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The Accountant's Certificate in Connection with the Accountant's Responsibility*

BY SIR WILLIAM PLENDER

The subject upon which I have been asked to address you at this conference is comprehensive in scope and character. The duties undertaken by the professional accountant in Great Britain today cover a wide field and are of varied nature, but it is true to say that to a very considerable extent the result of the accountant's work is embodied, and finds its expression, in the form of a report or certificate. Indeed, if any evidence were required of the extent to which the investing public and business community associate the accountant's duties with his report or certificate, it is to be found in the frequent use and acceptance of the phrase "the accountant's certificate," as indicating the bona fides of figures which the accountant has reported upon or certified, or in respect of which his investigation and confirmation are desired.

A clear conception by accountants of their duties and responsibilities in connection with certificates issued by them is thus of vital importance. An exhaustive treatise dealing with the matter in all its aspects would occupy much more time than has been allotted to me and occupy more space in your transactions than can be spared; neither do I imagine you would wish me to enter upon a detailed dissertation on the many and varied circumstances leading up to the issue of certificates. I therefore propose, in my remarks, to deal with the subject broadly and in general outline, in such a manner as to indicate the fundamental principles which every accountant should bear in mind, when called upon in the exercise of his professional duties to prepare and attach his signature to a certificate.

In Great Britain the profession of an accountant is not exercisable under any legal enactment, and the accountant has, therefore, no legal status in the same way as a lawyer. So far as I know, no country has accorded the profession legislative sanction as such. The practice of the profession of an accountant by members of recognized bodies with disciplinary powers has, however, long been accepted and regarded in Great Britain by the courts and the business community as one of high standing and

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responsibility. Neither do the duties or responsibilities of accountants as such form the subject of any act of parliament. It has, however, become necessary from time to time for the courts to consider the question of the duties and responsibilities of accountants, and the judgments given in cases which have been adjudicated upon are available as a source of information and guidance. But whilst the accountant must have regard, for his own protection, to the legal aspect of his duties and responsibilities, no such limitation should be permitted to lessen the duty prescribed by a code of professional honor which he owes not only to his client but to the public, to the profession and to his own reputation. And perhaps in no other circumstances is a due sense of this moral duty and responsibility required in such high degree as when the accountant is engaged in framing a certificate.

Having thus briefly defined the sense in which I speak of the accountant, it is necessary to consider the various forms of certificates which accountants are called upon to give. Broadly, these certificates may be said to fall under two heads, namely:

- (a) Those given in accordance with statutory requirements; and
- (b) Other certificates.

The former in the main comprise certificates or reports by accountants as auditors of public and other companies. Amongst the latter may be cited those given in connection with:

- (1) Raising share and debenture capital by means of a prospectus or otherwise.
- (2) Absorption or amalgamation of companies or firms.
- (3) Trade agreements between groups of companies for sharing profits or losses upon a specified basis.
- (4) Determination of profits available for defined purposes, such as sums payable to different classes of share or debenture holders; management commission; profit-sharing schemes, etc.
- (5) Expenditure upon contracts.
- (6) "Fair value" of shares under terms of articles of association and valuation of shares for purpose of assessment to death duties.
- (7) Ascertainment of relative shares of capital and labor in profits of an industry under joint agreement.

The instances I have noted by way of example, whilst including some of the more important circumstances in which certificates are

frequently given, are by no means exhaustive. Other illustrations could be furnished, but it seems unnecessary for my present purpose to add to the list.

Whilst the same standard of duty and conduct should be observed, and the highest degree of proficiency exercised in the preparation of all certificates, the measure of the accountant's responsibility varies considerably and is dependent upon a combination of factors and circumstances. As exemplifying cases, to which the heaviest responsibility attaches, I propose in this paper to consider and deal with two classes of certificates well known to the general public in Great Britain, namely, certificates given by the accountant qua auditor in fulfilment of statutory requirements under the companies (consolidation) act, 1908, and certificates appearing in prospectuses inviting public subscription to issues of share and debenture capital. And as both these certificates have relation to the affairs of joint-stock companies, it may not be inappropriate at this stage if I refer briefly to the radical change which has taken place during the last 50 years in the financial structure of industry.

This transformation is chiefly apparent in the aggregation and transference of immense amounts of capital from the hands of individuals to joint-stock undertakings administered under boards of directors. The following figures extracted from the last published return of the British board of trade, dealing with the affairs of limited liability companies in Great Britain, show the rapid development and expansion of joint-stock enterprise:

Year	Number of limited liability companies	Total paid-up share capital
1885.....	8,924	£482,000,000
1895.....	18,607	£1,037,000,000
1905.....	38,317	£1,912,000,000
1915.....	63,969	£2,606,000,000
1924.....	90,918	£4,356,000,000

The figures quoted are exclusive of capital—running into many hundreds of millions of pounds—embarked in what are known as parliamentary or statutory companies incorporated under special acts of parliament, mainly of a public-utility character such as railways, canals, and gas and water undertakings. No official statistics are available of the aggregate amount of debenture capital raised and employed by joint-stock companies or of the accumulations of undistributed profits retained as free reserves or otherwise, but the combined amount thereof must be

very considerable. And apart from permanent share capital, free reserves and debenture capital—either irredeemable or of fixed maturity—financial obligations to creditors are contracted in the ordinary course of trade in respect of which vast sums are owing at any given date. These facts sufficiently indicate the importance of the financial interests of shareholders and creditors and the responsibilities involved in the administration of joint-stock enterprises. The part played by the accountant in the capacity of auditor and expert financial advisor has materially contributed to the growth and present standing of the profession as carried on today in Great Britain, and the position the accountant has thus attained in the public confidence, whilst enhancing his authority, has also widened his responsibilities.

Compulsory audit of the accounts of limited companies—other than banks—was not imposed by the legislature until the year 1900, but the appointment of auditors under a company's own regulations (articles of association) was customary and regarded as an essential safeguard by the majority of reputable public companies before that date. The statutory obligation requiring the appointment of auditors in the case of all registered companies was first contained in the companies act, 1900, and the duties of the auditor were therein laid down in the following terms:

Every auditor of a company shall have a right of access at all times to the books and accounts, and vouchers of the company, and shall be entitled to require from the directors and officers of the company such information and explanation as may be necessary for the performance of the duties of the auditors; and the auditors shall sign a certificate at the foot of the balance-sheet, stating whether or not all their requirements as auditors have been complied with, and shall make a report to the shareholders on the accounts examined by them, and on every balance-sheet laid before the company in general meeting during their tenure of office, and in every such report shall state whether in their opinion the balance-sheet referred to in the report is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs as shown by the books of the company, and such report shall be read before the company in general meeting.

In practice the certificate and report of the auditor became merged and, subject to reservations and enlargements as circumstances required or justified, usually appeared as one document at the foot of the balance-sheet in the following general terms:

“In accordance with the provisions of the companies act, 1900, I certify that all my requirements as auditor have been complied with, and I report to the shareholders that I have audited the books of the company, and in my opinion the balance-sheet is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs as shown by the books of the company.”

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The distinction between the auditor's "certificate" and "report" thus became more apparent than real; and although in the section of the companies (consolidation) act, 1908, which now governs the duties of auditors the word "certificate" has entirely disappeared and the auditor's report alone is mentioned, the habit previously acquired of referring to the auditor's certificate still largely obtains.

The statutory rights and duties of auditors of limited companies are now embodied in the companies (consolidation) act, 1908—an act, as its title implies, consolidating and codifying previous legislation—as under:

113. (1) Every auditor of a company shall have a right of access at all times to the books and accounts and vouchers of the company, and shall be entitled to require from the directors and officers of the company such information and explanation as may be necessary for the performance of the duties of the auditors.

(2) The auditors shall make a report to the shareholders on the accounts examined by them, and on every balance-sheet laid before the company in general meeting during their tenure of office, and the report shall state—

- (a) whether or not they have obtained all the information and explanations they have required; and
- (b) whether, in their opinion, the balance-sheet referred to in the report is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs according to the best of their information and the explanations given to them, and as shown by the books of the company.

(3) . . . the auditor's report shall be attached to the balance-sheet, or there shall be inserted at the foot of the balance-sheet a reference to the report, and the report shall be read before the company in general meeting, and shall be open to inspection by any shareholder.

It is the exception, rather than the rule, for the auditor's report to constitute a separate document apart from that appended to the balance-sheet, and the form in which the report is most frequently framed follows closely the wording of the act. When the auditor is satisfied as a result of his examination that there are no exceptional or special circumstances to which the attention of the shareholders need be directed, he gives an unqualified report usually in the following terms:

"I have audited the above balance-sheet and have obtained all the information and explanations I have required. In my opinion such balance-sheet is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs according to the best of my information and the explanations given to me and as shown by the books of the company."

No attempt has been made in the act—nor, indeed, would it be possible in the varying circumstances and conditions under which business is carried on—to define even in general terms the extent or limits of the auditor's duty. The legislature has

placed at the disposal of the auditor simple and adequate means of inquiry to supplement the direct evidence afforded by the books and accounts and has not restricted in any way the scope of his report. It is thus left to the auditor himself, with his professional training and experience, to determine both the extent of his examination and the nature of his report by reference to the necessities of each particular case. The general principles which, according to legal interpretation, the auditor should bear in mind and follow, have been enumerated with great distinctness by the British courts in three well known and familiar cases in which auditors were accused of neglect in the performance of their duties, and the judgments delivered may be summarized thus:

(a) An auditor is guilty of misfeasance (that is, breach of duty) who, when dissatisfied with the accounts of a company, does not plainly draw attention to the grounds for his dissatisfaction in his report (the case of the *London and General Bank, Ltd.*).

(b) An auditor is not guilty of breach of duty who, in the absence of suspicious circumstances, relies upon statements made by trusted officers of a company (the case of the *Kingston Cotton Mills Co., Ltd.*).

(c) An auditor is liable if falsification in the accounts of a company might have been discovered by the exercise of reasonable care and skill (the case of the *Irish Woollen Co., Ltd. v. Tyson and others.*)

Widely as individual circumstances may differ in practice, the measure of the auditor's legal responsibility in connection with his certificate may be said to rest upon the practical interpretation of these three decisions. I therefore propose to examine the principles applied by the court in determining whether an auditor has properly fulfilled his statutory duties.

The development of the office of auditor is a natural corollary to the expansion of joint-stock enterprise, and although he is appointed by and reports to the shareholders as a body, the nature and object of the office involve in special degree a duty to the shareholders concerned solely as investors as distinct from shareholders engaged in the management and direction, i. e., directors. This distinction has been recognized judicially in the following words:

“Possibly he” (the auditor) “did not realize the extent of his duty to the shareholders, as distinguished from the directors, and he unfortunately

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consented to leave the chairman to explain the true state of the company to the shareholders instead of doing so himself. . . . It is impossible to read . . . the companies act . . . without being struck with the importance of the enactment that the auditors are to be appointed by the shareholders, and are to report to them directly, and not to or through the directors. The object of this enactment is obvious. It evidently is to secure to the shareholders independent and reliable information respecting the true financial position of the company at the time of the audit." (*Re London and General Bank, Ltd.*)

The object of the audit is thus defined in judicial language, and the view expressed may be regarded as an adequate and clear interpretation of the intention underlying the statutory requirements. These requirements involve two essential and interdependent assumptions. First the exercise of independent judgment as conveyed by the words "in my opinion," and, secondly, the possession of a high degree of professional skill and ability in ascertaining the facts justifying the opinion expressed that the balance-sheet is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs according to the best of the information and explanations given to the auditor and as shown by the books of the company. As will be seen hereafter, the protection afforded to the auditor by the use of the phrases "in my opinion" and "according to the best of my information and the explanations given to me and as shown by the books of the company," is dependent upon his own professional efficiency and the extent of his examination and inquiries. Nor would it be in the best interests of the profession to avoid responsibility—either legal or moral—by attaching a too literal meaning to the words I have quoted.

As exemplifying the scope and limits in law of the auditor's duties and responsibilities, the judges have laid down the following dicta, which for convenience I have arranged under four headings:

- (1) The general nature of the auditor's duties.
- (2) The scope of the auditor's investigation and inquiries.
- (3) Limitations of the auditor's responsibilities.
- (4) Considerations affecting the auditor's report.

I am led to give in some detail the views of British judges which bear on an auditor's duties and responsibilities as my audience here may not be so familiar with them as would be the case with an audience exclusively British. But their value is to no small extent international.

(1) THE GENERAL NATURE OF THE AUDITOR'S DUTIES

"His business is to ascertain and state the true financial position of the company at the time of the audit, and his duty is confined to that. But then comes the question, How is he to ascertain that position? The answer is, By examining the books of the company. But he does not discharge his duty by doing this without inquiry and without taking any trouble to see that the books of the company themselves show the company's true position. He must take reasonable care to ascertain that they do. Unless he does this his audit would be worse than an idle farce. . . . His first duty is to examine the books not merely for the purpose of ascertaining what they do show but also for the purpose of satisfying himself that they show the true financial position of the company." (*Re London and General Bank, Ltd.*)

"The words 'as shown by the books of the company' seem to me to be introduced to relieve the auditors from any responsibility as to the affairs of the company kept out of the books and concealed from them but not to confine it to a mere statement of the correspondence of the balance-sheet with the entries in the books." (*Re London and General Bank, Ltd.*)

"Auditors of a limited company are bound to know or make themselves acquainted with their duties under the articles of the company whose accounts they are appointed to audit and under the companies acts for the time being in force." (*Re Republic of Bolivia Exploration Syndicate, Ltd.*)

"That it is the duty of a company's auditor in general to satisfy himself that the securities of the company in fact exist and are in safe custody, can not, I think, be gainsaid. . . . An auditor is not, in my judgment, ever justified in omitting to make personal inspection of securities that are in the custody of a person or company with whom it is not proper that they should be left. . . . The duty of the auditor is to verify the facts which it is proposed to state in the balance-sheet, and in doing so to use reasonable and ordinary skill." (*Re City Equitable Fire Insurance Co., Ltd.*)

(2) THE SCOPE OF THE AUDITOR'S INVESTIGATION AND INQUIRIES

"An auditor, however, is not bound to do more than exercise reasonable care and skill in making inquiries and investigations. . . . What is reasonable care in any particular case must depend upon the circumstances of that case. Where there is nothing to excite suspicion very little inquiry will be reasonably sufficient; and in practice I believe business men select a few cases haphazard, see that they are right, and assume that others like them are correct also. When suspicion is aroused more care is obviously necessary; but still, an auditor is not bound to exercise more than reasonable care and skill even in a case of suspicion." (*Re London and General Bank, Ltd.*)

"An auditor is not bound to be a detective or . . . to approach his work with suspicion or with a foregone conclusion that there is something wrong. He is a watch-dog but not a bloodhound. He is justified in believing tried servants of the company in whom confidence is placed by the company. He is entitled to assume that they are honest and to rely upon their representations provided he takes reasonable care. If there is anything calculated to excite suspicion he should probe it to the bottom, but in the absence of anything of that kind he is only bound to be reasonably cautious and careful. The duties of auditors must not be rendered too onerous. Their work is responsible and laborious and the remuneration moderate." (*Re Kingston Cotton Mill Co., Ltd.*)

"The duty of an auditor is verification and not detection . . . it is for the auditor to use his discretion and his judgment and his discrimination as to whom he shall trust; indeed, that is the right way to put a greater responsibility on the auditors. . . . I throw a burden upon him in respect of which the test of common sense and business habits can be applied rather than impose on him a rigid rule which is not based on any principle either of business or common sense. . . . In my opinion it would not be right that auditors should deliberately adopt a standard of verification

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below the ordinary standard because the persons with whom they are dealing are persons of specially high reputation." (*Re City Equitable Fire Insurance Co., Ltd.*)

"The auditor can not shelter himself from any breach of duty under the neglect of the directors; he is there to do his duty to the company." (*London Oil Storage Co., Ltd. v. Seear, Hasluck & Co.*)

(3) LIMITATIONS OF THE AUDITOR'S RESPONSIBILITIES

"It is no part of an auditor's duty to give advice either to directors or shareholders as to what they ought to do. An auditor has nothing to do with the prudence or imprudence of making loans with or without security. It is nothing to him whether the business of a company is being conducted prudently or imprudently, profitably or unprofitably; it is nothing to him whether dividends are properly or improperly declared provided he discharges his own duty to the shareholders. . . . He is not an insurer; he does not guarantee that the books do correctly show the true position of a company's affairs; he does not even guarantee that his balance-sheet is accurate according to the books of the company. If he did he would be responsible for an error on his part even if he were himself deceived, without any want of reasonable care on his part—say by the fraudulent concealment of a book from him. His obligation is not so onerous as this. He is perfectly justified in acting on the opinion of an expert where special knowledge is required." (*Re London and General Bank, Ltd.*)

"It is no part of an auditor's duty to take stock. . . . He must rely on other people for details of the stock-in-trade on hand. Auditors must not be made liable for not tracking out ingenious and carefully laid schemes of fraud when there is nothing to arouse their suspicion and when those frauds are perpetrated by tried servants of the company and are undetected for years by the directors. So to hold would make the position of an auditor intolerable." (*Re Kingston Cotton Mill Co., Ltd.*)

(4) CONSIDERATIONS AFFECTING THE AUDITOR'S REPORT

"He must be honest—that is, he must not certify what he does not believe to be true and he must take reasonable care and skill before he believes that what he certifies is true. . . . A person whose duty it is to convey information to others does not discharge that duty by simply giving them so much information as is calculated to induce them or some of them to ask for more. Information and means of information are by no means equivalent terms. An auditor who gives shareholders means of information instead of information respecting a company's financial position does so at his peril and runs the very serious risk of being held judicially to have failed to discharge his duty. Still, there may be circumstances under which information given in the shape of a printed document circulated amongst a large body of shareholders, would by its consequent publicity be very injurious to their interests and in such a case I am not prepared to say that an auditor would fail to discharge his duty if instead of publishing his report in such a way as to insure publicity he made a confidential report to the shareholders and invited their attention to it and told them where they could see it." (*Re London and General Bank, Ltd.*)

"In reporting upon the accounts submitted to them the auditors do not, of course, report as to the details of accounts to which they find no cause to take exception. Their duty is to call attention to that which is wrong, not to condescend upon all the details of that which is right. . . . Those who are engaged in commerce are familiar with the fact that undue publicity as regards the details of their trade or as to their financial arrangements may often be very injurious to traders having regard to the rivalry of competitors in trade, to complications sometimes arising from strained relations between capital and labor and the like. There are legitimate reasons for ensuring secrecy to a proper extent. It is not, I think, necessary, nor having regard to the great utility of these acts, is it desirable to expose persons who trade under these acts to the necessities of a publicity

from which their competitors are free unless such publicity is required to insure commercial integrity." (*Newton v. Birmingham Small Arms Co., Ltd.*)

"When it is shown that audited balance-sheets do not show the true financial condition of the company and that damage has resulted the onus is on the auditors to show that this is not the result of any breach of duty on their part." (*Re Republic of Bolivia Exploration Syndicate, Ltd.*)

That the practical application of these principles is frequently a task of great difficulty is self-evident from the language used, and recognition of this fact has been expressed by the courts in more than one case as the following extracts taken from the remarks of the judges will show:

"It is quite easy to lay down to you in general terms what the duty of an auditor is; it is very much more difficult . . . to apply that duty to the particular case." (*London Oil Storage Co., Ltd. v. Seear, Hasluck & Co.*)

"They (the auditors) had to exhibit a standard of professional skill, and if they did not come up to that standard that was for the judge or jury . . . to say and that was always a difficult matter to try." (*Arthur E. Green & Co. v. The Central Advance & Discount Corporation, Ltd.*)

A dishonest auditor renders himself liable to prosecution under criminal law for wilfully making a statement knowing it to be false in any material particular. Proceedings may be brought against him:

(a) Under section 281 of the companies (consolidation) act, 1908, which reads:

If any person in any return, report, certificate, balance-sheet, or other document required by or for the purposes of any of the provisions of this act specified in the fifth schedule hereto, wilfully makes a statement false in any material particular knowing it to be false, he shall be guilty of a misdemeanor, and shall be liable on conviction on indictment to imprisonment for a term not exceeding two years, with or without hard labor, and on summary conviction to imprisonment for a term not exceeding four months, with or without hard labor, and in either case to a fine in lieu of or in addition to such imprisonment as aforesaid:

Provided that the fine imposed on summary conviction shall not exceed one hundred pounds.

(b) Under section 84 of the larceny act, 1861, which enacts:

Whosoever, being a director, manager or public officer of any body corporate or public company, shall make, circulate or publish, or concur in making, circulating, or publishing, any written statement or account which he shall know to be false in any material particular, with intent to deceive or defraud any member, shareholder, or creditor of such body corporate or public company, or with intent to induce any person to become a shareholder or partner therein, or to entrust or advance any property to such body corporate or public company, or to enter into any security for the benefit thereof, shall be guilty of a misdemeanor, and being convicted thereof shall be liable at the discretion of the court to any of the punishments which the court may award as hereinbefore last mentioned.

In this paper, however, I am concerned only with the penalties to which the auditor is exposed in civil proceedings by reason of errors of omission or commission amounting to breach of duty on

his part. Such proceedings may be brought (1) under common law on the ground of negligence for which every agent is liable through lack of reasonable care or diligence, or (2) when a company is being wound up by way of misfeasance summons, under section 215 of the companies (consolidation) act, 1908, which enacts:

(1) Where in the course of winding up a company it appears that any person who has taken part in the formation or promotion of the company, or any past or present director, manager or liquidator, or any officer of the company has misapplied or retained or become liable or accountable for any money or property of the company, or been guilty of any misfeasance or breach of trust in relation to the company the court may, on the application of the official receiver, or of the liquidator, or of any creditor or contributory, examine into the conduct of the promoter, director, manager, liquidator, or officer and compel him to repay or restore the money or property or any part thereof respectively with interest at such rate as the court thinks just or to contribute such sum to the assets of the company by way of compensation in respect of the misapplication retainer, misfeasance or breach of trust as the court thinks just.

The section shall apply notwithstanding that the offense is one for which the offender may be criminally responsible.

It is interesting to note the views of one of the lords of appeal upon the terms of section 165 of the companies act of 1862, which corresponds in almost precise words with the section of the act of 1908 which I have just quoted. He says:

“That section creates no new offense, and it gives no new rights, but only provides a summary and efficient remedy in respect of rights which apart from that section might have been vindicated either at law or in equity. It has also been settled that the misfeasance spoken of in that section is not misfeasance in the abstract, but misfeasance in the nature of a breach of trust resulting in a loss to the company.” (*Bentinck v. Fenn.*)

The measure of the auditor's responsibility under the above section is, therefore, the loss sustained by the company—direct or consequential—due to failure on his part to point out a state of affairs the disclosure of which would have either prevented the initiation of a wrongful or mistaken course of action or conduct or have resulted in its discovery and discontinuance.

(To be concluded)