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Editorial

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EDITORIAL

I. C. C. and Accounting Principles

The forty-eighth annual report of the interstate commerce commission dated December 1, 1934, is a document which will be read with interest and some little astonishment by accountants. When the commission was established it was understood that one of its chief purposes was to bring about adequate accounting and to insure proper application of the rules laid down by the commission for the conduct of carriers engaged in interstate commerce. On page 35 of the report now before us under the heading "bureau of accounts" we find the following.

"As has been stated in previous reports this bureau was created to enable us effectively to regulate and by periodic field investigations supervise and police the accounts of carriers subject to the act in order that uniformity in accounting as an essential regulatory requirement as well as a factor otherwise in the interest of the public could be assured."

We wish to draw particular attention to the expression "police the accounts." Apparently this means that the commission is to see that all accounts conform rigidly to the requirements laid down, and we assume that it means also that the accounts shall be kept in a proper manner. Now let us turn to page two of the same report under the general heading "railway earnings and traffic" where we find the following:

"The expenses for the nine months of 1934 were 10.2 per cent. higher than in the same period in 1933, reflecting changes in traffic, wages, prices of materials and maintenance policy. Although depreciation charges continue on a pre-depreciation basis, we have permitted extensive retirements during 1933 and 1934

to be charged to profit and loss instead of to operating expenses and also some repairs carried out with the aid of public-works-administration loans have been, with our permission, in part charged to profit and loss instead of to operating expenses. Beginning with 1935, depreciation of equipment will be charged to operating expenses on a standardized basis."

A Strange Concession to Expediency

If this means anything it means that in the cause of expediency, or perhaps for the sake of appearances, retirements during 1933 and 1934 were not to be charged as they should have been, but beginning with 1935 the commission will insist upon a return to sound accounting principles. Why, we may ask, should the years 1933 and 1934 be regarded as years outside the influence of sound accountancy? Can any good purpose be served by permitting a departure from what is generally regarded as good accounting? Certainly accountants will not agree with such a proposition. If accountancy is sound in one year it is sound in every year, and simply because times are hard and revenue small is no earthly reason why there should be any relaxation, particularly when the ultimate effect of the letting down of bars is more injurious than would have been the strictest adherence to the rules. This action of the interstate commerce commission in permitting something which the commission itself evidently recognizes as undesirable does not accord with the expression "police the accounts," and serves to emphasize the fallacy of the theory that any bureau, commission or other section of government can take the place of a wholly independent audit. Necessarily the work of the interstate commerce commission must often be largely superficial. There are not enough men and there is not enough time to make a complete investigation of the records and accounts of the common carriers of this country, and no doubt many things are done which should not be done and never come to the knowledge of the commission, but here the incorrect accounting is known to and approved by the commission.

No Reason for Exemption of Carriers

Under the rules of the securities and exchange commission railways and other common carriers are exempt from the requirement for independent audit which applies to other companies whose securities are listed on the exchanges. The reason

for the exemption is the supposed thoroughness and impartiality of the investigations conducted by the interstate commerce commission and the maintenance of that police power to which the commission lays claim. Yet here is a case in which the commission admits that it has permitted a relaxation of the rules in order to meet the exigencies of the moment. The investing public can not be expected to differentiate between the rules of the commission in 1933 and 1934 and the rules for other years; yet the purpose of the creation of the securities and exchange commission was to insure full disclosure of facts and to protect the public against misrepresentation. We do not exactly blame the interstate commerce commission for a certain laxity in times of great distress, but we deplore anything done by the commission which can be regarded as an interference with the purpose of the securities and exchange commission. It would be far better, it seems to us, that the securities and exchange commission should require the same degree of frankness in the reports of common carriers as they require in the reports of all other security issuers. To that end it would be desirable that the securities and exchange commission rescind its exemption of railways and other carriers and require the full statement of facts and the strict adherence to the rules of sound accounting which they require of industrial and other corporations. One of the chief media of investment in this country has been for many years the securities of railways. Every fiduciary has in its portfolio bonds and stocks of railways. Countless thousands of American citizens have invested sums ranging from the smallest to great amounts in such stocks and bonds. Why, then, should the securities and exchange commission display a readiness to accept from such companies statements which do not conform to the requirements for the statements of other companies? The matter is inequitable and we trust that it will be given further consideration by the securities and exchange commission so that the rules of the commission shall apply universally.

Members' Representation in National Associations

On another page of this issue of THE JOURNAL OF ACCOUNTANCY we publish an interesting letter by John N. Aitken, who was chairman of the committee on nominations of the American Institute of Accountants during the year 1934–35. There has been so much discussion of the nature of representation

in the governing bodies of national organizations that it seemed desirable to have an expression of opinion from some one who had made a study of the question, and accordingly we requested Mr. Aitken to write, as he has done, setting forth his views and those of his fellow committee-men on the subject. We direct attention to this letter because it explains clearly the purposes underlying the scheme of representation which has prevailed in the American Institute of Accountants since its foundation in 1916. There are various ways in which the voice of the membership of a great national society may be heard. The intent, of course, is to assure the membership throughout the country some form of representation which will permit the reflection of the sectional views of members as well as the purely national view. In a nation so large as the United States there must be wide differences of opinion between the members in various parts of the country. Matters which are of paramount importance in the commercial centers do not appeal with the same force to members in the agricultural sections. Members in the north have views and purposes differing widely from those of members in the south, and there is also a difference between the views of members in the east and those in the west. Any scheme of representation which will succeed must be founded upon fair principles and must not lend itself to an undue exercise of influence by one part of the country against the interests of another part. According to the letter to which we draw attention, the Institute's plan has worked admirably. The number of members of council from any one state is limited, and an attempt has been made at each recurring election to see that the geographical divisions receive appropriate representation. There is, however, another aspect of the case. The men who are elected to represent the accountants in the various sections must have, in addition to their local knowledge, a fairly wide grasp of national interests. They must not be solely concerned with what any one district may desire. We all know that many of the representatives in congress are so strongly swayed by local prejudices that they are of little real value to the country as a whole. Far too many of the members of the house of representatives and a few senators seem unable to regard the subjects before them in a national light. They see only with the restricting vision of the parish-pump politician who wants something for his own constituents, let the country as a whole suffer as it may. This sort of thing should be and can be avoided

in any national organization, and we believe that the system adopted when the Institute was founded has been the most effective of any that could have been devised. The committee on nominations selects the candidates after a careful survey of local and national affairs. In every district there are men who have breadth of vision as well as an understanding of their immediate surroundings. These are the men who should be appointed to represent not only the several districts but also the profession as a whole.

Accountancy—Profession or Trade?

We have received the following letter from an esteemed correspondent, who takes issue with THE JOURNAL OF ACCOUNTANCY on editorial comments which appeared in the August, 1935, issue of this magazine. He says, in part:

"In August, 1935, issue of THE JOURNAL OF ACCOUNTANCY editorial comment was made regarding house bill 2236 which was introduced in the Pennsylvania legislature in the 1935 session. Your editorial comments were in opposition to the bill.

"This communication is not for or against the bill, but deals with a matter that you did not bring out in your editorial, and that is, the nature of the opposition to the bill. The opposition to the bill was almost entirely on the proposition that accountancy is not a profession, but a business.

"I am told that this was reiterated by representatives of national accounting firms who attended the meeting in opposition to the legislation. If accountancy is a business, and not a profession, why do we have the American Institute of Accountants and other similar organizations instead of a trade association?

"When I first became a member of an accountants' society, I remember hearing addresses by members of national accounting firms on the question of ethics. We were told that we should not solicit clients, should not advertise and should conduct our affairs in the same manner as doctors and lawyers.

"If accountancy is a business and not a profession, why all this fuss about professional ethics? Is it merely a 'game' to keep the young practitioner from making himself known? Why all this talk about the 'coveted degree of certified public accountant'? What difference does it make if the American Institute is merged with the American Society of Certified Public Accountants if we are drifting toward a trade association?

"I was a member of a state board of public accountants for twelve years and during that period did everything possible to aid the young accountant in securing his certificate and in getting started in his work. When advice was asked for, I laid particular stress upon the ethics of the profession, and now, after all of these

years, I find that I was 'barking up the wrong tree.' What I should have said was: 'Advertise all you want to—get business where and how you can—accountancy is not a profession, but a business.'

"For years I have thought I was a member of a profession, now I don't know what I am."

The Situation Evidently Misunderstood

We are glad to publish this letter, because it seems to reveal a misunderstanding which may have been created in the minds of a few other readers as well. The comment to which our critic refers dealt with a bill introduced in the legislature in Pennsylvania for the purpose of restricting the practice of accountancy so that no firm bearing the name of a former partner could practise in that state. The bill seemed to us to be aimed directly at some of the larger firms and a few small firms which conducted practice in the state and carried in the firm designation the name of one or more partners who were not actively concerned. We deplored the introduction of this bill, because it seemed to us to be unfair and unnecessary. Arguments against the bill succeeded in bringing about its defeat—and for that we are grateful. We confess, however, that we can not understand our correspondent's arguments on the question of trade and profession. Why a bill which would have destroyed many well established and well conducted practices should be construed as the defense of a profession quite passes understanding. There was nothing said in the bill and nothing was said in our arguments against it which raised the question of advertising or any other one of the many things which are permitted in trade but forbidden in professional work. Perhaps we may be permitted to quote briefly from the editorial notes to which our correspondent refers:

"It is a little difficult to understand why such a bill as this should have been proposed. It has been alleged that the proponents have explained their purpose to be founded upon the contention that if the name of a deceased or retired partner be continued in a firm name, the professional character of the practice is lost and the firm becomes merely a concern engaged in a business or trade. We do not follow such an argument, because every one knows that many firms of lawyers, architects, engineers and other professional men carry, sometimes for a generation or more, the names of men who have died. Why accountants should be singled out for the peculiar exclusiveness which this bill indicates is beyond our comprehension. In truth it would be

most unjust to the firm concerned and to its clients and potential clients if it were made obligatory to change a firm name to conform in every case with the current personnel. The majority of the most widely known accounting firms spent many years in building up a high reputation, and the names of the founders of the firms are familiar to business men throughout the country. Clients know the name of A. B. & C. but they might be seriously confused if the firm name were changed to A. D. & F. There would be nothing to indicate the continuity of the practice. The goodwill attaching to a well-known firm name is the most valuable asset of the firm. That goodwill is a reflection of the years of work, the adherence to high standards and the development of an efficient staff."

It is going rather far afield to read into any comments of this kind an assertion that accountancy is a trade and not a profession.

Loose-leaf Records Rejected

The Accountant, London, in its issue of October 19th reports a court decision which must have been received with some consternation among accountants and others. According to this report a judge of the chancery division gave it as his opinion that loose-leaf books could not be accepted in evidence. According to the report:

"In an action brought by Mr. James Charteris Burleigh, chartered accountant, as liquidator of the Hearts of Oak Assurance Co., Ltd., against James Flower and Sons, stockbrokers, Copthall court, Throgmorton street, E. C., which was settled in the chancery division on the 9th inst., Mr. Justice Bennett gave an important decision rejecting the admissibility as evidence of what are commonly known as loose-leaf books.

"Mr. Fergus Morton, K. C., on behalf of the liquidator, tendered as evidence a minute book in which were recorded the resolutions passed by the directors of the Hearts of Oak Co.

"Mr. Gavin Simonds, K. C., for the defendants, objected on the ground that the 'chattel' submitted was not a book within the meaning of section 120 of the companies act. He contended that to be a book it must be cohesive, bound together and incapable of being tampered with. It must be sewn or pasted together.

"Mr. Justice Bennett, giving his decision, said that the thing which Mr. Morton called a minute book consisted of a number of loose leaves fastened together between two covers in such a physical condition that at any moment anybody who pleased to do so could take out any number of leaves and substitute any number of other leaves. This was a thing which people, if they were minded to be dishonest, could readily and easily tamper with

without anybody being able to see that it had been tampered with. What he had to decide was whether this thing was a book within the meaning of section 120 of the companies act, 1925. So far as he knew there was no authority on the question, but he would hold that it was not a book, as he thought it most undesirable that anything that could be added to or taken away from at any moment without anyone being the wiser should be put in as evidence under the section. On that ground he found that what was tendered was not a book within section 120 and he rejected the evidence."

An Attack on Established Practice

The editor of *The Accountant* commenting upon the decision of Justice Bennett expresses what we believe will be the views of most accountants. It is true, of course, that loose-leaf books do lend themselves more readily than other books to manipulation. It is easier to extract a sheet from a loose-leaf binder than from a bound book, and it is easier also to substitute another sheet than it would be in any other form of binding. On the other hand, however, bound books can be manipulated, pages can be torn out and with a certain amount of care new pages can be bound in so that even an expert might almost be deceived. The great point in the case is not the ease with which manipulation can take place but is rather the question of common business practice. Every one knows that loose-leaf records have been adopted throughout the civilized world. The whole scheme of bookkeeping in these days depends rather largely upon the use of records which can be readily typewritten and quickly and conveniently bound. If the decision of Justice Bennett is to hold it will mean a complete reversal of established practice, great expense in order to conform to the dictum of the court and a general upheaval of accounting systems. Probably the English decision will be quoted in American cases hereafter, but we do not believe that it will be sustained by American courts. Facts must prevail as well as theories, and it is going somewhat toward extremes to attempt the complete alteration of business practices to meet the theoretical expressions of a jurist, however eminent. The English accountants are distressed by this decision and we can imagine that the manufacturers of stationery are placed in grave quandary. In all probability an effort will be made to override the decision of Justice Bennett and to bring about common sense as well as theoretical nicety in administration of the companies acts.

Obligation of a Company for President's Acts

The Corporation Journal for October, 1935, contains the following report:

"In October, 1932, the president of the Eisler Electric Corporation engaged plaintiff, an accountant, by letter to 'continue' to audit the books of the corporation and to make monthly reports, the agreement 'to continue in effect until December 31, 1936.' Some time later the president was succeeded by another, and, difficulties arising between the accountant and the corporation, his services were dispensed with and this action was brought to recover for services rendered. It was claimed that the contract was ultra vires, was never authorized or ratified by the corporation, and that it was not within the scope of the president's official duties to enter into such an agreement. The court of errors and appeals of New Jersey, in passing on the points raised, says that if the former president had the authority he alleges, which is not disputed, he had the power to engage the accountant to make the audits. 'It is well settled that when, in the usual course of the business of a corporation, an officer has been allowed to manage its affairs, his authority to represent the corporation may be implied from the manner in which he has been permitted by the directors to transact its business. It is undisputed that the plaintiff was under contract with the defendant company since April, 1930, and it is not denied that the contracts entered into prior to the one now involved were made on behalf of the company by the former president, as he alleges."

The full decision was published by the Commerce Clearing House and from that report we extract the following:

"The fourth defense and the allegation contained in the affidavit of C. A. Laise to the effect that the services of the plaintiff were not performed according to the agreement might entitle the company to defend were it not for the fact that these charges were inconsistent with a letter signed by Laise and forwarded to the plaintiff on July 30, 1934, wherein he states that the company will be forced to employ new accountants to audit the books in order to reduce expenses, and reads in part:

"'We have spoken to you on several occasions about your excessive accounting charges. . . . Apparently, you consider your services of such a high order that you could not see your way clear to adjust your rate in line with new world conditions. We were therefore forced to get quotations on our accounting work from other C. P. A.'s, and all parties quoting gave us a price less than 50% of what you were charging. . . . In line with our new policy of adjusting ourselves to live within our income and in justice to our stockholders, we are therefore forced to employ new accountants. . . . We will arrange to pay you for the July audit, and if in the future we need accounting of a high order, we will call upon you, but for the time being we will have to resort to more reasonable

accountants to do our regular work.' It is apparent that the plaintiff's work up to July 30, 1934, was entirely satisfactory, and that Laise, who in his affidavit questioned the quality of plaintiff's work, contemplated again engaging the plaintiff if the necessity required it. The fact that the plaintiff called at the office of the defendant on April 4, 1934, and conferred with one J. Kurtz, vice-president of the company, in reference to the contract involved, which was found to be in the company's files at that time, as alleged in the second affidavit of the plaintiff, is not disputed by any proof offered by the defendant, although Laise denies that he had any knowledge of such contract."

An Important Decision This case is of interest to every accountant, and it is gratifying to know that the New Jersey court of errors and appeals sustained the decision which was the subject of appeal. Had the decision not been what it was every lawyer, accountant or other professional advisor or servant of a corporation would be placed in an anomalous position. To the ordinary lay mind it does not seem that there can be any doubt whatever that a contract made by the president of a corporation in his official capacity can not be set aside simply because some other man has been elected to the same position before the completion of the contract. In all probability half at least of the agreements made with accountants to audit the books of corporations are made on the word, sometimes not even written, of officers of those corporations. Boards of directors as a rule do not interfere with arrangements of that sort made by their presidents. The usual procedure is to approve the act or acts of the president in making agreements for audit, and it seems ridiculous to claim, as was claimed in the case quoted, that a change in the presidency nullified the retiring president's official acts. This is an unusual case and there does not seem to be much precedent behind it, but it is evident that precedent was needed which the New Jersey court has now supplied.

ERRATUM

In the editorial pages in THE JOURNAL OF ACCOUNTANCY for October, 1935, it was stated that the Society of Incorporated Accountants and Auditors had the largest membership of any accounting organization in the world. This, of course, was an error. The membership of the Institute of Chartered Accountants in England and Wales, according to the last yearbook, was 11,073. That of the Society for the same year was 6,384.