Accounting Practice and Procedure

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VI. Receivers and Assignees in Bankruptcy and Plans of Reorganization.

The Public Accountant is peculiarly fitted by his ability and training and administrative experience to take hold of and manage large industrial undertakings, protecting alike the interests of creditors and owners, avoiding unnecessary sacrifice and tedious delay in liquidating the property, investigating the facts, probing into irregularities due to ignorance or crime which may have contributed to the collapse of the undertaking, and seeing that the interests of the community are preserved by the punishment of those, if any, who may be criminally responsible for the conditions found; and finally, as a result of his investigations, forming his conclusions, reporting to the courts, the creditors and the stockholders, and, if possible, preparing and carrying through plans for the reorganization and rehabilitation of the business.

The frequency of the necessity for the reorganization of large corporations is one of the natural results of the present methods of their formation, and in nearly all cases will be found to be due mainly to over-capitalization resulting from the unduly optimistic views or the greed of promoters, frequently accentuated by large expenditures incurred for new construction exceeding the financial ability of the company and consequently defrayed to a much too large extent out of borrowed money.

The consideration of a plan for the reorganization of a property which has been reduced to a condition of insolvency requires a full and accurate knowledge of all the existing conditions with regard to the property and its past and probable future earning capacity. The elements to be investigated and determined will therefore be as follows:

(1) The sources and nature of the Gross Earnings and the prospects of any increase therein without further expenditures for development.

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(2) The cost of operation, with particular reference to the effect thereon of bad management or bad organization, and to the possibility of remedying these conditions; and the proportion which the cost of operation has borne and may be expected to bear to the Gross Earnings.

(3) A comparison of the Gross and Net Earnings and Capitalization of the property, with some actual or desirable standard, so as to determine the proportion which one should bear to the other if the reorganization is to prove successful.

(4) Hence to arrive at the total interest-bearing and dividend-paying capital, which the reorganized property will stand on some fixed interest basis.

(5) The rank of the different classes of obligations having regard to the property pledged as security therefor; the margin of security; the rate of interest; the date of maturity; the equivalent par value on the basis of the standard rate of interest adopted for all classes; and, if practicable, the extent to which the properties specifically mortgaged show sufficient earnings to meet interest on the indebtedness secured thereon. This class of information will probably require a report from an engineer or other expert on the value and the condition of the physical property.

(6) Following upon the determination of these factors a consideration of the various separately-mortgaged divisions of the property, with a view to determining whether any should be abandoned to the bondholders, rather than be included in a reorganization; and here it is important to observe that the contribution of any specific piece of property to the general organization is not necessarily measured by its ability by itself to earn interest on the obligations secured thereon. Numerous other factors will enter into a consideration of this point, and it may easily appear that a property earning little or nothing towards payment of its obligations is sufficiently valuable to the organization, as a whole, to be retained if possible.

(7) Another important factor is the amount of new money required to be introduced for the purpose of paying off the floating debt and rehabilitating the property, and the best
method of raising such money—whether by the issue of new prior lien securities ranking in front of or on an equality with those issued in exchange for existing mortgages, or by assessments on junior classes of securities. In the latter case it is important that sufficient inducement be given to the junior classes, in the proportion of new securities issued for old, to induce them to pay these assessments; while for the assessments themselves, the securities issued should represent the par value of the cash paid in on some reasonable market valuation.

Upon the information and facts so ascertained will depend the final allocation to be made of new securities in exchange for old, as far as possible, in equitable proportions to the different classes of security holders, although at this final stage an element of bargain must necessarily be introduced by reason of the different interests involved and the necessity of the reorganization managers coming to terms, separately, with each class of holders.

Enough has been said to show that the whole of the work involved in the preparation and carrying out of such a scheme may well be entrusted to the Public Accountant; and while a strong reorganization committee is, perhaps, a necessity in order that all classes of security-holders may feel that they are represented in the preparation of the scheme, no such committee should proceed without keeping in close touch and consultation with some representative member of the accounting profession, who should be retained as their technical adviser.

In other countries accountants have in many cases established and maintained their reputation as leading figures in the commercial community in the class of work here described, and have thereby acquired so high a reputation and standing for the profession, that it is only in rare cases that an accountant is not, as a matter of course, appointed to the position of receiver or liquidator, and entrusted with the entire work of either liquidating or reorganizing the business.

VII. Cost Accounting and Systems.

Increasing competition resulting in a narrow margin of profits and the greater magnitude of business undertakings, making
impossible a close supervision of all details by the responsible managers, have raised to a matter of first importance the quick determination of accurate costs of processes of manufacture and finished products.

Modern systems, based upon the cost of the service rendered by the manufacturer to the public and so showing the amount of material, labor, and other expense put into completed work, are rapidly superseding the old forms, based upon the cost of the service rendered by the public to the manufacturer, i.e., upon the quantities of goods purchased or of labor paid for; and if such systems are to be of the greatest possible use, it is further essential that the results should be available promptly and in concise form, so that defects disclosed in organization, management, or detail may be quickly remedied.

The principal objects to be attained by a modern cost system may be stated as follows:

(1) To ascertain the cost of the same product at different periods in the same mill or at the same period in different mills, and so to remedy inequalities in cost by reducing all to the results shown by the best.

(2) By an accurate ascertainment of the cost of output to maintain running book inventories, which will show at any time, without a physical inspection, how much of each class of materials, supplies, etc., is on hand, and so reducing stocks and capital invested to the lowest level consistent with efficiency; and at the same time avoiding the delay, expense and interruption to business consequent upon the old method of taking a complete physical inventory at a specific date in each year.

(3) The preparation of statistical information as to costs of parts, quantity, and variety of output; relative efficiency of different classes of labor and relative costs of labor; and material, between different mills and periods.

(4) The preparation of periodical statements of Profit and Loss in a condensed form, readily giving Directors all material information as to the results of the business. This is, perhaps, the least important of all the objects aimed at; and it may safely be said that the cost of a system designed merely to produce periodical statements of Profit and Loss,
without providing for the other and far more important objects set out above, may be considered as money thrown away.

In devising such systems it is important to avoid too great multiplication of detail, giving theoretical rather than practical accuracy, and a very high cost of installation and operation; and it is equally important that the system installed should take into account local conditions.

The preliminary step to the devising of any cost system should be a careful study on the ground of all conditions governing the operation of the factory, not omitting a consideration of the personnel of the managers and staff, to whom the completed system must be eventually handed over, and without whose thorough and hearty co-operation no ultimate success is possible.

There is a tendency to attach undue importance to the terms "cost accounting," "cost department," "production accounting," "production engineers," and similar terms applied to and held out as a special definition of this class of work, and to believe that it is separate and distinct from the practice of accounting. While in many respects cost accounting work is of a highly technical character and different from other branches of the work of the profession, yet those same qualities and that same training, ability, and experience, which are called for in the latter, are equally necessary for the successful construction and installation of a complicated system of cost accounting; and if the best results are to be obtained, the designer and operator of a cost system must be first of all and pre-eminently a Public Accountant.

VIII. Consulting Accountants.

It is a common practice on the part of corporations and individuals to retain counsel on the basis of a yearly consultation fee, which gives them the right to call upon him for legal advice at any time. This practice might, with advantage to his clients, be extended to the Public Accountant, and there are signs already that such a course is beginning to be more seriously considered. There can be little doubt that agreements dependent upon accounts or the interpretation of accounts would frequently be better drawn and lead to less confusion, difficulty and litiga-
tion afterwards, if, before being finally settled, they were submitted to a Public Accountant familiar with all the facts. Similarly, the examination of witnesses in cases involving accounts or figures would be much facilitated and the necessary points more clearly brought out if an accountant were retained in every such case to thoroughly investigate the principles involved and to be at counsel's elbow, during the whole of the proceedings, to prompt him on these technical questions.

Such work, and many other matters of similar character, form the duties of a Consulting Accountant. This position, which represents only a small part of the field which the Public Accountant's practice should cover, is withal, not only an important, but an interesting one. It calls for continuous exercise of all those higher faculties required in the profession and may be likened in some degree to the position of a judge in relation to the members of the bar. Just as a lawyer, after a long, useful and busy career at the bar, is promoted to the bench as a position of greater responsibility but less physical effort, in which he may continue to devote his abilities to the services of the community, so the Public Accountant, who has for many years carried the burden of work and responsibility involved in the conduct of a large practice, might equally assume the honorable and responsible, but less onerous, position of Consulting Accountant, so keeping in touch with his profession and placing his ability and experience still at the disposal of his clients.

IX. Office Organization.

In considering the method by which the Public Accountant is enabled to perform for his clients the various services already shortly outlined, the most important is, undoubtedly, the organization of the office. This may be divided into the following essential departments:

(1) A Staff of Accountants is absolutely necessary unless the principal is to waste his own time or his client's money in performing detail work which can quite as well be done by others of less experience or ability, or, as an alternative, is to accept without verification all the facts and figures submitted to him by his client, merely forming his own con-
elusions based upon these figures. While the latter course may be at times justifiable, it forms the work of a Consulting Accountant more than of a Public Accountant, in the full sense, and can be considered only as a small branch of his work; nor would it be safe or proper for him to certify statements of accounts prepared on such data without expressing clearly in his certificate these limitations upon its value.

(2) A Correspondence or Stenographic Department is necessary to enable him to turn out the best kind of work of this class, accurately and quickly; but it must always be remembered that such a department is an auxiliary and not a principal department, and that the contents of the documents produced are of very much greater importance than the manner of their production. While this may seem a truism, a word of caution is not altogether unnecessary, as there appears to be a tendency (from which, unfortunately, those for whom the reports are made are not always free) to judge of their value rather by the outside appearance than by the contents. Provided, however, the latter be always considered the more important, there is no question that on the principle that "what is worth doing at all is worth doing well," the outside appearance should be made as attractive as possible.

(3) A Statistical Department will be found of great value in tabulating results of different kinds of business; collecting books of reference, reports and other documents of interest, or value; maintaining a complete library similar, but of different character, to that of the lawyer, and keeping and maintaining the whole in such a condition as to be ready for reference at any time. It has been truly said that in these modern days it is impossible for one individual to keep all information in his head, but that he should at least know where to obtain it quickly when required. The Statistical Department in an accountant's office stores information and holds it ready on demand, leaving the minds of the principals and their staff free for more important matter.

(4) The Filing Department is of especial importance by reason of the confidential character of the Public Accountant's
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work. The papers should be preserved in such a way that access can only be obtained to them by two or three people authorized for their custody; and at the same time the system must be such that papers required for reference in connection with pending work can be obtained at a minute's notice.

(5) The Finance Department has the control of the accounts of the business (consisting of the time records of the staff, forming the basis for the cost accounts), the rendering of bills for work performed, the keeping of the necessary books of accounts, the preparation of periodical statements of business done and the profit or loss thereon. The importance of a proper system of cost accounts is not always recognized among the profession, and it may, perhaps, be said that it is the exception rather than the rule for any records to be kept in addition to the number of hours expended upon any case. The value of a complete ascertainment of cost can not be overstated, especially in view of the different grades of salary paid for different classes of work and the consequent unreliability as a basis of charges of the number of hours expended without the introduction of some equivalent to represent the money value of those hours.

The above form the essential features of an office organization, whether large or small. Although in the latter case the lines of division between the different departments will not be so clearly defined and much of the office work may even be done by the principal himself, yet it is all equally necessary for his complete equipment. Some may, perhaps, be disposed to add to this a Promotion Department, whose work might consist entirely in endeavors to obtain new business. Such a development, however, is one to be deprecated as not being consistent with the professional character of the Public Accountant's work, and especially as being derogatory to his high standing and to his confidential relations with his clients. Such methods are usually confined to so-called Audit Companies, whose object seems to be to carry on a purely commercial business on commercial lines, rather than to practice an honorable professional calling. It may well be asked
what respect can be expected for professional work carried on under such conditions; and it is certain that the high aims set forth in this paper on behalf of the profession—aims which have been largely realized in other countries and are in a fair way to realization here—will never be attained if such purely commercial ideas are permitted to obtain a foothold among the general body of what should be an honorable and distinguished profession.

The selection and maintenance of a thoroughly trained and experienced staff is essential to a proper conduct of the accountant's work, and necessarily involves carrying that staff through regularly recurring periods of slack work or business depression.

Universities and colleges are now maintaining special courses of study designed to train men for the accounting profession. These courses are usually laid out on excellent lines and undoubtedly are of great value as a preliminary education, but enough has probably now been said to show that any such education can only be considered as preliminary and that the student who has passed through such a course and its accompanying qualifying examinations is only then on the threshold of his profession. His real experience begins when he enters the office of an accountant and settles down to hard, practical work, much of which must necessarily for a year or so, at any rate, seem to him mere drudgery. It is, however, none the less essential, and long experience brings the conviction that the only way to build up a thoroughly valuable organization is to start men at the bottom rung of the office ladder and let them gradually work up to higher positions, step by step, as they can demonstrate their ability to fill them. The whole progress of a member of the staff through the office is a continuous education, lasting, though perhaps in a lesser degree, even after he has reached the highest available positions. It is for this reason that the salaries paid in the junior positions in accountant's offices are, as a rule, lower than would be paid for somewhat similar work in a commercial business, and that the exacting and responsible work which the accountant performs for his clients is carried out on a lower basis of remuneration than in many other professions.

Another essential feature in staff organization is that it should aim at general experience in all kinds of business rather than at specialization in one or two subjects. Specialization
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to a certain extent is bound to exist; certain men will be found to be fitted for or to take a fancy to some particular class of work rather than another and will be preferably allocated to such work; but to carry this principle to any extreme, to create certain departments for certain work and to give the staff engaged thereon no opportunities of obtaining a wider experience in other branches of business, is to deprive them of opportunities for acquiring knowledge and experience, and that many-sidedness which forms one of the most important qualifications for future success. Methods of accounting, books of account, systems of internal check, preparation of systems and forms, defacations and embezzlements, and, in fact, nearly all matters which come before the Public Accountant, in the course of his practice, involve the same basic principles, and with the exception of a few technical terms peculiar to each class, which are easily mastered in a few hours, apply equally to all kinds of commercial, industrial, and general business. It is in the accountant’s knowledge of these general principles, in his full experience in their application, and in his power and ability to adapt them to all the varied cases that may come before him that his real usefulness to his client lies; to specialize in one particular class of business or one particular class of work, is to deprive himself of a very large proportion of that usefulness.

The Public Accountant employs his staff for the purpose of—

(1) Ascertaining the facts, and

(2) Preparing statements of such facts in any desired form.

In this work close supervision and direction of a principal is essential to good work, and he can not exercise this supervision properly unless he knows more than his assistants, and is fully competent to take up the work and do it himself if necessary. Hence the necessity for the assistant to work his way up steadily from the bottom to the top, so that when it comes to his turn to organize and direct his own business he may be eminently fitted to show his assistants the best way to do everything, from adding up a column of figures or counting securities, to preparing complicated accounts or devising systems and forms.

The practice of the Public Accountant involves highly difficult and responsible duties and calls for qualifications of no mean
order, and the importance of the training of the accountant's clerk will be seen from the following statements of those qualifications which long experience has shown to be the most essential:

(1) A thorough and complete knowledge of accounting principles, gained partly from theory, but to a much greater extent from practice and experience under the supervision and direction of his seniors.

(2) Familiarity with figures; the faculty of quickly grasping the meaning and purport of financial statements and accounts, and the principles, commercial or legal, upon which they are based.

(3) A legal and judicial mind accustomed to weigh facts and to attach to them their relative importance, and so quickly to reach the core of the case and form a conclusion as to the equities involved.

(4) The ability to argue and discuss a point, either as an advocate for the purpose of getting at the other side of the question or as a judge in order to put all sides of the question in their proper light.

(5) A sound knowledge of business and financial methods, and the principles, economic and legal, which govern them, derived mainly from a varied experience.

(6) Above all, absolute integrity combined with a superabundance of tact and good temper.

This list of qualifications merely illustrates an ideal which every member should have steadily before him, but which few can hope to attain completely; but it suffices to show that the qualifications for conspicuous success in this profession are in the main the same as in any other, and that no one can hope to become a leading Public Accountant by short cuts any more than he can so become a great judge, a great lawyer or a great doctor, or, in fact, can attain eminence in any other profession.

X. FORMS OF REPORT.

The facts having been obtained and placed into desired shape, it remains for the principals to determine upon the form in which
the information should be transmitted to the client. This is
the moment at which the training, experience and ability of many
years is most necessary, and the work can not, therefore, with
justice to the client’s interests, be delegated to others.

The facts as ascertained must not be colored in favor of his
client or against his client’s opponent, if there be one. His re-
port must be based upon a statement, to use an old expression
which in these modern days is too often neglected, of “the truth,
the whole truth and nothing but the truth,” and should be ir-
respective entirely of the party for whom the report is made.

It is not permissible for an accountant to conceal or to be a
party to the concealment of any material fact, nor must he so
state the material facts as to give them greater importance than
they deserve relative to other facts. He is not an advocate
but a judge, and, like a judge, in all his public acts he
must not take sides but must remain absolutely im-
partial. In giving evidence the same attitude is neces-
sary, with this difference—that like any other witness an
accountant should not volunteer information, but his client
must understand that he will not aid in concealing the
facts, but will truly express his own opinion if the questions of
the opposing counsel require answers on such points.

His position is an absolutely confidential one; no information
obtained during the progress of his work, either directly or
indirectly, must be imparted to others, whether they be indi-
viduals or courts of justice, without the authority of his client.
The law in this country has not generally recognized this privi-
lege; but inasmuch as the accountant is in most cases called as
an “expert,” he can not be compelled to testify, and it will usually
be found that the courts are prepared to admit this claim of privi-
lege. At the same time he may, according to the present status
of the law, be put in the position of answering questions and so
disclosing information which he has obtained in his confidential
capacity, or in default be committed for contempt of court; in
such cases his duty and interests are identical and he has the
alternative before him of refusing to answer or seriously dam-
aging his practice. It is to be hoped that this unfortunate posi-
tion may be generally avoided by the courtesy of the courts, if
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not by statute law, and that he may be placed on the same ground as other professional men and be permitted to plead that the communications made to him are privileged and not to be reported without the consent of his clients.

As to the form in which his report should be rendered the Public Accountant must, of course, be guided largely by the subject matter, but it is possible to lay down a few general principles which should be adhered to as far as possible. Careful attention should be given to the literary character of the documents; figures make dull reading even to the initiated and a style which will deal with them in concise narrative form will undoubtedly appeal to clients. At the same time a literary effort designed merely to please the ear by stringing together a number of pretty phrases, which on careful analysis mean little or nothing, is to be deprecated.

The order in which subjects are dealt with is of material importance; a little preliminary thought as to the order in which items in the accounts are usually stated and as to the relative importance of the points discussed will usually establish the logical sequence of the report; and since the writer’s endeavor is to attract and hold the attention of the reader from the outset, the more important conclusions and points should, if possible, be brought out early in the report. Where a report deals with an undertaking with which the client is not familiar it may with advantage begin with a short historical section which will make later comment more readily appreciated. Remembering also that the client is usually a busy man of affairs, care should be taken that the statements of figures embodied in the report should be those, and those only, which will suffice to set forth the salient features disclosed by the examination. To include in the body of the report masses of dry detail figures which are merely the material upon which the findings are based, or to relegate to exhibits those figures which are essential to a proper understanding of the subject, detracts from the value of the report. Detail figures indeed, unless specially required, should be eliminated from both report and exhibits. They cost money to produce and time to read and understand, and frequently are en-
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tirely unimportant in considering the situation or conditions for which the report is required.

And finally there should be no appearance throughout the report of any attempt to make out a case, or to attribute undue importance to any point, for the purpose of currying favor with any one. The tone of the report should be marked by justice and moderation, and it is a good rule for the accountant in making his final revision to imagine himself under cross-examination, and then to expunge or modify any statements which under such cross-examination he may feel he could not substantiate.

The importance of the ability to write a good report can not be over-estimated, especially when it is considered that in the majority of cases the only opportunity the client has of judging of the value of the work for which he is paying is by the contents of the report. Many a good piece of work has failed of the appreciation which it deserved, owing to inability to express the results in a good report, which would carry conviction with it; and on the other hand, unfortunately, many a poor piece of work has received more than due credit, owing to the excellence of the form in which the final conclusions were embodied.

Bearing this importance in mind it is a most essential part in the training of a young accountant that he should acquire ease and facility in converting the results of his work into just the right kind of report, and many firms make it a practice to require their assistants to put into report form the results of every small piece of individual work with which they may be entrusted. These subsidiary reports form a good record to be filed with the working papers of the work that has been done, and of the way in which it has been done, and are also an invaluable training for the assistants themselves.

In concluding this paper the hope may be expressed that it may be of some interest to each of the various classes of readers to whom it is intended to appeal. Necessarily general in its character it may perhaps suggest to practicing accountants some subjects which might be more fully dealt with in future papers to the advantage of the whole profession. If at the same time it helps
in some small degree towards the realization by the student members of the fact that they are entering into a profession full of difficult problems, and calling for the exercise of all their ability, tact, and courage; and by the larger public of the growing importance of the Accountant in the business world, the labor involved in its preparation will have been amply repaid.

(The End.)