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## Editorial

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# The JOURNAL of ACCOUNTANCY

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A. P. RICHARDSON, *Editor*

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## EDITORIAL

### The Accountant Is Discovered

Several correspondents have drawn attention to what was described in the daily papers as a speech, delivered by G. A. Van Smith, chairman of the economic council of the California Bankers Association and vice-president of the Anglo and London Paris National Bank, San Francisco. We have received a copy of the *Bulletin* of the California Bankers Association dated June, 1928, from which it appears that this speech was really in the nature of a report. The *Bulletin* from which we quote is doubtless the official publication of the California Bankers Association and what it contains may be regarded as authentic. In introducing the speaker the president said:

"Our very efficient economic council has prepared a report in the form of a discussion on just what does the bank actually get from certificates of certified public accountants. George A. Van Smith will deliver this talk which, I understand, is illustrated. Are you ready, George?"

Then follows a headline which reads, "Report of Economic Council Demands Standardization of Auditors' Certificates." The introduction and the heading give to the statements of the speaker a greater importance than we had at first been inclined to accord them. Some of the daily papers, particularly that kind of paper to which sensationalism is the breath of life, seized avidly the remarks of the orator, and we find such headings as, "Accounting methods flayed," "Bunco audits," "Public accountancy attacked," "Auditing statements not always reliable guides," "Accountants under fire," "San Francisco banker warns against certification." Now that the official copy of the speech or report, or whatever it was, is before us it must be admitted at once that some of the newspapers distorted the speech with that charming disregard of accuracy which characterizes the yellow press. To be brutally frank, when we had read the newspaper reports the incident did not seem to call for consideration. The

name of the speaker was quite unknown to us. If he is a national figure in any sense we had overlooked it, and long experience has taught most of us that it is not necessary to pay much attention to all that is said from every rostrum. Many an orator overstates for sake of effect. He likes to see his audience wriggle with laughter or vexation. The speech which we are now considering seemed like only one more of that great number which may be read and forgotten, or simply forgotten. However, the matter attracted the attention of a good many accountants in California, and, when it was demonstrated that this speech had somewhat the appearance of a report to an important body of bankers, it was lifted above the question of personality, and it demands attention.

### The Value of Ratios

The feeling of amusement with which the speech was first read may yet remain, but coupled with that there is a feeling of regret that one who was addressing a meeting of bankers in an official way should speak without giving evidence of full knowledge. At the outset let us admit that much of what is contained in this report is true. For example, the speaker expressed the opinion that it was a fallacy to depend wholly upon a ratio of two to one between current assets and current liabilities as a basis of credit rating. This may have been an epochal disclosure to the bankers who were at Pasadena, but we doubt it. It is quite a common belief among modern bankers that the two-to-one-ratio theory is far from satisfactory. In this case the speaker discovered a moon in the sky. Accountants and everyone else will agree that it is a moon. The mark against which the report was chiefly aimed was not the fallibility of any theory of ratio. The beast in the jungle was the certified statement of the accountant, and throughout the speech or report, even when ratios are the subject, we catch glimpses of the pursuit of the accountant. For example, near the beginning we find this:

“This report is in no sense designed as academic instruction in credit ethics, practices or deductive methods of solving credit problems by arithmetical formulæ. It is designed to show, by concrete exposition, the frailty of one and the vice of another tenet of credit diagnosis, the development of which in fifteen years has been not unlike the growth of the Arab's camel.”

It is not quite clear whether frailty or vice is the attribute of the certified statement, and we pass over the somewhat mixed rhetoric without comment. But if we may be permitted to

select, let us claim vice for ourselves and say that it applies to the certified statement. In the midst of the discussion of ratios we find:

“The certification of a public accountant may be of exceeding value or it may be a snare and a delusion—a smoke screen behind which are hidden from the banker facts which, if disclosed, would radically modify or terminate his relations with the borrower. The certificate of a licensed accountant is generally as good as it purports to be—and no better. That does not always follow. Frequently it is not nearly so good as it would appear to be.”

This sentence perhaps has some occult meaning, but we can not tell. Suppose for the sake of argument we regard it simply as a flourish of the clairvoyant's hands—for effect upon audience. On the principle of “tu quoque” let us say that the statement of a banker may be of exceeding value or it may be a snare and a delusion—a smoke screen behind which are hidden from the public facts which, if disclosed, would radically modify or terminate its relations with the borrowing company. One likes particularly the statement in this paragraph to the effect that the certificate is as good as it purports to be. We had feared from the context that it was far, far worse.

#### **The Meaning of Qualifications**

Remembering its text the report now reverts to the question of ratios, after which we find that the chase is taken up with renewed ardor. “So much for the ratios. Now let us examine a few ‘audited statements’ and auditors’ certificates.” The report then gives several examples of what are described as good and bad certificates. Every accountant would probably agree with the classification of those described as bad, but there would be a difference of opinion with regard to those described as good. It is the old question of qualifications in certificates, and the speaker showed very clearly that he was not one who would be misled by the specious words of any accountant. He evidently knew how to treat an auditor and no one could pull the wool over his eyes.

#### **Many Bankers Can Read**

Now, quoting again from the report as printed in the *Bulletin* of the California Bankers Association we find:

“And there is the danger sign every banker should see and heed. When you bankers of California accept a statement submitted or signed by an auditor, what responsibility, if any, still attaches to your borrower under your statement statute? Can he exculpate himself behind the auditor and the auditor, in turn, with confident assurance, call your attention to the text of his certificate?”

"We said at the beginning that the certificate of a licensed accountant is generally as good as it purports to be—and no better. If our exhibits have failed to convince you on that score certainly they must have suggested that it were the better part of credit discretion to postpone analysis of the certified statement itself until after an analysis of the certificate—an analysis designed to disclose whether the instrument in hand is submitted as a balance-sheet, a consolidation of figures from books of account, a recording of hearsay or, in fact, a statement of the results of actual audit and comprehending a disclosure of operations for the period.

"If it be any of the former it is, at best, of small worth and properly the object of real concern. If it be the latter it is of the highest value and representative of a service bankers may well encourage and foster."

Precisely—accountants have been preaching for years the necessity for intelligent reading of a certificate. If the certificate disclaims all responsibility and merely reports a transference of figures from books to a balance-sheet, and if the banker regards such a thing as having value, we suggest a course in the meaning of words. The ideal certificate is the unqualified certificate, but we have not yet reached that point of perfection at which the ideal is always the possible. Many business men engage pseudo-accountants to make what someone described as flapdoodle balance-sheets, and some bankers have been foolish enough to mistake flapdoodle for endorsement. But why blame the true accountant because the banker is sometimes blind?

**Behold the Banker Sleeping** But let us return to the text of the report:

"There are many auditors who want to render that kind of service—some who will not render any other kind for submission to banks for credit purposes. The arguments upon which the auditor's report idea has been sold to the American banker are, in their essence, neither original nor complimentary. They are appeals to cowardice and laziness. They promise protection without price and without effort. The potency of those appeals finds proof in the fact that for a decade there has been an ever-increasing number of bankers voicing the virtues of the audited report and sleepily relying upon almost anything that bore the hypnotic symbols 'chartered public accountant'."

Chartered public accountant—Oh, Mr. Van Smith! Or should we say, Oh, gentlemen of the economic council! Why not engage a certified public accountant, which is more American? Or is it possible that you don't know that there is no official class of chartered public accountants in this country? If "the auditor's report idea has been sold to the American banker because he is cowardly and lazy" let us consider for a moment some of those bankers whose cowardice and laziness have helped to make possible the use of certified statements. The letters from which we now quote were written in the year 1913 and published in a

book entitled, *The Influence of Accountants' Certificates on Commercial Credit* by the American Association of Public Accountants, predecessor of the American Institute of Accountants. In addition to those from which we shall quote there were many others, but it occurs to us that perhaps the speaker who is before us may recognize some fairly well known names among those about to be mentioned. Some of the writers have since gone over into the Better Country, but their words remain and their work endures. These letters were written, be it remembered, when accountancy was far from being what it is today. Much has happened in fifteen years and the endorsements of 1913 would certainly be far more emphatic in 1928. David R. Forgan, then president of the National City Bank of Chicago, wrote:

"When we consider that more than half of the loans made by commercial banks are based on the statements of the borrowers, and that the competition between banks themselves, and between banks and commercial paper brokers, is, in ordinary times, very keen, I should think it would be difficult to find a banker who does not approve of the efforts your association is making to have all borrowers' statements certified by public accountants. This is one of those happy cases which combines with the furtherance of your own interests as accountants the purifying and strengthening of the entire system of credits through which nearly all modern business is transacted.

"I hope, therefore, you will continue your good work until it is as common to have borrowers' statements properly certified as it is now to have a title examined before purchasing property."

James G. Cannon, late president of the Fourth National Bank of New York, wrote:

"Referring to your letter of February 20th, respecting the certification of borrowers' statements by public accountants, we strongly advocate and prefer to buy the paper of those concerns whose accounts are audited by established firms of accountants.

"We find that where this is required the suggestion is generally well accepted and acted upon.

"It is difficult to state to what extent borrowers voluntarily submit certified statements, but a large number of statements received are certified, and the percentage is constantly increasing.

"The matter of certification or non-certification has not reached a point with us where it affects the rates charged.

"The question of increase or decrease in the proportion of certified statements of borrowers is covered, we think, by our statement that the percentage is constantly increasing.

"It is our belief that the time is not far distant when the demand for an audit of all statements by certified public accountants of established reputation will be practically universal."

Joseph T. Talbert, vice-president of the National City Bank of New York, wrote:

"We prefer, in all cases, to have certified statements, but only insist upon it in cases where we feel the indebtedness is becoming disproportionately heavy or we have reason to suspect some irregularity. In all such cases we do insist."

*Editorial*

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Festus J. Wade, president of the Mercantile Trust Company of St. Louis, wrote:

"I am most heartily in favor of all firms and corporations that borrow without collateral filing with banks and trust companies from which they borrow statements of their business certified to by public accountants.

"We have several customers of that kind now, and not only feel more comfortable with their business but actually do give them a larger ratio of credit and better rate of discount by reason of the fact that we know their statement is unquestionably true.

"Every bank and trust company of the country is obliged to undergo expert examination at least once (and in many instances three times) each year. Their officers are obliged to make sworn affidavit of the correctness of the statement, the banking laws making it a penal offense if they swear falsely.

"Why should not the banking fraternity not only expect, but exact and demand, the same examination of those to whom they lend their money without collateral?

"I hope you will push the good work until it becomes the universal custom of all borrowers, large or small, to have their books and accounts examined and certified to by public accountants."

James B. Forgan, president of the First National Bank of Chicago, wrote:

"The movement among bankers to encourage, if not demand, that statements made by borrowers as a basis of credit should be verified by an audit of their books and certified by public accountants has my heartiest sympathy and support.

"No longer is it regarded as discreditable, but the reverse, to furnish such statements. Many of our best borrowers voluntarily supply them, and their number is constantly increasing. For their own protection and satisfaction they regard an annual audit necessary, and the certified balance-sheet furnished their bankers becomes a source of pride to them."

E. W. Decker, president of the Northwestern National Bank of Minneapolis, wrote:

"Replying to your favor of May 29th, will say that I am a firm believer in the audit by certified public accountants of books and business of borrowers, whether paper is taken direct by the bank or through brokers. Of course, this check is not absolute, but it is an additional safeguard to the lenders of money. This practice is generally followed here with very general satisfaction."

Before the book from which we have been quoting was published, 844 bankers had responded to a questionnaire sent out by the American Association of Public Accountants. These questionnaires asked for the personal opinion of the presidents of the banks with reference to the desirability of certified statements. The replies were classified as follows:

Strongly in favor . . . . .	121
Favorable . . . . .	501
Opposed . . . . .	15
Strongly opposed . . . . .	5
Non-committal . . . . .	202

**There is an Honest  
Accountant**

While reviewing the testimony given by bankers we had almost forgotten the cause of this research. But let us return. We quote again from the report of the economic council of the California Bankers Association, Van Smith loquitur:

"A revulsion has set in. There is no disposition on the part of thinking bankers today to decry the value of genuine audits or the work of accountants who are conscious of their ethical obligations. There is, however, a general awakening to an uncomfortable realization of the fact that they have been properly goldbricked.

"We have been told that the American Bankers Association will take formal cognizance of the evil at its ensuing convention. We believe that the California Bankers Association should, at this meeting, not only sound a warning to its members but formulate and enunciate a policy which shall set definite standards of acceptability for certified public accountants' certificates and statements and which shall be a declaration of a war for the extermination of the bunco audit."

This extract from the report makes good what might have seemed to some readers an omission. One sees that there is no disposition on the part of thinking bankers to "decry the value of genuine audits or the work of accountants who are conscious of their ethical obligations." It seemed for a little while that this might be overlooked. When the smoke of battle had drifted away the bankers, at Pasadena assembled, passed the resolution which follows:

"*Resolved*, That while this association fully appreciates the value of the service the public accountants render in the preparation of financial statements for clients employing bank credit, it also recognizes and deprecates what seems to be a growing tendency on the part of some accountants to ignore or evade any ethical obligations to the lending banks. It warns its members of the dangers inherent in qualified certifications and calls upon the public accountants of California to set and adhere to unequivocal standards of practice in their certificates. Further, it recommends that the president of this association, acting with either the economic council or the executive council, should seek to procure from the organized accountants of this state an agreement upon standards of practice which shall be satisfactory to the banking interests."

The text of the resolution is much less subject to adverse comment. Of course, we all know that there are accountants whose work may be described in the vernacular as rotten. That is one reason why it is necessary to have an American Institute of Accountants and certified public accountant laws and other preventive measures.

**A Word on  
Criticism**

As we have said, this whole incident would not have been worthy of consideration had it not been for the fact that it assumed the nature of a report by a committee to an important group of bankers. But criticism is always a risky thing. No



doubt the speaker, whose remarks we are now considering, is quite familiar with the writings of Matthew Arnold—every critic should be—but we crave forgiveness while we quote a paragraph or two which seem to us apropos:

“Sometimes, no doubt for the sake of establishing an author’s place in literature, and his relation to a central standard (and if this is not done, how are we to get at our *best in the world?*) criticism may have to deal with a subject matter so familiar that fresh knowledge is out of the question, and then it must be all judgment: an enunciation and detailed application of principles. Here the great safeguard is never to let oneself become abstract, always to retain an intimate and lively consciousness of the truth of what one is saying, and, the moment this fails us, to be sure that something is wrong. Still, under all circumstances, this mere judgment and application of principles is, in itself, not the most satisfactory work to the critic; like mathematics, it is tautological, and cannot well give us, like fresh learning, the sense of creative activity. To have this sense is, as I said at the beginning, the great happiness and the great proof of being alive, and it is not denied to criticism to have it; but then criticism must be sincere, simple, flexible, ardent, ever widening its knowledge. Then it may have, in no contemptible measure, a joyful sense of creative activity; a sense which a man of insight and conscience will prefer to what he might derive from a poor, starved, fragmentary, inadequate creation.”

Of course, one may differ from Mr. Arnold, but there are some of us who still think that truth is a desirable adjunct to criticism. Some might go so far as to say that criticism should be all truth. This is not to infer that Mr. Van Smith or the council for which he purported to speak did not mean well. No doubt he or it did. And indeed accountants have often presented statements which told the truth misleadingly. It is wretched stuff when one tells half the truth or makes a statement which may have two meanings.

“If, with intent to lead the plaintiff to act upon it, they put forth a statement which they know may bear two meanings, one of which is false to their knowledge, and thereby the plaintiff putting that meaning on it is misled, I do not think they can escape by saying he ought to have put the other. If they palter with him in a double sense, it may be they lie like truth; but I think they lie, and it is a fraud. Indeed, as a question of casuistry, I am inclined to think the fraud is aggravated by a shabby attempt to get the benefit of a fraud without incurring the responsibility.”

This is a quotation from a judgment of the celebrated Justice Blackburn of England. Telling part of the truth or truth in a double-faced way is always a bit dangerous. A wise banker should know this. Had the speaker or the report affirmed that a great majority of accountants are honest, upright, capable; that the banker or any other client can distinguish between the good and the bad; had it affirmed that a few accountants are crooks but not that the profession as a whole is crooked, the allegations would not have fallen under imputation of malice or ignorance. But the report takes a part of the truth and magnifies it until it

obscures the whole landscape. It is rather a pity that it does this. The report might have made a very telling assault on the practice of incompetent accountants and it would have achieved as much publicity without peril of refutation. It seems unfortunate when an opportunity to do some very good work is allowed to pass. The incident will not do any great harm. An intelligent banker will not be misled, and those who know the facts will not believe that every accountant is not worthy or that most statements are false—but we repeat, it is rather a pity.

**Assistance is Always  
Acceptable**

The Pasadena incident serves one useful purpose, however, in that it provides a text upon which any accountant can construct a powerful argument for himself and his clients. There has been such a sad prevalence of attack on the accountant that one wearies of it. Like bobbed hair and the meretricious lipstick it will pass. The mischief of it is that the public makes possible the activities and evils of the incompetent. There are crooked lawyers, grafting politicians, false engineers, lying accountants and what not. Most of them continue because they serve a public which has something to gain from their moral obliquity. We all, or almost all, join in the chorus of wrath against the incompetence of some legislators. Yet when the elections come again we put the same sort back in office. So the public complains because the lawyer is venal or the accountant lies, when it—the public—is too lazy or indifferent to separate the professional sheep from the goats. Accountants are much concerned about the unworthiness of some who call themselves accountants. It is more important to them than to anyone else to eradicate incompetence and malfeasance. The intelligent bankers of the country know that accountants, lawyers, engineers and all the other professions which have direct contact with business are busily housecleaning year by year. The professions know that bankers have a long task of sweeping and garnishing to accomplish before the inside of the bank will be as fair to look upon as is the outside. Bankers can be trusted to do the job quite thoroughly. Each profession can be trusted to take care of itself. But there are many things that all workers in the vineyards of business can do to make lighter and more effective the labors of others. Assistance is always welcome.