Adverse Criticism of the Public Accounting Profession

American Institute of Accountants

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A study has been made by the public information department in order to collect together material on adverse criticism of the public accounting profession. Reports, speeches, books, and articles in the Institute library were used.

Excerpts from the relatively few general criticisms of the last ten years which seemed significant, some from highly prejudiced sources, have been included in this set.

I. Securities and Exchange Commission

A. Report to Congress: "A Proposal to Safeguard Investors in Unregistered Securities", June 1946.

In this well-known report last year the SEC took a stand on what it considers full disclosure in financial statements published for investors. Its attitude is briefly summed up in this statement: "The fact that the financial statements examined in the course of this study were generally grossly inadequate, notwithstanding that 90% had been subjected to the expert review of a certifying accountant, makes it quite clear that the procedure of certification does little to assure adequate information for investors."

B. Address by Andrew J. Cavanaugh, Assistant Director, Registration Division, SEC, at Middle Atlantic States Accounting Conference, 1941.

On full disclosure, Mr. Cavanaugh said ". . . it seems to me that the aim of the accounting profession should be to make those statements and certificates as clear and unambiguous as their technical nature permits. Financial statements which conform to conventions and customs are not adequate if, in fact, they serve to conceal or fail to bring to light financial conditions or results which an intelligent investor needs to know in order to form a judgment. Certificates are not adequate if they evade expression of opinion regarding accounting practices which are not sound."

To this he added: " . . . one of the reasons why accountancy has not more nearly fulfilled its possibilities is the tendency to rely on precedent rather than on the scientific method."

C. Report to Congress (Part III): "Investment Trusts and Investment Companies", 1940.

In the section on the role of independent accountants, the report raised the question of independence. It said in part, "How much untrammeled independence can realistically be expected of 'independent' accountants whose hire, compensation, and tenure of employment all rest with the very management group whose conduct of the business these accountants are expected to appraise and disclose to stockholders."

D. Address by George C. Mathews, SEC Commissioner, at Institute on Accounting, Ohio State University, 1938.

Although recognizing that principles of accounting are in process of development, Mr. Mathews stated his belief that flexibility has caused certified public accountants sometimes to go along with management in using unsatisfactory principles.

He also criticized "ambiguous and non-informative expressions of opinion", and on the subject of independence suggested that "stubborness is not likely to be carried to the point of losing a client."

E. Address by James M. Landis, Chairman of the SEC, before Investment Bankers Association of America, 1937.

"The impact of almost daily tilts with accountants, some of them called leaders in their profession, often leaves little doubt that their loyalties to management are stronger than their sense of responsibility to the investor. Such an experience does not lead readily to acquiescence in the plea recently made by one of the leaders of the accounting profession that the form of statement can be less rigidly controlled and left more largely to professional responsibility alone. Simplicity and more adequate presentation is of course an end much to be desired, but a simplicity that misleads is not to be tolerated."

II. Congress

A. Monograph # 11: "Bureaucracy and Trusteeship in Large Corporations", a study of concentration of economic power by the Temporary National Economic Committee, 1940.

This report was prepared by the Assistant Secretary of Labor and a research consultant, Therefore, although prepared for the TNEC, it did not necessarily state the Committee's views and was considered only as evidence.

It contained a recommendation for legislation requiring "that public accountants certifying the accounts of (companies engaged in interstate commerce) not only satisfy themselves that the records have been kept in accordance with accounting principles but also that the accounts themselves appear to be correct."

The only supporting argument in the text of the monograph was this: "When certified public accountants audit the books of such a concern, they should, of course, satisfy themselves that they are 'in accordance with accepted principles of accounting', but in addition they should sample the accounts to see that they are in themselves correct. The mere appearance of conformity to rather nebulous principles of accounting is not enough."

B. Hearing on claims against Defense Supplies Corporation, United States Senate, 1943.

It was brought out that the Defense Supplies Corporation had caused an examination to be made by certified public accountants to determine whether certain claims against DSC conformed to rules laid down in advance. Among the claimant companies were some for which the accountants concerned also acted as independent auditors.

A Senator questioned whether the same accountants should act in both capacities - whether "any company is wholly independent of their best customers."

III. <u>Educators</u>

A. Paper: "What's Wrong With Accounting?" by Billy E. Goetz, published in Advanced Management, 1939.

The author, a professor at the Armour Institute of Technology in Chicago, leveled three basic changes at the accounting profession:

1. Forgetfulness of objectives (accountants neglect service to management).

2. Grotesquely inaccurate premises (assumption that the value of the dollar is constant).

3. Blundering logic (generally speaking).

IV. <u>Industrialists</u>

A. Article by Cyrus Eaton, Financial World, February 2, 1944.

After calling lawyers parasites, he wrote: " ...... those other highly respectable but equally parasitical professions of accounting and engineering have come to enjoy an unprecedented position of importance in the investment-banking world, although no audit or engineer's report ever increased the intrinsic value of any stock or bond issue one jot or iota."

V. <u>Bankers and Other Credit Grantors</u>

A. Article: "The Auditor's Report and the Banker", by Philip F. Gray, Journal of Accountancy, December 1941.

Mr. Gray claimed that because of the use of the short form report, bank credit grantors were not able to learn whether or not an auditor had test checked inventory and receivables. He was not willing to rely on the judgment of the accountant as to the proper scope of this part of the examination.

VI. Industrial Accountant

A. Book: "Truth in Accounting", by Kenneth MacNeal, 1939.

Mr. MacNeal preached the theory that accounting principles have been based on expediency rather than on truth. He called the typical certified public accountant "little more than a graduate bookkeeper" who rarely knows anything about economics or economic theory. In his opinion the "intellectual horizon of the profession" should be broadened, its educational standards raised.

Advertisements issued by the publishers (University of Pennsylvania Press) for this book were even more uncomplimentary. The advertisements asked such leading questions as "Do certified financial reports inform or deceive the public?" and "Why may accounting firms no longer certify that financial statements are correct?"

VII. Labor

A. Article: "The Truth About Fake Company Financial Statements", by Robert Kaplan, District 50 News (United Mine Workers), July 1946.

Mr. Kaplan's article was a rough and ready attack on everything in or around the public accounting profession. The article stated that an auditor's certificate means nothing, for financial statements are "incomprehensible, false, and misleading", and that certified public accountants are only "a set of checkers hired for show." It went on at length in a similar vein.

VIII. Attorneys

A. Book: "False Security", by Bernard J. Reis, (accountant and attorney), 1937.

In the chapter on certified public accountants, Mr. Reis said that "seemingly they (certified public accountants) have but one objective in view and that is to serve the master who pays". The chapter was mainly a development of this theme. He quoted several court cases to support his criticism, including the Ultramares Case. According to Mr. Reis, this case established accountants' liability to third parties. Nevertheless "prominent firms of public accountants seem willing to serve the subversive ends of persons who are unquestionably out to 'do' the public".

IX. Unclassified

A. Book: "Are You a Stockholder?", by Alden Winthrop, 1937.

The author was on a crusade for full and clear disclosure in corporate reports to stockholders, and he seemed to blame public accountants more than anyone else for the lack of disclosure he believed necessary.

In one place he stated "if the American Institute of Accountants would only realize it, what is needed is a revolution, a face-about in this staid, ultra-conservative attitude on the part of accountancy, an attitude of righteous independence which will recognize a greater responsibility to stockholders as owners of corporations than to management . . . (the profession) has failed to develop uniform standards of practice which are essential in a business world where corporations have thousands of part owners . . ."

Later in the book he stated that accountants as a class "have little of imagination or vision in their work, little or no conception of the public good, of any change in their relationships to operating management from whom they receive their yearly or monthly stipends, little if any idea of public relationship . . ."

These two quotations are samples of types which abound throughout the book.

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