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## Accountancy and the Tax Problem\*

BY J. PERCY GODDARD

It is necessary that the principles and methods which make for success in private business be more generally adopted in public affairs. For some reason the idea seems to be prevalent that public business is something different from private business and particularly that wholly different methods of accounting are required in public offices. The absurdity of this idea will be apparent if we consider the activities carried on by municipalities which are also conducted as private enterprises. Examples are found in the building and maintenance of roads, the construction and maintenance of office buildings and of water systems, together with the operation of schools, hospitals, electric plants and automobile repair shops.

On this question the following pertinent statements are contained in a *Handbook of Municipal Accounting* prepared by the bureau of municipal research of New York.

The citizen and the officer of the public corporation are entitled to the same completeness, the same accuracy, the same lucidness of statement about public affairs as are the shareholder and officer of the private enterprise. In each case the persons to whom the facts are to be made known are those who hold a beneficial interest or a position of trust and responsibility.

The historic reason for the statement that the accounting of a city is "entirely different" from that of a private corporation is this: that heretofore few cities have maintained any accounts other than those which are required in order to keep the officer out of jail. Practically no accounts have been kept pertaining to subjects in which the officer as administrator and the citizen as beneficiary are interested. Few cities have kept accounts of property, stores, equipment. Few cities have a complete account of their liabilities. Few cities keep operation or cost accounts. Few cities attempt to keep operating data which will enable the citizen or the officer to know what results are being obtained or to obtain information by means of which the efficiency or economy of management may be measured. For this reason many persons who have grown up in the municipal service have thought that the occupation of the municipal bookkeeper has nothing in common with what has been too often called "commercial bookkeeping." The fact is that everything of interest to the community has been left out of the picture.

It is certain that no private business in these days of keen competition could possibly succeed with as imperfect and inadequate records as those kept by most of our municipalities. Some of the

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loose and unbusiness-like methods which I shall describe will probably seem so crude that many will find it difficult to believe that they are common, but my experience of thirteen years in the public-accounting field convinces me that such conditions are more nearly the rule than the exception, and I have good reasons to believe that our conditions in Utah are not one whit worse than in other states.

Executive and administrative officers are often themselves misled by untruthful statements furnished as a result of faulty accounting methods and the taxpayer who places reliance thereon is also misled.

A few years ago an outgoing administration in one of our larger counties published a financial statement showing a small operating balance on hand at the close of the year and I have no doubt that the outgoing officers congratulated themselves upon the showing. The actual condition, later revealed through an audit of the accounts, was an operating deficit of over \$300,000.

The system employed had been the common one of taking no obligations into the records until they were paid; consequently it developed that there was outstanding indebtedness incurred but not set up on the books amounting to about \$200,000. This amount became a disbursement of the incoming administration. Committees of taxpayers must be careful to take conditions like this into account in making comparisons.

It was further found to have been the custom of the county to take into its revenue account not only the amount actually received, but to include therein the amount estimated to be realizable from taxation and other sources. In this case more than \$100,000 of uncollectible revenue had been taken on to the records and the amount had already been spent. The setting up of the liabilities and the writing off of the uncollectible receivables, of course, resulted in showing a deficit of over \$300,000.

The next administration adopting different methods appeared to have run the county far into the hole, whereas it merely inherited the condition from its predecessors. Figures published for political effect are often very misleading because of such inaccuracies in the accounts.

Again, municipal financial statements are sometimes misleading in that amounts which should be set up as separate trust funds, reserved for specific purposes, are included with operating-fund balances. The result is misleading in that a much better financial

condition of operating funds is made to appear than would be shown by a correct statement.

Attempted comparisons in receipts and expenditures as between years or administrations, or as between municipalities of the same class, are often rendered valueless, if not altogether misleading, by variations in the classification or grouping of items. Standard and uniform classifications in accounts are of utmost importance to any individual or body of citizens that undertakes a study of public finances, yet such standard and uniform classifications are woefully uncommon.

It is obvious that only like things can be properly compared and yet when making comparisons of published municipal reports because of lack of uniformity of classification we are seldom comparing like things.

Two publications in our state commented on a marked contrast in the per-capita operating costs of two out-county school districts. The one was praised for its economy; the other criticised for apparent extravagance. It later developed that the high district had been carrying out a much needed building programme and the cost of new buildings had been erroneously included in operating costs. If the same methods are followed, this year is likely to show a reversal in the relative expenditures of these two districts. This sort of failure to differentiate between investments in buildings and equipment and strictly operating and maintenance costs is a very common defect in public accounts.

Not only are municipal accounts frequently misleading to administrative officers and taxpayers, but they are frequently almost valueless as a guide to budget construction on account of inadequate or improper classification of revenue and expense. The records of revenues and expenses of past years should be of great importance in determining future requirements, but if the accounts are not thoroughly classified and departmentalized they are of little use for this purpose.

However, the most important evil and danger in the lax and slipshod accounting and in the unbusiness-like methods employed in many public offices is that they invite the embezzlement of public moneys and other property and, consequently, loss to the taxpayer. Few people realize the astonishing proportions to which this class of crime has grown in our country during the past few years. The most trustworthy estimates available conserva-

tively place the annual losses from embezzlements and forgeries in the United States at \$200,000,000.

There is no greater social problem confronting the people of our country today than that created by the increasing crime tendency, but our attention is largely attracted to the more spectacular forms of crime often characterized by violence, and the frequency of crimes within the ranks of those engaged in public and private business is not often brought home to us.

Fidelity-insurance premiums paid in 1923 were practically three times what they were in 1917 and losses paid were practically four times in 1923 what they were in 1917. One large surety company reports under date of June 16, 1924, that it "is today handling twenty-five fresh defalcations every working day as against thirteen two years ago." B. J. McGinn, manager of the claim department of the American Surety Co., recently declared that according to the statistics of his company "there are more defalcations at the present time than at any other time in the history of the company, dating back over a generation."

From a recent publication of the American Institute of Accountants I quote:

An abnormal crime tendency undoubtedly exists—a tendency which imposes stupendous and unnecessary losses upon the producing members of the community and which strikes at the very foundations of society. Every right-thinking citizen, particularly every citizen who is technically trained with respect to financial affairs, should immediately do what he can to stem the rising tide of crime.

I have not available figures to show the proportion of the embezzlement losses that occur in public offices, but without doubt the percentage is relatively large, and of this I am certain, that the number of thefts that occur and go undiscovered is disproportionately large in public offices. There are plenty of people who seem to think it is all right to steal from the government if they can get away with it. Then again, only a small part of our public accounts is subjected to such scrutiny as will reveal dishonesty where it does exist; and even where examinations are made by most competent auditors it is often found that the records are so incomplete and the system of handling funds is so crude that it is not possible to prove such thefts of cash or other property as the auditor strongly suspects. Even where safeguards exist for the protection of cash we often find that no record is kept of valuable property after its original purchase. For example, I have observed instances where surveyors' instruments, guns, automobile

tires and other kinds of property had disappeared, nobody knew where. No check is made in many cases to see whether these and scores of similar items are accounted for or not.

There are numerous instances in which no satisfactory audit has been possible, and in several cases I have found shortages in funds but have been unable to place the responsibility therefor because of the deplorably lax methods in use. Some of the conditions which accountants meet with in public office are almost unbelievable.

We have found cases where for a period of years treasurers have made no reconciliation between their books and the accounts of the banks in which their funds were carried, and in some cases there had been one or more changes in treasurership without any adequate reconciliation having been made. We have seen cases where the methods employed were such that serious shortages might have occurred in such a way that, even if discovered, it would have been impossible to determine which of two or three administrations or which of two departments was responsible.

Through lack of any business-like method of receipting for moneys collected the auditor is often at a loss to satisfy himself that all receipts have been recorded. The taxpayers' funds are in great danger where such conditions exist. I had one strange experience with a small town whose treasurer had deposited twelve hundred dollars of sinking funds in savings accounts and had failed to tell his successor about it. The successor did not become informed of the accounts from anything he found in the records, so they were lost until a special audit was made. Then it was found that the small-town bank had written the accounts off into profit-and-loss. I trust you will believe me that there is laxity in municipal accounts.

Next, what is the remedy for these evils?

Naturally one recognizes the need for selecting more competent public servants, but I find that Socrates complained that in his time men were selected for public office without reference to their fitness, so I despair of any revolutionary change in this direction during my lifetime.

Two things are needed; one is the installation of adequate systems of accounts and modern office methods such as are in use in private business. Such methods, as compared with the old, furnish more information and greater safeguards with a minimum of cost and effort. The second thing needed is, after improved

methods have been introduced, that this work shall be followed up with such competent supervision and such thorough examinations as will guarantee satisfactory operation, even by the least qualified office holder, of the systems introduced and will have the effect of restraining unscrupulous public servants.

Two methods, at least, for the accomplishment of these results are being tried.

One is to assign to some state department the responsibility of supervising municipal accounts in the state, with the object in view of standardizing accounting methods and of providing for periodic audits or examinations. The other method, which is still an experiment in Utah, is to require municipalities within the state to employ competent accountants to audit their accounts periodically.

It appears that the first of these methods should be the more economical but the important consideration is whether or not it will accomplish the desired results. In the first place the whole matter is placed in the hands of a political appointee who may or may not be competent for this important and enormous job. In the second place, even if by good fortune a big, able man is selected, the chances are ninety-nine to one that no such appropriation will be made as will permit the employment of the amount or kind of help that will be required to do so big a job satisfactorily. The result will be that after the first year or two the so-called audits will degenerate into mere perfunctory examinations. A few additional names will have been added to the state's payroll with very little good accomplished.

We are experimenting with a new law in Utah, which was passed by the last legislature largely through an organized effort of taxpayers. I am frank to admit that its operation is still an experiment, but after nearly two years of the law I believe that the best informed, disinterested observers will vote that its advantages exceed its disadvantages.

The statute in question reads:

An act providing for the auditing of accounts of cities, counties and school districts.

Section 1. It shall be the duty of each board of city commissioners of cities of the first and second classes, and city councils of the third class, and of each board of county commissioners, and of each board of education of each school district in the state of Utah, respectively, to have made, at least biennially, beginning with the calendar year 1922, by or under the immediate direction and supervision of a competent accountant, an audit of the accounts of all officers of their respective cities, counties or school districts having the care, management, collection or disbursement of

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moneys belonging to their respective cities, counties or school districts as the case may be, or appropriated by law or otherwise for their use and benefit.

Section 2. Such audit, for any calendar year, shall be begun not later than twelve calendar months after the close of such year, except in cities of first and second class the commissioners shall at the end of each year cause a full and complete examination of all books and accounts by competent accountants.

Section 3. Copies of all audit reports made in conformity with the provisions of this act shall be filed with the county, city or school district and a copy thereof filed with the state auditor's office, and copies of reports affecting school districts shall also be filed in the office of the state superintendent of public instruction.

Under the provisions of this law nearly all our counties, cities and school districts have been audited, but I am frank to state that a number of the so-called audits have not been by competent accountants and some of them have been a joke.

There is a law in our state which makes it a misdemeanor for any person to practise without a state license as a public accountant, doctor, nurse, pharmacist, dentist, architect or barber, but no serious attempt has been made as yet to enforce the law with respect to accountancy.

Many people have an idea that an audit is merely a check of the mathematical accuracy of the books, whereas the fact is that the experienced auditor is as much concerned about what is not on the books of account but should be there, as he is with what is on the books.

Besides seeing that, as far as he can discover, all revenue is properly entered, and that all expenditures have been accounted for and have been legitimate and within the law, the experienced public accountant investigates such matters as surety and depository bonds and bond sinking funds which are often found to have been neglected, sometimes at great injury to the taxpayers.

Many of the audits have been made by certified public accountants, and where this has been the case great improvements have been made in accounting methods. And, by the way, the certified accountants did not raise their rates as some predicted they would when the law went into effect, and because of the distribution of the work among several firms none has made any extravagant increase in earnings through the operation of the law.

It is true that complete uniformity in accounting methods has not resulted from the work of the experienced accountants, but committees of the state association of certified accountants have been working on uniform methods and have accomplished a good deal in this direction. This movement was also materially aided



by means of a conference of county treasurers and auditors called by the state auditor, at which accounting and other problems were discussed. The certified accountants of the state participated in the conference and several improved accounting forms were adopted for use of all counties.

A committee of accountants also coöperated with the office of the state superintendent of public instruction in the preparation of forms of records for use in the school districts of the state. These forms have been sent to all districts with the recommendation of the state superintendent for their adoption. Often a considerable saving is made in the cost of records by having forms stocked in quantities by one or more stationers for general use of counties, cities or school districts.

Even though all the municipal audits made under our law have not been satisfactory, we still feel that much real improvement has already been made in the municipal accounts of Utah through the operation of the audit law, and, indeed, that more good has resulted than would have been derived in the same length of time through supervision under any state department.

This much is certain, one of the big problems of the taxpayers is to see to it that by some means the accounting and the business methods in public offices are modernized. You can only accomplish this through an organized effort by the taxpayers. An organization of the public accountants cannot initiate such a movement or they will be accused of purely selfish motives, but I am positive that if a taxpayers' organization in any state will call upon the public accountants you will find them ready to coöperate in the true spirit of public service.