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Editorial

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EDITORIAL

Ethics in Tax Practice

The treasury department has shown a steadily increasing desire to regulate the practice of attorneys and agents before the bureau of internal revenue so that the administration of the tax laws of the country may be conducted with the least possible loss and inconvenience to both government and taxpayer. At first it was impossible to lay down rules which would be sufficiently comprehensive to prevent all undesirable practice, and many taxpayers were represented in a way which did no good to their cause and led to a great deal of dissatisfaction among officers of the treasury department. However honest may have been the intentions of some attorneys and agents, many of them lacked a keen perception of the difference between ethical and unethical acts. As a consequence there has been an accumulation of rulings designed to prohibit conduct which might be considered as unfair, if not actually criminal. It is always a difficult matter to lay down rules of conduct for a group of men whose purpose it is to obtain the best possible results for their clients. This fact is recognized by such organizations as the American Institute of Accountants, the American Bar Association, the various medical societies and similar bodies of professional men. Codes of ethics have improved little by little until today they are fairly comprehensive, but even at the best there must always be some omissions which will be brought to attention as offenses occur. The treasury, however, has shown a praiseworthy desire to cope with the difficulty as promptly as possible and the rules which have been promulgated have been productive of results. Their inhibitions have been irksome to many persons desiring to practise wrongfully, but that is as it should be.

From the Abstract to the Concrete

Now, however, the treasury has gone a step further and has practically adopted as its own certain rules and standards approved by the leading professional organizations of lawyers and accountants. In department circular No. 230[1], issued over the signature of the secretary of the treasury, the department takes a more definite stand than ever before. Every accountant, lawyer or other representative of taxpayers must comply with the rules of conduct which have been laid down by the American Bar Association and by the American Institute of Accountants. The following quotations from the circular indicate its comprehensiveness. The full text of the circular appears in the *Income-tax Department* of this issue of THE JOURNAL OF ACCOUNTANCY.

> In order better to protect the taxpayer's interests and to expedite practice before the department, applicants should clearly establish their right to enrolment by showing that they possess (1) a good character and reputation; (2) a sound education; and (3) a familiarity with the laws and regulations covering taxes or other subjects which they will present to the department. Practice before the treasury department is not restricted to duly licensed attorneys at law and certified public accountants; but an agent who is not an attorney or accountant and attorneys and accountants licensed in states where, in the opinion of the committee on enrolment and disbarment, the licence requirements are not adequate, must show satisfactory educational qualifications and evidence of an ability to understand tax questions or such other matters as will be presented to the treasury by the applicants. An applicant's character and reputation can only be established by inquiry among those who have had the opportunity of knowing the applicant in the community in which he has lived. A bad reputation as to integrity or any previous conduct of applicant which is unethical, as viewed by the standards of the American Bar Association or the American Institute of Accountants, or such conduct as would be considered unfair in commercial transactions, will be regarded as sufficient to justify the rejection of the application. References as to the applicant's character should be given, and in addition the applicant should furnish the names of those with whom he has come in contact in his business and of whom inquiry may be made. The committee on enrolment and disbarment will endeavor to ascertain all facts deemed necessary by it to pass on any applicant without expense or undue inconvenience to the applicant, but the committee may require, where it is not satisfied with the information received, that the applicant appear in person before the committee or its duly authorized representative.
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> Causes for rejection, suspension, or disbarment. — In general, any conduct which would preclude an applicant from enrolment will be sufficient to justify his suspension or disbarment. Specifically, the following matters, among others, will be considered grounds for suspension or disbarment:
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> (a) Violation of the statutes or rules governing practice before the treasury department.

(b) Conduct contrary to the canons of ethics as adopted by the American Bar Association or the rules of professional conduct approved by the American Institute of Accountants, or their equivalent.

(c) False or misleading statements or promises made by the attorney or agent to a taxpayer or misrepresentation to the treasury department.

(d) Solicitation of business by the attorney or agent. This includes letters, circulars, and interviews not warranted by previous association; printed matter appearing on the letterheads or cards of the attorney or agent indicating previous connection with the treasury department or enrolment as attorney or agent; or representation of acquaintance with treasury officials or employes. It includes also the use by attorneys and agents of any titles which might imply official status or connection with the government, such as "federal tax expert" or "federal tax consultant." It is not considered a violation of this regulation for treasury employes, on severing their connection with the department, to send out announcement cards, briefly stating their former official status and announcing their new association, provided the cards are addressed only to personal or business acquaintances, and provided further that such cards are distributed only at the time of severance of the official connection with the government. These cards are regarded by the committee not as advertising but as the customary announcement cards issued for the express purpose of identifying the sender with his new association or business.

To Protect the Taxpayer

It is pleasant indeed to be able to record this recognition accorded by the treasury department to the codes of ethics adopted by the leading professional organizations concerned. Both the American Bar Association and the American Institute of Accountants have repeatedly demonstrated their willingness to assist the government in the administration of tax laws, and both bodies have given consideration, time and again, to the prevention of undesirable practice by members of the professions which they represent. The ethical codes approved by the professional organizations have been adopted only after long experience and profound consideration. It is not believed that they can work a serious hardship on any honest practitioner, but they may be regarded as likely to prevent much misrepresentation of claims before the department and much otherwise reprehensible practice. The public is heartily tired of the activities of so-called tax experts whose sole claim to attention is their anxiety to extort fees and commissions. It is probably safe to say that there is not a taxpayer of any consequence who has not been solicited by at least one person or organization offering to obtain refunds or abatements and alleging peculiar ability for such service. If, as we believe likely, the treasury will rigidly insist upon the enforce-

ment of its present rules, it will be possible to exclude from practice the great majority of the unqualified and unscrupulous practitioners in income-tax work. We congratulate the secretary of the treasury upon the increasing evidence of his steadfast desire to make the administration of tax laws as fair as it may be.

Accountants and Bankers

One of the most gratifying developments in the activities of accountants as a profession is the growth of understanding between accountants and bankers. There was a time when there seemed to be a complete divergence of opinion on many points between these two classes of men, but as time goes on the differences are passing away and it is not unlikely that there will be an even better spirit of coöperation in future. At the last annual meeting of the American Institute of Accountants an important and valuable report was presented by the chairman of a committee on coöperation with bankers. The *Monthly Bulletin* of the Robert Morris Associates, which, as most readers know, is an organization of credit men of banks throughout the country, in its September issue contained a brief article by J. W. Richmond which may be quoted in full, with the hearty endorsement of the accounting profession:

> Within the past few weeks one of the justices in the United States district court of New York confirmed a report dismissing a reclamation proceeding, brought by a prominent silk corporation against the trustee in bankruptcy of a silk jobber, to recover merchandise alleged to have been obtained on the strength of a false financial statement, as the basis for the credit granted. The circumstances under which credit was obtained were not unusual. The corporation had been transacting business with the jobbing house for several years prior to the latter becoming bankrupt, and had extended a fairly liberal line of credit on the customary basis. Between the placing of the order and the date of delivery of the goods several weeks later an independent investigation was made relative to the condition of the firm, and a comparatively up-to-date statement was furnished. The strangely unusual feature of the case was that at the hearing in question the fact was conceded that the financial statement was actually false as alleged, but defense was able to sustain its contention that credit is granted on a company's record, length of time in business, manner of payment, method of honoring contracts, and the general knowledge of relations with competitors, etc., and that sole reliance is not placed upon the condition reflected by a statement; this, in spite of the fact that the other creditors had received a similar statement, and doubtlessly were favorably biased in the expression of an opinion in consequence thereof.
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> This decision should have a far-reaching effect in credit circles if reliance cannot be placed in a company's balance-sheet. The answer is obvious. We must work in closer harmony with auditing houses, and we must insist that the financial statements submitted to us be

prepared with certificates attached by recognized and reputable firms of certified public accountants in whose work we would have confidence and against which we would have recourse. We should all work together to this end, and if this course is pursued the black sheep will gradually be eliminated.

Specific Recommendations

We have referred to the report of the special committee on coöperation with bankers and feel that further information should be given in regard to this important matter. The committee had been requested to consider the question of certification of a balance-sheet giving effect to transactions consummated at a date later than the balance-sheet. The matter was discussed by the committee with representatives of the Robert Morris Associates, and certain rules were suggested which received the approval of the council of the Institute. The report will be printed in full and distributed to Institute members, but the rules are of interest to all accountants and are presented herewith.

I. The accountant may certify a statement of a company giving effect as at the date thereof to transactions entered into subsequently only under the following conditions, viz.:

(a) If the subsequent transactions are the subject of a definite (preferably written) contract or agreement between the company and bankers (or parties) who the accountant is satisfied are responsible and able to carry out their engagement;

(b) If the interval between the date of the statement and the date of the subsequent transactions is reasonably short—not to exceed, say, four months;

(c) If the accountant, after due inquiry, or, preferably after actual investigation, has no reason to suppose that other transactions or developments have in the interval materially affected adversely the position of the company; and

(d) If the character of the transaction to which effect is given is clearly disclosed, i. e., either at the heading of the statement or somewhere in the statement there shall be stated clearly the purpose for which the statement is issued.

II. The accountant should not *certify* a statement giving effect to transactions contemplated but not actually entered into at the date of the certificate, with the sole exception that he may give effect to the proposed application of the proceeds of new financing where the application is clearly disclosed on the face of the statement or in the certificate and the accountant is satisfied that the funds can and will be applied in the manner indicated. It is not necessary that the precise liability shown in the balance-sheet before adjustment should actually be paid out of the new money. It is sufficient, for instance, where the balance-sheet before the financing shows bank loans, if the proceeds are to be applied to bank loans actually outstanding at the date of the balance-sheet. Ordinarily, however, the accountant should not apply the proceeds of financing to the payment of current trade accounts payable, at least not against a normal volume of such current accounts payable, because there must always be such accounts outstanding and the application of new moneys against the outstandings at the date of the balance-sheet results in showing a position

which in fact could never be attained. The accountant may usually best satisfy himself that the funds will be applied as indicated by getting an assurance from the issuing house on the point.

III. In any description of a statement or in any certificate relating thereto it is desirable that the past tense should be used; it should also be made clear that the transactions embodied have been definitely covered by contracts.

IV. When the accountant feels that he cannot certify to such a hypothetical statement, probably because of the length of the period which has elapsed since the accounts have been audited, he may be prepared to write a letter, not in certificate form, stating that at the request of the addressee a statement has been examined or prepared in which effect is given, in his opinion correctly, to proposed transactions (which must be clearly specified). Such letters should be given only in very special cases and with the greatest care.

The Rules Exemplified

The committee illustrates the special form of statement and certificate, and also of the letter coming within the terms of rule IV, as follows:

Form of balance-sheet and certificate where conditions laid down in rules I and II have been met

A. B. C. COMPANY
BALANCE-SHEET
DECEMBER 31, 1922

(Giving effect as at that date to the sale of $5,000,000 first mortgage bonds since consummated and the application of the proceeds in part in reduction of liabilities)

Assets
Liabilities

We have examined the books and accounts of the A. B. C. Company for the year ending December 31, 1922, and the agreement dated March 2, 1923, for the sale of $5,000,000. first mortgage bonds, and we certify that the above balance-sheet is, in our opinion, a fair and accurate statement as of December 31, 1922, of the financial position of the company, giving effect at that date to the provisions of the agreement mentioned.

New York,
March 2, 1923.

The committee also presented a form of letter which could come within the terms of the fourth rule:

New York, August 25, 1923.

Mr. John Smith, Vice-president,
A. B. C. Company,
52 William street,
New York.

DEAR SIR:

In accordance with your request, we have examined the attached balance-sheet of the A. B. C. Company as of June 30, 1923, and beg to advise you that in our opinion it is prepared so as to reflect correctly the position of the company as shown by the books, but giving effect as at that date to the pending issue of $300,000. first mortgage bonds as provided in the agreement dated August 25, 1923, and to the extinguishment, out of the proceeds of the new financing, of the notes payable to bankers to the amount of $300,000.

It will be understood that we have not audited the books since the close of the fiscal year on December 31, 1922. You have heretofore been furnished with the audited accounts as of that date, which were in accord with the books.

Yours truly,

Legal Liability of Accountants

One of the things most needed for the welfare and reputation of the accounting profession is swift and vigorous emphasis on legal liability where it belongs. The old question of the responsibility of an auditor for the statements which he makes or for the failure to state matters which he should have included in his report is familiar to every accountant. Unfortunately the number of court decisions in regard to legal responsibility is practically negligible in the United States, and the decisions rendered by British courts, while satisfactory so far as they go, do not go to the point of exactly defining the limits of the accountant's responsibility. They still leave, and probably must always leave, the question of the border line of responsibility to depend upon the opinion of the court or other adjudicator. In regard to the responsibility for actual misrepresentation or fraud, however, there is no room for difference of opinion. Every accountant will welcome court decisions which place the blame for wrongdoing; and if accountants or those who describe themselves as accountants are found to have been guilty of moral turpitude, it is earnestly to be hoped that punishment will be inflicted with the utmost rigor. Every court decision which helps to define responsibility is welcome, and every infliction of penalty where penalty belongs brings nearer realization the Utopian dream of a stainless profession. Of course we do not expect that accountancy will always be free or will ever be free

from charlatanism, and there will doubtless be fraud and wrongdoing until the dawn of the millennium, but it is the duty of every member of the profession to assist in every possible way to ensure the full force and penalty of law where law has been infringed. Recently there have been cases in which so-called accountants have been found guilty of wrongdoing, and the likelihood of punishment is not seriously lessened by appeals which have been taken to higher courts. It is unfortunate, of course, that there must be accusations and that accusations should sometimes be well founded, but all reputable members of the profession must regard with profound gratification everything that helps to clean house.