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Editorial

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The JOURNAL of ACCOUNTANCY

Official Organ of the AMERICAN INSTITUTE OF ACCOUNTANTS

A. P. RICHARDSON, *Editor*

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EDITORIAL

The New Year

This issue of THE JOURNAL OF ACCOUNTANCY will reach readers as the bells ring out the old year and ring in the new, and all of us, whether poor or rich (if there be any rich) will regard the passing of 1933 in a spirit of resignation without grief and the advent of 1934 in a spirit of hope, let us pray, undaunted. Not for fifty years has there been in the history of America so dark an era as that through which we have passed. Nineteen hundred and thirty-three was, we all trust, the last of the years of the great depression following the war of the world and the wild orgy which succeeded. It was in a way the worst of the years because it was an accumulation of woe upon precedent woes. Had it been a lone year of hard times, we might have borne it more cheerfully, but with nerves frayed by experience and with patience well-nigh exhausted, no one was able to carry the load without groaning of the spirit. Now as we come into this brand-new year there is undoubtedly a feeling of something approaching assurance. Nearly everyone believes that we have seen the worst of it, and what ensues must be at least a little better than what we have gone through. Without placing too much faith upon the inspired prognostications of returning prosperity, there is still a possibility of looking forward with less of dread and dismay than has been our lot during the past four years. For no apparent reason there is abroad in the land a revived will to carry on. Every business man knows something of this renewed hopefulness. Stocks of merchandise are at their lowest point. We

have lost the extravagant notions of 1929. We believe, most of us, that there is a norm of business to which we may rightfully adjust ourselves. We do not think that we shall see again in any near day such vast possibilities of the rapid and often unjust acquisition of wealth as that which we thought reasonable in the days of the great boom. We must, however, eat and clothe ourselves and travel and conduct the business of life. All these things involve the employment of men and the utilization of material and the transactions of trade—and these things of themselves will make sufficient demands to involve all of us in the march of progress.

**Ready to Weigh
Anchor**

It has been said in these pages and in many other places that the real nadir of depression was passed while we knew it not in 1932. Since that time we have been wallowing in a slough of despond and we have been hesitant, uncertain, wavering; but nevertheless there has been an upward tendency in all the principal activities. We long to go forward, and that is the happiest augury for the days which are ahead. We have given up repining and we talk very little about the good old times when it was easy to make money and easy to spend it. We are now concerned not much with the past but almost entirely with the future. We are, in a word, ready to start. But we are being held back by uncertainty, not about ourselves or our abilities or the natural momentum of our business life. It is, rather, an uncertainty which is artificial and not truly a part of us. We are ready to start, but how shall we start and what shall we use as the medium of exchange in this new year? To what port shall we lay our course? We are enveloped in a fog, or perhaps it would be better to say in a smoke from the fires of experiment. Everything around us is obscure. We can not see even the horizon, and so we dare not get under way. We are beclouded with what is called emergency legislation and the extraordinary powers vested in our administration. Theorists are seeking to interpret the chart. The ship lies at anchor inside the harbor-mouth ready to sail, and as soon as there is a better visibility and we can see the sky and can learn the condition of the sea outside the bar we shall set sail and up-anchor on a thousand voyages, all of us, we hope, helping to build up the commerce of the world in general and of our own nation in particular.

Editorial

American Institute Benevolent Fund, Inc. Action by the American Institute of Accountants followed swiftly upon the suggestion, to which reference was made in the July, 1933, issue of *THE JOURNAL OF ACCOUNTANCY*, that a benevolent fund be created for the purpose of relieving members of the Institute who may be in financial distress. At the banquet of the Institute at the time of its annual meeting in New Orleans in October, Edward E. Gore, of Illinois, made an effective plea for the support of such a fund and subsequently a few subscriptions were received. It was considered desirable, however, that the entire membership should have an opportunity to contribute to this worthy cause and a letter was sent to all members and associates explaining the purpose and asking for small donations to be used for current necessities. It was explained that it was the intention to establish a permanent and substantial fund, but that the present was not the most propitious time to ask for donations of large amount. In the letter explaining the purposes of the fund an interesting illustration of the way in which such a fund could operate was given. We quote the following extract from that letter:

“A member who had reached advanced years was discharged from an advisory position which he had had every reason to believe was permanent, and he and his wife were left without resources sufficient to support them for more than a few months. When the condition had become desperate an opening occurred in one of the most desirable institutions in the country where this accountant and his wife could be admitted and spend the rest of their lives in peace and freedom from care. It was, however, necessary that a sum of \$700.00 should be available to obtain admission. There was no time to lose and one of the members of the Institute personally advanced the money that was required in order that this opportunity might not pass without action. The member and his wife who were left destitute are now comfortably housed and will receive every care and attention so long as they both may live.”

It was decided by the executive committee of the Institute that the new organization should be chartered in the state of New York under the title American Institute Benevolent Fund, Inc. The incorporators were: William B. Campbell, Will-A Clader, Allan Davies, P. W. R. Glover, James Hall, Frederick H. Hurdman, Arthur W. Teele. A charter has been received and the fund is in active operation. Many subscriptions have come in

and there has been universal approval of the plan, even in some cases by men who were unable at the moment to make any monetary contribution. This addition to the Institute's activities is one of the most gratifying examples of the usefulness of organization. In all probability when there shall have been a resumption of business activity it will be possible to build up a sum in the principal of the fund which will produce sufficient annual income to take care of the most urgent cases which will arise. Naturally, the demand for assistance will be less in prosperous times, but even at the peak of prosperity misfortune may befall a practitioner and his family, and it is eminently appropriate that there should be some source of financial relief available in such cases.

**Responsibility of
Auditors**

Canadian and British accounting magazines have been commenting upon a recent case in the province of Ontario, which is of general interest to accountants everywhere. We quote the following from the report appearing in the *Canadian Chartered Accountant* for October, 1933, under the heading, "Responsibility of Auditors." The case was the *County of Renfrew v. Lockhart and Meehan*:

"What degree of skill must be exercised by persons who are not chartered accountants or professional auditors but who accept the responsibility of auditing accounts? A partial answer to this question was furnished recently by the judgment of Mr. Justice Wright in the above unreported case. The defendants, who were not chartered accountants or professional auditors, although they had some experience in auditing, were employed by the plaintiff to audit the accounts of the county treasurer. Commencing in 1925 the treasurer's accounts had been short every year until his ultimate exposure, but he had managed rather skilfully to cover up his defalcations during that time. The defendants did not discover these shortages when making their annual audits and this action was brought against them for damages for their alleged negligence.

"One of the principal charges was in connection with the shortages in the bank account. The judge found that at the end of December, 1929, the cashbook showed a balance of \$64,966.94, whereas the real balance in the bank was merely \$4,966.94—a shortage of \$60,000. The defendants, however, were put off by a falsified bank book which was produced for their inspection and which showed a balance of \$64,966.94, corresponding with the balance shown by the cashbook. In the judge's view the true

balance would have been discovered if the defendants had added up the different items in the debit and credit column of the bank book or had compared the items in the cashbook with the items in the bank book. Were the defendants negligent in not adopting either of these courses of action? The court held that while they were somewhat lax in the performance of their duty, their laxity did not amount to negligence, and that while their obligation was to perform their duty in a reasonably skilful and careful manner, yet their limited experience as auditors should be taken into account in determining the degree of skill that should be expected of them. Even if negligence on the part of the auditors had been proved, the court observed that a further point would have to be considered. Had the plaintiff shown that the losses sustained by it were the result of the defendants' failure to report the defalcations? It has been held in our courts (*Canadian Woodmen of the World v. Hooper*) that auditors are not responsible for the loss flowing from the misconduct of a defaulting employee, but only for the loss resulting from their failure to report the true state of facts. On the evidence in this case the judge concluded that even assuming negligence on the part of the defendants, the plaintiff had not made out a case as there was nothing in the evidence to show that had the auditors reported the defalcations at an earlier period, the services of the treasurer would have been dispensed with. In the result, therefore, the action was dismissed, but in view of all the circumstances, and in particular the laxity of the defendants, the judge allowed them only three-quarters of their costs.

"An appeal from the above judgment was heard on 21st September by five judges of the court of appeal for Ontario, and was dismissed with costs, two judges dissenting."

**Value Not Always
Received**

In the course of comments upon the same case in the *Incorporated Accountants Journal*, London, November, 1933,

it was said:

"The important aspect of this case is that the court took into consideration the limited experience of the auditors which in effect means that if a municipality chooses to appoint auditors who are not properly qualified, they do so at their own risk. As one of the judges of the court of appeal remarked, the county council 'got about the sort of audit for which they paid; they were about equal.' The moral is that auditors should be selected for their competence and not for the smallness of their fee."

In general it may be said that the opinion voiced by the judge of the court of appeal is true enough. People do usually receive about what they pay for; but it is not always true. In a case

such as the present, it seems to us that, whatever the county council paid, the service for which it paid was less valuable than the compensation. This does not mean that any particular blame attaches to incompetent persons who are deputed to perform a service outside the range of their experience and knowledge. It is quite common to find fraternal societies and many other organizations which subject their accounts to two or three men for audit when no one of the selected auditors is experienced in the science of accounts. In some cases it is known that treasurers have been appointed, with or without assistants, to audit their own accounts. Of course this is the height of folly. No argument is necessary to demonstrate the fallacy of incompetence. But there is another and more important aspect of the opinion of the judge whose remarks we have quoted, and that is one which is of direct concern to the profession of public accountancy.

Low Fees Are Costly Everybody knows that in all vocations there are men better fitted than other men to perform certain tasks, and as a rule the less efficient the man may be the less fee he demands. Consequently, there is a natural inclination on the part of many people to buy in the cheapest market, whether the goods for sale are merchandise or personal services, and it is not always true that the man who buys the cheapest article gets "about what he pays for." He often gets nothing, and he has to pay something. Then, again, at the other extreme, every one knows that there are professional men who charge utterly exorbitant fees and render no service of peculiar value. Here again the buyer does not get value for what he pays. What the learned judge had in mind, no doubt, was the perfectly incontestible truth that cheapness may be the most expensive thing in the world. So in the broad practice of accountancy the clients who stick to the accountants who ask the lowest fees are not wise, and it may be equally true that those who pay the highest fees are not wise. Indeed, the whole question of price is not one that should be considered first in the selection of professional advisors. If people could only be educated to the knowledge that price is a secondary consideration there would be far less difficulty. In that ideal day for which we all yearn there will be no question at all about compensation, but the work will be assigned to the men who are considered best qualified and they will be trusted to render fair and accurate bills for services.

**A Good Time for
Reformation**

It seems probable that this winter there will be less of the intense activity which in former days was the terror of the accounting profession. The volume of business which will come to accountants' offices can not be expected to be as great as that which was encountered in normal years, but whether the number of engagements be large or small the same principle will be involved. The seasonal nature of much accounting practice is almost as troublesome in bad times as in good, because it makes it necessary to employ, during whatever may be the busiest season, a considerably greater number of men than that required during the rest of the year. Consequently there is a lack of continuity which is a severe handicap. When employees are not needed for the full twelve months they naturally become dissatisfied with a profession which offers only part-time employment. Men who are available are, in a great many cases, less qualified than would be desired, and the burden thrown upon the permanent staff is increased by the extra attention needed to supervise temporary assistants. This fact revives the old question of the date of the closing of books, and it seems that this is a good time in which to encourage reform. Countless corporations and other companies have passed out of existence or are being entirely reorganized, and accountants should seize this opportunity to urge the adoption of the natural business year rather than the calendar year for fiscal computation. There is no necessity to argue advantages of terminating the fiscal year at a period when inventories are lowest. Every accountant is familiar with the points at issue. When business is thriving there is a great deal of resistance to any change in arrangements because corporation officers and directors are disinclined to undertake anything which is not absolutely necessary. At present, however, few companies are working at full pressure and there is excellent opportunity to introduce reforms which will be helpful when the full measure of business shall have been attained. The accountants themselves can do more than any other group of men to arouse interest in the merits of this reform. It is, of course, to their own advantage to have the work spread over the entire year, but the question can be raised without laying undue stress upon selfish considerations. Every company which has a natural business year differing from the calendar year will derive benefit from adopting the most convenient period for the closing of books. The labors of the

taxing authorities will be relieved. Indeed, there is nothing to be said in favor of the common adoption of the calendar year except the spirit of inertia which militates against any change. This is the time when accountants can adduce their arguments and secure better results than ever before. A new company or a reorganized company can have no valid objection to the natural business year, and the companies which are continuing in their former status can not justify adherence to an inconvenient plan because of having no time to attend to it.

Questions in Ethics The board of examiners of the American Institute of Accountants has introduced into the auditing examination a question based upon the code of ethics of the Institute. The board apparently felt that a man who is competent to be an auditor must be familiar with the principles which govern the reputable practice of the profession. The first of these questions appeared in the examinations of November, 1933. It required the candidate to explain the rule against advertisement of professional ability. Some of the members of the board expressed the opinion that this question was too elementary, but the answers are instructive, nevertheless. One candidate wrote, "For an accountant to advertise professional attainments would be disclosing information which should not be made public." Comment upon this answer would be entirely superfluous. Another candidate wrote, ". . . by frowning upon blatant display of qualifications in the hope of winning favoritism and clients at the expense of their less noisome but probably more proficient fellow practitioners." "Noisome," as Polonius might have said, is good, very good. Another candidate wrote, "If an accountant solicits business, advertises, underbids, etc., he will not only cut his fellow accountant's throat but will reduce himself from a professional standing to the standing of a cut-rate drug store or to that of the oldest profession known." Another candidate, who probably knew what he was trying to say but disguised his knowledge admirably, wrote, "If advertising were adhered to it would tend to alleviate the professional qualifications." The best answer of all, however, is probably this, "It looks like hell for an accountant to advertise how smart he is." The examiner, who reported this answer added his own comment: "A bully statement of fact."