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A+B=Money for C

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classes of service. For this purpose, probably there is no better medium than the American Institute of Accountants.

The signs of the times point sharply to this demand. There is reason to believe that certain of those who collaborate with accountants will insist on something of the kind if relations are to continue. The insistence of the accountants should be no less strong. With common understanding on the part of all who are concerned with accountants' services will come a new day in which accountants, meeting every just responsibility but without having to bear unjust burdens, will take a place of increased usefulness to business generally.

A+B=Money For C

LET A represent the account; B the banker; C the customer of the bank and the client of the accountant. In borrowing money from B, C makes use of the services of A. B has a relation to C. A has a relation to C. Query: What is the relation of A to B?

In the triangular relationship, which, apparently, is a creation characteristic only of modern times, the purpose is to borrow funds with which to carry on legitimate business enterprise. The relationship finds existence in connection with fixed capital as well as current funds. The commercial banker lends for short terms. The investment banker places capital loans for long periods and obtains capital for permanent investment.

Character on the part of borrowers long has been an essential prerequisite for borrowing funds. Character still occupies a place of importance in considering the risk incident to the lending of money. There is reason to believe, however, that the importance of character is dwindling somewhat in the opinion of various bankers who have had the misfortune to sustain heavy losses through loans made to business enterprises whose officials were reputed to be men of character. Further, the now wider geographical distribution of loans by banks in large centers has tended to diminish the former intimacy of personal acquaintanceship.

Probably it is not an extravagant or immodest statement to assert that increasing dependence and reliance steadily are being placed by bankers upon the services of public accountants and the professional reports which they render. As independent verifiers, the opinions of public accountants with respect to financial condition and operating results have become more and more essential to bankers in the granting of credit and the lending of money. Experience shows also that the name and reputation of the accountant have an important bearing on the value of the report for credit purposes and in connection with issues of securities, as well as the marketing of commercial paper. It is a matter of complaint on the part of the younger and less known accountants in remote parts of the country that money in large amounts is to be obtained only through bankers in large cities, who demand reports of well known accountants. The impression prevails, and is true in some cases, that the bankers specify the accountants who are to be employed, and dictate generally the character of the service and particular information which they are desirous of having.

If it were true that all bankers are in this enviable position, some of the misunderstandings which arise between bankers and accountants would be eliminated. Unfortunately, in too many cases, the borrower retains the accountant, specifies the service which he desires, and upon receiving the accountant's report, submits it to the banker for credit purposes. In far too many cases the accountant has no contact with the banker and is judged by his report, without consideration of the specifications of his engagement.

The accountant is called upon to perform many different types of service. There is the general audit; the balance sheet verification; the cash audit; the general examination; the limited examination; the investigation; the preparation of statements from books and records without verification; the preparation and review of tax returns; contesting assessments or prosecuting tax claims; preparing and rendering opinions on tax matters; conducting surveys and devising and installing systems for both general accounting and cost finding; preparing and rendering opinions having to do with accounting, financial and business matters; together with many other miscellaneous kinds of service, such as acting as liquidating trustee, arbitrator, or umpire in accounting controversies and disputes; giving testimony in court; rendering advice in accounting matters, etc.

This great diversity of service necessarily gives rise to a great diversity of reports. An accountant's report is his representation of the service which he has performed and the results thereof. Therefore, it is but fair to any accountant that before he is judged, favorably or unfavorably, his report shall be read, regardless of his standing in the profession or the confidence which his reputation inspires.

While it is incumbent on the banker, or any one else who attempts to utilize or to rely on an accountant's report, that such person shall read the report carefully, it is equally incumbent upon the accountant that he shall make clear in his report precisely what he has and has not done, together with his conclusions. While bankers are not justified in assuming that every document which bears the name of a reputable accountant is a report containing certified statements, the accountant has no justification for rendering a report which is obscure and requires more than reasonable examination thereof in order to determine its meaning and the extent of its reliability. Even with the relatively limited experience which bank credit men may have had in utilizing accountants' reports for checking credits, they should know, it seems, that every service rendered by accountants is not one comprehending a general audit. On the other hand, there seems to be no excuse on the part of accountants who render a report which involves service other than that comprehended in a general audit, for not bringing out clearly the character, scope, and results of such service.

Manifestly, it would be more satisfactory to everyone concerned if clients were to avail themselves of general audit service and obtain, for presentation to bankers, a report which would be complete and conclusive. Briefly, the scope of such service should comprehend the verification both as to balances and as to the accuracy of the records, of the assets, liabilities, capital and surplus as of a given date, and of the cash receipts and disbursements, income, expense, and miscellaneous profits and losses for a current period ended on the same date. Under such circumstances, it would be possible to prepare an audit report accompanied by a certificate which should leave no doubt as to the ground which had been covered and the reliance which could be placed on the accountant's report. But the limitations of time and expense frequently operate to preclude general audit service and result in a variety of substitutes which are offered to the banker, placing on him the necessity of differentiating and appraising the various substitutes.

Out of this situation has arisen what commonly has been known as the balance sheet audit. This type of service is a modification of the general audit, requires less time, and involves less expense. For this reason the so-called balance sheet audit has become popular. The Federal Reserve Board several years ago issued an abbreviated manual outlining procedure designed to cover a balance sheet audit. As a fine, constructive piece of work designed to promote uniformity and improve the relations among borrowers, bankers, and accountants, probably it has had no equal in modern times. The document, however, requires a high degree of technical intelligence and skilled analysis to develop the fact that the procedure is not intended to detect fraud which may be concealed by falsification of the records, or hidden in transactions occurring during the period prior to the balance sheet date. With all that may be said in its favor, the fact still remains that it does not provide for the consideration of income and profits tax liabilities affecting prior years—a very potent danger which lurks in the path of sound financial condition in some corporations.

It seems only fair that the accountant should point out to a prospective client, as well as make clear to a banker or other person who may have occasion to rely on accountants' reports, that a balance sheet verification, or so-called balance sheet audit, does not contemplate service which will detect fraud concealed by falsification of the records or by the transactions preceding the date of the balance sheet. A balance sheet verification should comprehend a verification as of a date of the assets, liabilities, capital and surplus according to balances shown by the records, with such examination of the records—supplemented as to certain items, when occasion requires, by certifications of persons in authority—as may be necessary to substantiate the assets as stated and afford reasonable assurance that there are no liabilities (actual or contingent) other than those disclosed, together with sufficient review of the operations according to the records to give credence to the stated financial condition. But securities inspected and verified as to cost from brokers' invoices may be in agreement in total with the balance as shown by the general ledger account, and in agreement in particular with the items making up the total, without assurance that the records have not been falsified to reflect a balance smaller in amount than should be shown, accordingly concealing the purchase and misappropriation of securities during the period prior to the date of the balance sheet. A condition of this character could be detected with certainty only by verification of the transactions in securities during the period.

An accountant is not infallible. Such legal decisions as are available indicate that he should not be expected to exercise the function of guarantor, and that being properly qualified for his duties, he shall exercise reasonable skill and diligence in the performance thereof. Why, then, should not the fact be made clear that in a balance sheet verification the accountant does not undertake to detect the existence of fraud concealed by falsification of the records, when he might be expected reasonably to detect such irregularities only upon having an opportunity to verify the transactions leading up to the results at a balance sheet date?

Step by step the classification of accountancy service leads away from general verification of balances and transactions, as in the general audit, through the category of balance sheet verifications to the general examination. The latter type of service usually involves less verification of balances and of transactions, and tends generally to greater acceptance of the figures as shown by the records. This type of service usually arises in connection with financing, mergers, consolidations, or purchases and sales of companies or properties, and is distinguished by a report in which particular attention is given to classification in the statements and to appropriate information in the comments, with a view to meeting the requirements of financial interests concerned with issues of securities. As a sequel to service of this type, occasion arises frequently wherein it becomes necessary to prepare balance sheets giving effect to proposed financing. While the general examination usually involves a balance sheet verification with certificate, and the preparation of a statement of operations from the records without verification thereof, at times it may take the form of a verification of operations, with such examination of the asset and liability records as may be necessary to substantiate the operations. The statement of operations may be certified and accompanied by a balance sheet prepared from the books without verification. A general examination does not contemplate audit of transactions leading to the results, or the detection of irregularities concealed by falsification of the records.

A somewhat difficult type of engagement with which the accountant has to deal is known as a limited examination. It involves partial or complete verification of certain assets and liabilities, or of certain operating transactions, and the preparation of financial statements from the books without further verification. Probably it is safe to assert that no accountant desires this type of engagement. It requires particular care in the preparation of the report to make clear the character, scope, and results of the service. In other words, the accountant is put to a severe test in stating, so that there may be no misunderstanding on the part of any one who reads the report, what he has and has not done. Taking into consideration the technicalities of the work involved and the difficulties of finding expressions which will not be ambiguous or misunderstood, this is no slight task.

A report on a limited examination, as a rule, is so completely qualified as to be useless for purposes of credit seeking. To the alert credit man it is decorated, so to speak, with red flags. It is as unpopular with experienced credit men as with accountants. It is as unsafe, unless carefully examined and analyzed, as a statement submitted by an unknown borrower. This form of statement, however, frequently is submitted to banks as a basis for borrowing funds and supporting lines of credit.

The question now arises as to what are the duties and responsibilities of the respective parties to the triangular relationship among accountants, bankers, and borrowers. The duties of the accountant are to be experienced and skilled in the performance of his work; to prepare a report which states the facts and his conclusions resulting from the work which he has done; to present a report which is so clear that any one who reads it and has a reasonable knowledge of financial and accounting matters may understand; and to hold the affairs of his client in confidence.

The banker, in attempting to utilize the accountant's report, has a duty to possess reasonable knowledge of accounting matters, of the functions and service of public accountants, of the various types of accountants' reports, and to read carefully any report on which he intends to base judgment or use for purposes of lending money or checking credits.

The borrower who is required to furnish an accountant's report for purposes of credit has a duty to furnish a report which sets forth all the information a banker requires. It may appear somewhat naive to assert that the borrower should lay all his cards on the table; yet contact with modern banking proves beyond the question of a doubt that the borrower who is honest with his banker has nothing to fear from a full disclosure of all the financial data relating to his business. As a matter of fact, the assertion scarcely will be challenged that such borrowers fare best at the hands of their bankers.

The time-worn contention on the part of some bankers that accountants should refuse to render service which contemplates less than a general audit is little short of absurd. Many bankers will agree in the theory that the remedy would lie in their own hands, namely, that of bringing insistence to bear on the client, were it not for the fact that competition among bankers is so keen as to make such measures impracticable. Why, then, should the banks ask the accountants to assume a burden which, while acknowledging responsibility therefor, they are not willing to bear? This, while obviously a sharp question, is likely to find little response. The very conditions which surround modern banking and the practice of accountancy call not for the answering of pointed questions raised by either party. Undoubtedly, the solution of the problem lies along other lines.

If ever a problem required cooperation, it is the problem which is bound up in the triangular relationship among accountants, bankers, and borrowers. If the problem is to be solved, and there is no reason to doubt that it will be, even though admittedly the solution is a matter of time, each party must respond to his obligations. Once the borrower releases the accountant from his pledge of secrecy concerning the particulars of the client's financial affairs, the accountant can go to the banker for conference and explanation concerning his reports which have been placed in the hands of the banker, or for consultation with the banker as to the information which he requires, preferably before the engagement is undertaken. While accountants may be aware generally of the kind of information required in reports for credit purposes, individual bankers have their particular ideas concerning the information which they desire. The solution of the problem would be much advanced if commercial and investment bankers who have occasion to utilize the reports of public accountants were to urge on prospective and on actual borrowers the desirability of having their accountants confer with the bankers, since most clients probably would recognize the wisdom of such procedure.

Once the borrower understands that a limited examination report is of no value for credit purposes, limited examinations will begin to pass out of existence. The sooner the borrower learns that a general audit report with an unqualified certificate not only is the most useful document he can offer to the banker for credit purposes, but as well is an instrument of protection and help to him, the sooner accountancy practice, in so far as it relates to statements for credit purposes and to genuine business service, will move in the direction of general audits.

Invisible Management

PRESENT-DAY practices in the field of corporate organization and finance, as evidenced by a number of reorganizations and refinancings during the past year, recently have come under fire.

Professor W. Z. Ripley, of Harvard University, speaking not long ago before the annual meeting of the Academy of Political Science, took occasion to make a vigorous attack on what he termed a tendency to "the alarming divorce of the ownership of property, represented by securities emitted by corporations or trustees, from any direct accountability