and submitted to the administrators of the national industrial recovery act. They were not offered by either of the national societies of accountants and they are, we are told, the product of groups of men in different localities without any great claim to national influence. A few of the members of the Institute have wondered whether or not it would be possible to prepare a code for accounting practice and to have the government accept the code and enforce it. This, if it were done, would be placing the profession in the position of a trade and, consequently, would be subversive of the whole spirit of a profession. Moreover, even if a code were approved, it would be quite impossible to apply it to all parts of the country or to all the men who practise the profession. The relationship between an accountant and his client is not at all comparable with the relationship between seller and buyer. As we have said elsewhere, the fees of accountants vary according to the skill of each practitioner. A code would place all practitioners upon exactly the same level. Again, there is the infinite variety in the nature of accounting engagements which could not be governed by any code, however comprehensive it might be. Each case, to use a trite expression, must stand on its individual merits, and nothing in the nature of a general code of conduct or price fixing could be made effective. We believe that there will soon be a revulsion of feeling against some of the attempts to impose codes of fair competition even on many of the more easily regulated trades. We can not depart from the spirit of individual initiative which has made America great. There have been many grave injustices arising from unfair competition, and we all hope that the national industrial recovery act and some of its concomitant acts will end forever the price cutting, the gouging and, to use the current slang, the "chiseling" which have interfered with the proper progress of commerce and industry. The professions, however, can be regulated only by themselves and by common opinion.

Accountant and Auditor A correspondent expresses the opinion that there should be a clear distinction in definition of the words "accountant" and "auditor." He believes that the responsibilities attaching to the two official positions may have "lessened the severity of an auditor's ethics." This theory is of some interest, because it probably is subconsciously accepted by many persons who do not give the matter deep thought. The truth is that it is difficult to confine the application of the word accountant to men who are not engaged in auditing. The professional auditor is necessarily skilled in accountancy and may ordinarily describe himself as an accountant. It is admitted that the derivation of the two words is quite different, but with the development of modern business practice the auditing of accounts, which, of course, was originally merely the hearing of the record, has become so technical and complex that proper performance of the duties of an auditor requires a skilled accountant. Many members of the profession have felt for a long time that it would be desirable if either of the two words, accountant or auditor, could be restricted entirely to the designation of professional accountants; but the public accountant does many things which are not auditing and consequently he must adopt the broader classification of accountant. It would probably be safe to say that all professional auditors are accountants and some professional accountants are auditors, but we can see no way by which the application of either word can be restricted in the manner suggested by our correspondent.

Liability of Auditors We publish in this issue of THE JOURNAL OF ACCOUNTANCY the text of an address entitled *Liability of Auditors*, which was delivered by Sir Nicholas Waterhouse before the London members of the English Institute of Chartered Accountants. This address, while almost entirely concerned with the problems which confront the profession in the British dominions, will be read with interest by practitioners in this country. The address reveals the fact that the problem of moral and financial liability is arousing as much concern under the British flag as in our own land. There are, of course, many differences in the conditions of practice in the two nations. For example, the position of the company auditor in Great Britain is statutory, and the accountant has been longer recognized as a

member of a learned profession in Great Britain than in the United States. Furthermore the enactment here of the federal securities act last year and the probability of substantial amendment of the act in the present year give rise to questions which are peculiarly American. There is nothing in the British laws to compare with the all-embracing responsibility laid upon the accountant under the securities act. The address to which we refer reviews the whole subject of liability briefly but comprehensively, and we commend it to the careful consideration of every accountant who is engaged in public practice. No accountant can afford to conduct his profession without a clear knowledge of the moral duties and the financial responsibilities which may rest upon him.

Understanding Between Auditor and Client Particular attention should be paid to those portions of the address which deal with the question of understanding between the accountant and the client relative to the scope of audit or examination and the weight of liability which the accountant willingly assumes. The speaker quoted eminent authority for many of his arguments and summed up his conception of the scope of an official audit under three heads, namely, the accuracy with which the balance-sheets or other accounts agreed with books of account kept with ordinary care, the determination whether the books were properly kept and whether or not the officers and directors appeared to have dealt fairly with the shareholders. It will be noted that Sir Nicholas Waterhouse refers to the statutory audit. This means the audit conducted in accordance with the requirements of the companies acts. When the auditor goes beyond the region covered by the legal requirements he must use the utmost precision in the contract, express or implied, which he makes with the client. We use the word contract, of course, in its proper sense and are not referring at all to those unworthy cases in which accounting firms have sometimes employed what they call contract managers to go out canvassing the community and to bring in "cases." Every man who undertakes to perform a professional service for another man or for a company is a party to a contract, and that is the meaning which we have in mind at the moment. The speaker dealt with the question of internal check, as it is described in America, and gave it as his opinion that the accountant must permit no possibility of

misunderstanding with reference to the scope of the work to be done by him and the measure of responsibility which he will assume. In other words the auditor should be absolutely honest for the sake of his own reputation and prosperity and for the welfare of the client. "The value of the work of auditors is too highly appreciated for it to be excusable for the auditor to emulate the share pusher" [delightful word] "and attribute to his work a value greater than it can be expected to possess."

**"Strike Suits" Should
be Defended**

One of the most important features of the address was the emphasis which it laid upon the duty of the accountant to fight strike suits. It is undoubtedly true that there have been cases in which an accountant has acquiesced in the payment of claims which should never have been paid. Most of us are inclined to accept injustice if the amounts involved are not appalling. It is much easier to pay a small claim than to go to the trouble of defending even when defense is absolutely just. This sort of indolence or supineness merely encourages other litigations, and every settlement of an unfair claim without defense works an injury to the entire profession. On the other hand, if every accountant would fight, at whatever cost or inconvenience, every attempt made to extort from him damages or unjustified compensation, that small but offensive portion of the community which loves strike suits would soon learn that in the case of accountants, at least, these efforts will surely fail.

Exorbitant Wages

Some of the efforts of the federal and state authorities to provide work and a livelihood for the unemployed throughout the country may lead to a general disruption of business and industrial conditions. No one seems to be primarily responsible. It is rather the result of an excessive liberality, which bids fair to cause the whole movement to do an infinite amount of harm. Dangers of this kind always exist when anything in the nature of a dole is adopted. Many extravagant tales are being told of wages paid to men who are doing work which is largely unnecessary. We hear of men engaged to tear down obsolete buildings on government property and receiving for their services wages as high as \$1.20 an hour. It appears that men who are able to obtain classification as skilled artisans are offered work and paid these high wages, when it is

quite certain that they would have been glad to work for much less money. The movement seems to be running to ridiculous extremes, and the effect no man can foresee. A worker who is unable to obtain employment should, if possible, be given an opportunity to earn at least a living, but when we hear of men paid the rate of wages which we have mentioned and when the work itself is of doubtful value, it seems time to cry halt. One of the adverse effects of this tendency to pay high wages for unimportant work will certainly be a difficulty in inducing such men to engage in gainful occupations in the ordinary course of industry. As an illustration, the case of the farmer may be cited. When an unskilled laborer is paid on government work fifty cents an hour, it is improbable that the farmer will be able to obtain the men he wants when he wants them at any rate of wage which he can afford to pay. The working man who will become accustomed to receiving fifty cents an hour can not be accused of any misconduct if he prefers to work under the civil works administration and thereby leaves his legitimate field of activity unpopulated. The extravagance in the rates of pay, both to clerical and mechanical staffs, is one of the inevitable results of permission to expend money merely for the sake of spending it.

**Need for True
Economy**

It may be that the purpose of the federal and local authorities in paying these higher wages is to place money in circulation, but it would be interesting to know where the money is to be obtained to pay these wages. We are told that before long the country will face a debt of about thirty-one billion dollars, and we are also being told that there will be no increase of federal taxation upon incomes. We know that it takes at least a generation to pay for the expense of any war. Now, in a time of what is described as national emergency, we are thinking of laying upon posterity a burden which we have been accustomed to believe was justifiable only when the form of emergency which we call "war" was upon us. It is difficult to understand what motive can animate either the federal or the state governments in voluntarily paying men more than they themselves would demand. Surely, there is no economic truth underlying this policy. By all means let there be work for the men who are unfortunate and can not find other employment; but it seems clear that the sound principle would be to pay those

men only what they themselves would be willing to receive and to present every inducement for such men to take up their ordinary callings at the first opportunity. We shall soon be coming into a new season of agriculture. Business is said to be improving, and doubtless that is true. Industry is beginning to awake. Yet the great mass of the unemployed is being taught a lesson in false economics which will bear bitter fruit. Of course, in the administration of all works of this enormous character there will be graft and abuses of all sorts, but we are not astonished at that. The thing which is quite incomprehensible to the ordinary man of business, and probably to the so-called workers themselves, is the gratuitous expansion of the wage scale when nothing of the kind had been requested by the beneficiaries.

Good Deeds of 1933 The *Bulletin* of the American Institute of Accountants, published January 15th, contained an impressive survey of the developments in the field of accountancy during the year 1933. Generally speaking, that year was one of the worst for business and industry through which this country has passed. The depression which was prevalent throughout the world began to lift in many countries, but America lagged behind for various reasons, some known and some unknown; and therefore it might reasonably have been expected that the accomplishments of the year, so far as accounting was concerned, would be inconsiderable. The truth is that the year was marked by many important developments, some of which will have a lasting effect upon the progress of the profession. Among the most important accomplishments of the year was the action of the New York stock exchange requiring independent audit of listed corporations. In making the new rules which govern the conduct of the exchange, the American Institute of Accountants was frequently consulted, and suggestions of the utmost significance were made by representatives of the Institute. The enactment of the federal securities law placed a burden upon accountants and all others who are involved in the issuance of securities which, although extreme in the beginning, will doubtless be so amended that the result will be beneficial to everyone. In various states the movement for the requirement of independent audit of departmental accounts and clear statement of results of operation gained momentum. Within the Institute itself, several of the committees were unusually active and the achievements

were eminently gratifying. As a whole, the result of the year's experiences is a better understanding of the meaning of accountancy and the inculcation of sounder principles among the business men of the country. It was not a year of great monetary profits, but in point of common appreciation and knowledge of accountancy it was a year of the utmost importance to the entire profession. Now we are coming into a new year, and the progressive development of the profession will continue, possibly at an accelerated pace. The future of the profession seems brighter than ever; and, when we shall have emerged finally from the depths of woe, accountancy will stand where it should stand—in the forefront of progress.