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Robert H. Montgomery

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Accountants' Limitations *

BY ROBERT H. MONTGOMERY

The title of this paper was suggested to me by an experience at Columbia University last winter. Some of the senior students in the accounting courses had been analyzing the reports and balance-sheets of industrial companies. The students asked me questions about two balance-sheets on which they were working at the time. One was of a large chemical company, the other of a large automobile company. The stocks of each were listed on the New York stock exchange and had declined from above par to a few dollars a share. Successive balance-sheets had been certified by reputable firms of accountants and in each case a reliance on the expression "true financial position" in the accountants' certificates would have justified par value and more for stocks which were selling at practically nothing. Since neither company, then or later, went into bankruptcy, the usual explanation of "going concern" or book values was not sufficient. The obvious and accurate explanation was poor management in one case and general depression in the industry in the other. The question then arose: Is it impracticable or impossible for public accountants to reflect the obvious in their balance-sheets and certificates? If investors and stockholders must rely on independent investigations regarding operating conditions in each company and the specific conditions in each industry, how much benefit flows from the certified as compared with the uncertified balance-sheet?

The incident troubled me and I have not been helped by other incidents which have occurred since. In fact, the more I have thought about the matter the more I have been troubled. I feel that a taking of stock in our profession may do some good and can do no harm. If we are attempting too much in some directions, and too little in others, a frank discussion of conditions may help us to concentrate on matters which we can master, and we should acknowledge our limitations in matters which are beyond our scope and, what is more to the point, beyond our powers.

I do not underestimate our broad opportunities and almost unlimited usefulness within natural limits. What those limits are is the subject of this paper.

* Address delivered at the annual meeting of the American Institute of Accountants, Del Monte, California, September 20, 1927.

I would like to emphasize at the beginning of my paper, as I shall again at the end, that I do not think the public accountant, as such, should prophesy or predict regarding the future results of operations or in regard to any financial or economic questions which depend for their solution upon unknown factors. I may say that he is often in a position where he should be able to do so far better than many of those who do not hesitate to prophesy, but when, as and if he attempts to leave the realm of the known for the unknown, I hope he will call himself a business advisor or some other high-sounding name and keep secret his connection with public accounting.

DISTINCTIONS BETWEEN LIMITATIONS

There are natural limitations upon bookkeepers, statisticians and others in the employ of private concerns. They are the builders and keepers of the records. Their records are not trustworthy unless they accurately reflect transactions as they occur. To these transactions we can truly refer as the facts of business. Their importance must not be underestimated. When the accountant wishes to analyze and interpret he is helpless without the facts.

It is unnecessary to dwell upon the present-day skill of those who keep and are responsible for the accounts of modern business enterprises. It is perhaps due to their constantly increasing skill that the public accountants add little to many published balance-sheets. Whether concerns are highly prosperous or are on the thin edge of bankruptcy, there is little difference today between the compilations of skilful bookkeepers and the certified published accounts.

Is it satisfactory that there should be no difference? The bookkeeper deals with so-called facts which are mere records of the past; the accountant is supposed to bring to bear experience and skill equal to the bookkeeper's, plus something else which, shortly stated, is opinion regarding or interpretation of the facts—not a mererestatement. On the extent or use of these opinions and interpretations rests the future of the profession. If our limitations restrict these to confidential use our association with published balance-sheets is a private, not a public, benefit, and we are wrong to emphasize the value of our services to investors when they never hear of our opinions or interpretations, unless and until a concern goes on the rocks.

We have all heard criticisms of the accountants who have certified the balance-sheets of concerns which subsequently encountered financial difficulties. The accountants may have certified the balance-sheets under the time-honored (but I think moss-covered) tradition that as long as we use the term "going values" the concern can go bust any time it likes and no one can criticize us.

I do not say that accountants *should* be criticized for adhering strictly to the going-concern concept—I am still exploring the distinctions between professional accountants and skilful book-keepers.

It still lingers in my mind that in dealing with published balance-sheets there may be an insurmountable barrier which restrains the accountant from reaching the summit on which we are pictured as standing in all the glory of fearless searchers for truth, analysts and interpreters and independent investigators who fear neither man nor beast.

One of my perplexities lies in the difficulty of interpreting business conditions without doing a bit of prophesying!

UNNECESSARY LIMITATIONS

Sometimes we impose rigid limitations upon ourselves with reference to unimportant personal matters and sometimes we are uncompromising in our attitude towards equally unimportant professional matters. We cherish the theory that self-discipline creates character. It does, but not necessarily lovely character. If we think back far enough we shall recall instances when we were firm, very firm, in our insistence that a client or his representative should do or not do a certain thing, and later we discovered its relative unimportance. In discussing the natural limitations which we must meet, whether or not we are willing to look them in the face, I merely mention, without comment, that of all professional men the public accountant should avoid like the plague the self-imposition of unimportant limitations. We shall fall far short of success unless we maintain at all times open minds and a solemn realization that we are often wrong and make many mistakes.

It is becoming more and more difficult to keep our feet on the ground. The whole world went crazy over the idea that men could safely fly across the sea. Our excitement arose chiefly from the ever-increasing desire to get a few more emotions or excite-

ments out of life. Routine has become more and more irksome. Most of us envy the other fellow his job, and some of us dally with the thought that we could do it better than he is doing it. I think it is nothing to brag about that we are so often called upon to certify to the obvious, when nothing more is wanted than a certificate that the balance-sheet is correct. Suggestions are politely received and silently buried. In many cases the client or the banker would be happy to receive the certificate and pay a somewhat higher fee if no work were done than if the accountant insisted on looking *at* the books. I am referring now to cases in which the accounts are all right and nothing is concealed in the published statements.

It is reasonable for the client to state the *object* but he should not expect to dictate the *extent* of an investigation, otherwise the accountant surrenders all independence and becomes a hired man. It will be the fault of the profession if this condition continues or grows.

It may be urged that the client should be able to judge for himself what work he wants done. He may be able to do so, and it is a fair assumption that in most cases the ideas of the client and the accountant agree as to the extent of the work. But in professional work one must dominate and the other follow. In law, medicine and engineering the practitioner insists on doing his work in his own way. We laugh at the parvenu who tries to tell the artist what the artist must do.

It may be that organizations are now being built up which will accept dictation as to the extent of their work and so standardize so-called accounting services that they can bid on specifications and deliver what is ordered, no less and no more. From a business point of view this may be a necessary and logical development of standardization. But it is unthinkable that professional accountants should accept any limitation upon the extent of their work, and if it be true that some clients wish to secure, merely for the name, professional auditors who will do the work that a good bookkeeper can do, it is time that such subservience cease. It is impossible to agree in advance that one's opinions will be so and so. If opinions are not wanted what *is* the basic claim to professional standing?

We have talked for years of the importance and desirability of bringing into a business picture a disinterested expert whose independent comments and criticisms of the management and

results of a business will be helpful. But if he defers to the opinion of those whose work and accounts he must examine and criticize he loses his right and his reason for existence.

NECESSARY LIMITATIONS

At the thirtieth anniversary dinner of the New York State Society of Certified Public Accountants the members of the society were congratulated on being good diplomats, police commissioners, educators, arbitrators, interpreters of business conditions, soldiers, sailors, and what not, without much about any member of the society being a good accountant.

It is highly gratifying to think that from the ranks of the profession the army and navy and other important activities may be manned, and it is an added incentive to the young accountant to know that as he grows in wisdom and in stature he may have a chance at a job wholly unrelated to accounting. But the prospect may have an unsettling effect. Is it not possible that the horizon of the profession may become unduly broadened by a multitude of interests which in the aggregate make less certain our most important objectives? As an illustration: Why are so few accountants made receivers or trustees?

Despite much agitation and research we do not seem to be able to determine why it is that professional accountants in the United States rarely are appointed receivers or trustees. There are a few outstanding exceptions, but the number is negligible. The answer to the question may be that in this country lawyers want the jobs and get them and that the only reason they do not take them in Great Britain is that the lawyers are willing to forego the appointments. I am not sure that this is an accurate answer. Lawyers the world over are pretty much the same—they want all they can get.

One fact is established, viz., in England, there is a demand for the service, whereas here there is practically no demand. Supply usually follows demand and no matter how much merit one may have he will remain unnoticed and unsung until a demand arises.

I do not believe that the demand can be accelerated by one's own efforts. We have tried and failed. I am inclined to classify receiverships and trusteeships outside the limitations which must be recognized.

In other words, no matter how satisfactory we might be as receivers, hardly anybody wants us, and it is not conducive to one's

self-respect to be saying for years that our experience and skill peculiarly fit us to do certain things better than anyone else, and then to find that we are wasting our time. As a matter of pride shouldn't we accept the limitation and brag a little about our unwillingness to serve as receivers and trustees? If a certain rule holds good we may be overwhelmed by appointments when and if we show that we really do not want them!

LIMITATIONS ARISING FROM LACK OF KNOWLEDGE OF THE FUTURE

We are told that our outstanding service today lies in the investigations which precede the public flotations of securities, and the implication is that we serve the public and the investor. But how many investors know that many proposed flotations are not made because the investigations of the accountants disclose weaknesses which were not known to the prospective purchasers or bankers? This is a vastly important service and is not fully appreciated.

When representations regarding earnings, etc., are found to be true and securities are offered, bankers and their associates sell the securities almost solely on the prospects of the future—which depend on two major factors, viz., management and economic conditions of the particular industry. What has the accountant to do with either? If he has convictions, favorable or unfavorable, on the subject, as far as the public or investors are concerned he must keep absolutely silent about them. He completed his job when he certified to the past. This is a necessary limitation and should not be changed. We must not prophesy.

In the cases which troubled the students they found that the prices of the stocks were wholly unrelated to the balance-sheets. The losses or insufficient profits shown by the income statements told much of the past, but little regarding the future. The problem may be insoluble. If it is, we should recognize it.

Nevertheless, when businesses are successful, earnings increase and stocks rise, what measure of credit goes to the public accountant? None! When business declines because of poor management or depression in certain industries, who is criticized for certifying the "true" financial position of a company which shows \$200 of net assets per share of a preferred stock that sells for \$2 a share on the exchange? The public accountant!

IS SO-CALLED CONSERVATISM A NECESSARY LIMITATION?

I think that our so-called conservative attitude has been used against us by those who are sharper than we are. We are still discussing whether or not the values on a balance-sheet shall be as true as we can make them or as obscure as others want us to make them. When others want assets which are worth far more than cost to appear at cost they appeal to our ancient tradition, and we acquiesce. When they want assets to appear at reconstruction value they have an appraisal made and we use it. When fixed assets decline in value who ever heard of an appraisal? Take it any way you like, the so-called conservatism of the accountant hides understated values which it can never harm any one to know or hides overstated values which it would be useful to know.

I am afraid it is not courage which started the conservatism which accountants have, but fear. I want to see the profession maintain a reputation for sound conservatism but I do not want it to be an empty gesture.

It requires little courage, little skill to certify to the accounts of a concern which has made and is making a lot of money. It requires great courage, great skill properly to certify the accounts of a concern which has lost or is losing money.

We are pretty human after all and will only improve when our limitations are known to us. I seriously suggest that we set up a committee or tribunal which will impartially investigate the accountants' deficiencies, if any, whenever a concern gets into trouble. It should be arranged in advance as it would be invidious to start the movement after something happens. In order to be absolutely impartial as to who would be hit first I would suggest that we start with the stock exchange. Take the first company which has a creditors' or stockholders' committee appointed or a receiver or takes any similar action which indicates financial difficulty. If one of our members has certified the balance-sheet let us analyze the situation and get at the facts.

If students in accounting courses think it worth while to do this and spend much time on it (perhaps fruitlessly), we should be much more interested.

The public accountant has no superhuman qualities, and it is harmful to the profession to have it said of us that we can perform beyond very reasonable limits. An accountant is a critic who knows something about accounts. I feel quite sure that we do

not do enough research work, although we have material of unlimited value.

One of the perils of conservatism is that it leads to inaccuracies. What may be beneficial to society as a whole may be a calamity to certain individuals.

This is well illustrated by the almost ludicrous inaccuracies of Secretary Mellon regarding the national budget. During the war years when excess-profits taxes were new and untried, the actuaries of the treasury were uncanny in their estimates of revenues. Came Secretary Mellon and post-bellum years and simultaneously came tax estimates which were wrong by hundreds of millions of dollars. The only explanation we have ever had is that the estimates were conservative! I for one do not believe the explanation. I believe that the actuaries are as capable as ever, but that Secretary Mellon, knowing that he had to deal with extravagant congresses, changed a figure or two and said "Boys, this is all you have to spend."

I am not sure that public accountants have a moral right to follow such procedure. In the past we have taken pride in understating assets and overstating liabilities. It is not accurate procedure, no matter how commendable it may be, and in the long run ill-advised conservatism defeats its own purpose. Within the last few weeks the daily newspapers have reported several statements from prominent congressmen to the effect that next winter tax revision and appropriations will be based on the experiences of the last few years and it will be assumed by these congressmen that the treasury surplus next year will be several hundreds of millions of dollars more than is predicted by the treasury.

CAN THE VALUE OF ASSETS BE SEPARATED FROM THEIR EARNING
POWER?

Balance-sheets often show historic *costs* and do not show present *values*.

It must be admitted that the effective and profitable use of property depends on management, because in every industry we find that of different concerns owning the same sort of plant facilities some earn and some lose money. An appraisal of assets, not based on income, remains ineffective, because the action of purchasers of product is voluntary and depends on the will of the purchaser. This will to purchase must be considered with the

appraisal, or we exhibit an incomplete picture. I wish a committee of accountants would take the balance-sheets of fifty corporations listed on the New York stock exchange whose shares are selling at more than book value (excluding goodwill) and fifty corporations whose shares are selling at less than book value, and draw therefrom an answer to the question: "What is there to guide an investor in the asset side or net worth of a balance-sheet?" Probably it will be found that management and general prosperity in an entire industry are the major factors which affect both the prices and values of shares.

LIMITATIONS IMPOSED BY STANDARDIZATION

Our most precious asset is our independence in thought and act. Our method of expressing the use of our asset is by means of opinion or judgment. Slavish adherence to definitions or precedents would reduce our usefulness to a vanishing point. As has been said by George Agnew Chamberlain, "The seriousness of the Anglo-Saxon race, on its knees before accepted definitions, is the most stupendous joke on earth."

I do not think that we, on our professional side, are ready for a classification of services. In my opinion, it would not cure any present defects and it might obscure some of our insufficiencies. As it is impossible to standardize the minds of accountants, their work and their services can not be standardized.

A review of forty years of practice reveals to me unlimited scope and steady development in the service which calls for a free expression of what we believe to be true. As critics we are unexcelled. In the personal work for a known audience there are no limitations on the use of our skill and experience; when addressing the unidentified there are natural and logical limitations which are irksome even though they are necessary.

Any published classification of services is sure to be used by those who would impose limitations upon us. Instead of more limitations we should seek more freedom of speech, greater opportunities for unlimited service. If there are unrest and discontent within our ranks it is as it should be. It is a hopeful sign. We must keep our ideals and not lose our vision. Without discontent there will be no progress. Most of us do not wish to be standardized or classified. We long to be free to do our best, say what we think and accept the full consequences for our shortcomings and mistakes. We long for unlimited opportunities and

we fear any restrictions on hours of work, pay per hour or expressions of opinion. We will not join the accountants' union unless and until we can standardize and equalize our brains. Hand work has been standardized, brain work never.

In our endeavors to improve we add the pursuit of culture to the constant pursuit of technical skill and experience. Matthew Arnold has defined culture to be "contact with the best that has been said and thought in the world." Specialization is the persistent foe of culture. There is too much tendency to overvalue the sayings and doings of others. We eagerly read the book or article which has been written by one whose experience is less than our own. We suffer from prosperous critics who condemn everything which is old-fashioned or virtuous and pose as leaders of thought but never suffer for their views. We have few modern martyrs. We are afraid to confess that we do not know everything; we are afraid to confess that we have severe limitations, and because we do not acknowledge our deficiencies we fail to remove them. We gather knowledge, we accumulate experience but how much of it have we applied to the solving of business problems?

I think we should set ourselves against standardization and try to put over what we can deliver. For one thing let us set ourselves to the problems which confused the Columbia students. There would have been no confusion in their minds if they had asked for and received balance-sheets set up for a specific purpose. During the past year or two much has been written about balance-sheets for special purposes. There has been much criticism, other than from Professor Ripley, of the conventional condensed balance-sheet and income account. But I can see no practicable or safe way of certifying for publication purposes more than one balance-sheet of the same concern at the same date.

The solution (if the problem is soluble) is to improve the content of the present all-purpose balance-sheet. Practically all corporate officers are keen about disclosing all that properly can be disclosed. It is quite possible that a little missionary work may lead to more informative balance-sheets. Some of us have thought that balance-sheet practice would improve if and when we were to agree on good accounting procedure, but I am afraid that the problem is more difficult and the cause of the trouble deeper seated.

So far I have confined myself to practitioners. It has been urged that classification of services is important to students.

This is obvious in so far as the purpose of classification corresponds with the courses of study which must be imposed upon students in addition to practical experience. The study and reading necessary to the student are so broad, however, that I question the advisability of any limitations upon their concept of professional service. If they will study one subject after another they will gain a general familiarity with all phases of accounting work.

A prescribed classification would be desirable if it were possible to agree upon its content. It will do no harm to discuss classification, but I deprecate any move which tends to limit or define the thing we do so well, i. e., critical or analytical work.

There are no known limits to culture, education, technical training, skill, experience. This is the true heritage of the public accountant. In our zeal to educate others we are apt to claim that we have discovered something new, and that if we can not impart and others receive it the world will suffer an irreparable loss. Occasionally, when I tremble at the thought of some new way of lightening the burden of students I turn to the written records of accountants whose zeal equaled ours and of whom we have authentic records back to 1494. Almost always I find that some one had the same thought two or three hundred years ago and that it was expressed then better than I can do it now. In looking for a few thoughts on the education of students in accountancy I found a reference by a comparatively recent writer who had read the earlier writers and who admitted that he had improved upon their methods. In the preface to *Book-Keeping Methodized*, by John Mair, published nearly 200 years ago (1736) we find, "I shall only add, That the Theory of this Art or Science is beautiful and curious, very fit for improving the Minds of Youth, exercising their Wit and Invention, and disposing them to a close and accurate way of thinking. On this Account several Gentlemen, after having got acquainted with it themselves, have been induced, from the Satisfaction and Entertainment they found, to recommend it to others, as a valuable Piece of humane Literature, proper to be studied and understood by every one who pretends to liberal Education."

LIMITATIONS OF ALL-PURPOSE BALANCE-SHEETS

THE JOURNAL OF ACCOUNTANCY, in an editorial in the June, 1927, issue, warns the accountant not to accept "an indeterminate

measure of responsibility” and in effect suggests to accountants that we leave inventories alone. This is what I was told nearly forty years ago. I do not like to believe that it reflects good accounting practice today. I find authority for a gratifying increase in the supervision of inventories by accountants. It is a useful, critical service. Sometimes in a few hours or at the most in a few days, accountants find serious errors in inventories. Leaving inventories alone does not appeal to me. When certificates of persons associated with the concern under audit are mentioned by auditors as a limitation upon their own work the impression gets out that we have carefully avoided something about which we know nothing.

We set up huge appreciation in fixed assets, which adds little to financial strength and earnings and we hold up our hands in horror when it is suggested that we state the market values of marketable inventories which have appreciated in value, even though the trend thus reflected means a real increase in financial strength and earnings. On the other hand, stating an inventory at cost or market, whichever is lower, may obscure an unfavorable trend, unless the income account clearly reflects the losses due to downward fluctuations. But this usually is not the case. I am merely trying to discover the point of highest efficiency within the accountant’s scope of duties and possibilities.

We must admit that the accountant does his best and most constructive work when he is absolutely free to criticize and condemn. When balance-sheets and income statements must be published there are natural and logical limitations to their form and to their content. It is not enough to say that the accountant is limited and sometimes hampered in making public his comments on past performance, present conditions and future probabilities. Accountants who are critical of other accountants, whose views are not made public, would be astonished if they knew how often accountants are wrong and how often executives, bankers and lawyers are right. The accountant often accepts a compromise in the set-up of a balance-sheet, its terminology and the treatment of certain charges and credits. He does not necessarily surrender his independence when he modifies or reconstructs to meet the wishes of those who also have their responsibilities to the public.

It is not easy to satisfy everyone. For illustration most of the forms of balance-sheet proposed or required by the federal

reserve and other banks ask that accounts be "aged" and that the classification be stated on the face of the certified balance-sheets, but when their requests are analyzed it is found that they want the information for themselves and are quite willing that no one else should have it. This attitude is not helpful to the auditor who is expected to submit a balance-sheet to meet all possible conditions. Bankers are the auditors' best friends and greatest trial!

LIMITATIONS ARISING FROM IGNORANCE OF
REPRODUCTION COSTS

It is important to know the cost of reproducing essential plant or equipment which is wearing out all the time and must be replaced. If the replacement period is imminent the depreciation allowance may be wholly inadequate, and a concern with a small margin of profit may find that depreciation allowances on reproduction costs would wipe out the profit.

But reproduction of *existing* facilities frequently does not mean reproduction of essential facilities. Herein lies one of the weaknesses of many revaluations. When an appraisal company is requested to ascertain depreciated reproduction cost it can not be expected to act as a consulting engineer and present an estimate of what something else more suitable would cost to build. The only measures of the value of existing plant are the quantity and quality and cost of product which can be turned out. In almost all cases where facilities are more than a few years old, the owners would not reproduce existing plant in its present form. Elements of inadequacy and obsolescence may be more important than ordinary depreciation. It is a difficult problem and must have attention.

OF WHAT PRACTICAL VALUE IN THE FUTURE IS A
KNOWLEDGE OF ORIGINAL COST?

Balance-sheet valuations at cost ignore the practical, and substitute historical and sentimental measures of value. Bookkeepers and statisticians are forced to deal with the cost of assets because they are recorders of business history. Costs are interesting to statisticians, but most investors are not statisticians. What makes an investor buy? What are the controlling factors in business? Certainly among the major factors we find the intention to pay debts and to realize a profit. We can not pay

a single debt with assets at cost, nor can we sell goods at profit based on cost. I am of course referring to business in general and not to monopolies and near monopolies where cost is used as a measure of fair return. The inference might be drawn from such businesses that because they operate on a cost-plus basis they are invariably successful. If cost alone were enough to ensure success the bookkeeper would serve all purposes as well as the public accountant. But a survey of concerns which are supposed to work solely on a cost-plus basis and of public utilities quickly dispels the thought that cost of assets automatically fixes profits.

It has been suggested by several well-known writers that depreciation allowances should reflect reproduction rather than original cost, but the arguments against the rule that depreciation allowances should be based on original cost are not persuasive.

Adherence to the assets-at-cost concept does not mean that I am in favor of ignoring present values when reasonably trustworthy figures can be ascertained.

If we were to attempt to retain cost of fixed assets as the basis of book and balance-sheet figures and to meet the demand for additional information, perhaps the most satisfactory method of conveying information on a balance-sheet would be to carry fixed assets at cost, less what we usually call normal depreciation, and note in parentheses or by footnotes the latest trustworthy information about current values.

When inventories are worth substantially more than cost, the same procedure might be followed.

Professor Ripley is not alone in his criticism of the modern balance-sheet, and while some of his comments are unjustified, public accountants should study the situation and do their part to improve conditions, provided anything can be done.

One fact we must face. Thousands of revaluations have been made and thousands of balance-sheets reflect present-day values more or less accurately. Many more thousands of balance-sheets have not been adjusted. Considerable numbers of them do not even show cost, less normal depreciation, but on the contrary show cost, less abnormal depreciation.

When the practice first started of writing up the value of fixed assets accountants were almost unanimous in aggregating the offset to excess values in an account called "surplus arising from revaluation." Then came no-par-value stock, stated capital,

paid-in, initial and capital surplus complications, coupled with formidable legal opinions that accountants should mind their own business and not use such terms as earned surplus.

Due largely to pressure from lawyers came the merger of carefully worded special surplus accounts into one surplus account. And of course when you only have one surplus account it is all available for dividends! And there you are! No wonder it is difficult to compare the balance-sheet of one concern with that of another in the same industry.

In the case of new legal entities it is hardly practicable to go back to original cost, but it might be feasible, if we all agreed, to insist on sticking to cost when no change is made in the legal entity. It would be quite simple to state present values or reproduction cost side by side with cost, and thus convey the information which seems to be demanded and at the same time circumvent the lawyers by not having any capital surplus for us to name and for them to rename.

Depreciation of the increased values is a serious problem, but is not a factor when the appreciation largely consists of land investment. Stockholders are entitled to information about such appreciation and if mentioned in a footnote the disclosure is as effective (and safer) than if appreciation be added to surplus.

The foregoing and other reasons no doubt explain why it is that writers and students advocate the preparation of different balance-sheets for different purposes, contending that the all-purpose balance-sheet loses its effectiveness in most instances. It is said that auditors place too much stress upon the possibility and probability that balance-sheets—no matter for what purpose they may be prepared—will be used as a basis for obtaining credit in money or goods, and that this influence is so strong that undue weight is given to the factors of current assets and current liabilities. There is much truth in the claim that more balance-sheets are prepared for the use and assistance of clients who are not interested primarily in seeking credit than are prepared for credit purposes, but as long as the auditor has no practicable method of restricting the ultimate use of the balance-sheets which he submits he is forced to assume that in every case the balance-sheet may be submitted to credit grantors.

Where there is a personal and intimate relationship between the auditor and his clients and where there is a close corporation, there should be opportunity for personal and intimate comments

and suggestions. The auditor restrained is not the auditor who can state what he thinks with all the vigor and candor of which he is capable. It is futile to say that the auditor always can make a supplemental report in which he can say what he likes. The theory is good, but in practice the auditor who has exercised all his powers of restraint in the preparation of a lifeless, colorless, conservative balance-sheet for publication purposes is human enough and astute enough to refrain from putting himself in the position of submitting supplemental reports which may bear the appearance of inconsistency, even though that may not be a fact.

One of the necessary evils (if evils can be necessary) of the auditor's passion to be conservative is that usually he is conservative in those cases when it makes absolutely no difference, whereas when concerns are on the edge of insolvency or bankruptcy he must strictly observe all tenets of good accounting practice to the limitation of high asset values and the setting up of only those contingent liabilities which are necessary.

The ordinary all-purpose balance-sheet does not begin to disclose all the information required by those who have under consideration the financing of a business. A potential purchaser very properly wants to know values, and while he is interested in what assets have cost he is vastly more interested in current values.

The all-purpose balance-sheet should give the short-term creditor most of the information he requires, but naturally he prefers his own form, and this generally requires a rearrangement and amplification of the auditor's form.

Those whose chief interests are not centered in the liquidation of short-term loans need more information than is contained in the all-purpose balance-sheet. The auditor who does his work thoroughly will have collected sufficient data to enable him to submit a more detailed balance-sheet than is now considered good practice. The condensed balance-sheet is the one most difficult to prepare. When the inevitable demand for more comprehensive balance-sheets arrives the auditor can supply it without any additional work or any additional fee.

The balance-sheets prepared by auditors for rate-making purposes are prepared on the basis of a formula prescribed by law and contain many necessary variations from the all-purpose balance-sheets.

LIMITATIONS ARISING FROM UNAUTHORIZED USE OF REPORTS

The future success of an enterprise depends upon the profitable use of its capital investments. The lender on short time who is interested to know whether or not a forced liquidation would repay his loans with interest may ignore the value of capital assets in determining the credit risk, but the prospective investor in stocks or bonds must rely on two major factors, viz., adequate facilities properly maintained and adequate earnings. A few years ago it was believed that we could not refer to net income until all costs and charges were deducted, but now we find that perhaps most public offerings of bonds contain statements that carry to ignorant or careless investors an implication that certain funds are as available for interest as for depreciation and taxes. If it were not for the sincerity of most of these statements I would have to characterize them as intentionally misleading. And, of course, I do not refer to the statements where the amounts of depreciation, depletion and taxes are clearly stated somewhere in the circulars, so that investors can determine without too many computations of their own how much net income is left after the deductions for depreciation and taxes. It is beside the point to say that public accountants do not certify to net income unless depreciation and taxes have been deducted, but the investing public is not astute enough to determine, after reading many bond circulars, what the accountant has certified and what the banker has computed. If the practice is wrong, accountants can readily tell the bankers what must go in and what must be omitted. There is no law to force an accountant to continue to work for bankers who issue misleading or inaccurate circulars.

Statements showing so-called net earnings from which depreciation and taxes have not been deducted are fallacious because there is absolute necessity for the maintenance of capital assets and the payment of taxes at least annually and in every practical sense before interest on bonds. By a practical sense, I mean that taxes and capital renewal expenditures must be made currently precisely the same as expenditures for raw materials. The penalties for not paying federal income taxes promptly are so heavy that practically all corporations pay their instalments sharply on time.

The limits of this paper will permit no more than a reference to judicial valuations. Our ideas of the meaning of "going value"

receive a jolt when we survey the interpretations of the courts dealing with the subject. In some outstanding cases the courts have determined the value of specific property to be vastly more than book value. Intangibles have been measured and large values attached. Certainly from the standpoint of those who consult balance-sheets *for any purpose whatever* the disclosure of assets with true earning power is of controlling interest as against the showing of assets at cost which have no reasonable earning power.

Therefore when we speak of the "going concern" concept we must adopt authoritative definitions of the term and ignore the accountants' definition—if it disagrees.

In many cases judicial determination writes down book values when they are excessive because of mistakes or other factors which make the cost of assets no longer representative of value. The common use of the word "going" comprehends motion or use.

The courts have decided that "going value" means something entirely different in the following cases:

Rate making—when an owner is entitled to a fair return on the value of his property.

Taxation—when an owner is entitled to the same basis of assessment as others similarly situated receive.

Sale under foreclosure—when there are different kinds of liens.

In the case of reorganizations, when dissenting stockholders are entitled to the fair value of their shares, the ordinary balance-sheet sheds little light on the net worth of the corporation. I do not include forced sales under foreclosure, etc., as then the upset price which may be fixed in advance has no necessary relation to going values. But the courts never deal with going values unless the status of the interested parties is known, and this accounts for the widely varying values placed upon similar assets.

In the monograph on accountants' reports published in 1927 by the New York State Society of Certified Public Accountants this significant statement appears:

"The creditor is entitled to all information which has a material bearing upon the credit risk; and a certified balance-sheet is usually not sufficient."

If the short-time creditor is entitled to more information than usually is furnished, certainly the long-time lender or the investor is entitled to far more information than the ordinary creditor.

From the standpoint of the inquiring investor the conservative balance-sheet will be from the prosperous and well managed company and because of its conservatism will not give him the full, true picture.

When there is poor management or the concern or industry is not prosperous the balance-sheet will not be conservative. Good accounting practice will be strained to the limit to obscure the bad and to magnify the good.

LIMITATIONS IMPOSED BY AND ADVANTAGES DERIVED FROM
LEGISLATION

There will be attempts to limit our activities by restrictive legislation, which purports to classify accountancy as a profession and would probably recognize, as qualified public accountants, vast numbers of the unqualified and refuse to recognize at all many who are qualified. This is a limitation beyond the scope of this paper and may be dismissed with the thought that it is highly amusing if not edifying to find that those who wish to protect bankers from the unqualified usually are unknown to the bankers, whereas the only ones who are to be barred are the very ones upon whom the banker relies.

The public cares little whether or not the public accountant is legally or in common parlance a member of a profession. In referring to accounting as a profession there is an implication that it is in itself a profession, that it has marks of identification which distinguish it from other professions. What these marks of distinction are I do not know. I have never been able to understand just what it is we gain from calling ourselves a profession. Do we merely try to put over to the doubtful and skeptical that we *do* use brains instead of hands or machines? It has not hurt us to keep on insisting that our work is of a professional character but we must remember that most of our clients refer to their own commercial activities as professional pursuits. President Lowell, in conferring their degrees upon the graduates of the Harvard school of business administration, spoke of "Business, the oldest of the arts, the youngest of the professions." This either includes us or excludes us, you can take your choice!

In *United States v. Laws* (163 U. S. 259) the United States supreme court in deciding whether or not an accountant was a member of a learned profession said: ". . . However broad such meaning may be, it would seem that an accountant would fall without it."

Probably no one would dispute that if you omit the word "learned" we are members of a profession. The new standard dictionary defines the word profession as follows: "An occupation that properly involves liberal education or its equivalent, and mental rather than manual labor." If we apply a broad interpretation to the foregoing we find that there are hundreds of professions.

So far legislation largely has concerned the individual. The demands of the public largely have concerned the accountants' organizations. There has been a conflict and the issues will become more acute in the near future.

In his fundamental work the public accountant functions and will continue to function in spite of and not because of legislation. Legislation has been valuable in demanding more study and in keeping together the best elements in the profession but it has not made a learned profession out of accounting and never will.

In one state at least (Ohio) the legislature has taken notice of the existing lack of uniformity and clearness in balance-sheet terminology and has paved the way for the accountant to stiffen his backbone. It is provided, for instance, that unrealized appreciation, if entered in the books, must appear in accounts separate from surplus profits and capital surplus or paid-in surplus. Surely there will be no excuse for an accountant to allow his name to be connected with a balance-sheet in which the separation on the books is not expressed on the balance-sheet.

IS THERE ANY LIMIT TO THE SIZE OF A PROFESSIONAL FIRM?

Accountants should not pose as public benefactors. Many have been forced to carry on their practices as businesses and have tried to maintain professional standards. The task is difficult and the outcome is somewhat uncertain. It is charged that large accounting organizations are well equipped to turn out fine specimens of balance-sheets and income statements under the most approved factory methods of quantity production and standardized product. But what is intended to be a reproach may be founded on inaccurate premises. Sometimes the highest quality is found in the largest factories and the best product is the result of painstaking standardization. The justifiable comment may be that professional work can not be done in quantity nor under standardization of methods. Probably big business which has forced into being big accounting organizations has

forced some accountants out of the profession, unless we admit that the accounting profession is not a learned profession which demands personal attention to all details.

It is not necessary that the accountant should ignore standardization but he should not worship it.

The outstanding characteristic of the accountant today, as it always has been, is character. Then he must have courage and imagination. To his integrity he should add some knowledge of accounts. The tendency is to standardize his service and to subordinate his imagination. If care is not taken the most essential element will be removed—namely, *personal* service.

In our business organizations the accountants have gone so far that the general counsel for the commissioner of internal revenue says that the income of partners in accounting firms is not earned income, in the sense that it is derived from personal service. We are charged with running big business enterprises. It may be that the only professional accountants are those who render personal service.

SERVICE WHICH HAS NO LIMITATIONS

There is practically no limitation on the work of determining costs or profits of departments of businesses, of comparing results of one department with another, of comparing costs and results of one concern with other concerns. Accountants accumulate vast stores of data of incalculable value which are often unused because of the apparent necessity of secrecy and repression.

The Institute did a fine piece of constructive work in the preparation and distribution of the bulletin "Credit frauds" in 1925. The accountants' participation in the running down of fraud was described in numerous ways. How could the accountant be more useful? What is more constructive? The estimates of losses due to credit frauds run into the hundreds of millions annually.

In this work there are no limitations on the accountant. He can prophesy and estimate and cogitate and allow his imagination to run riot. It is not unattractive and is highly appreciated.

There is no limit on the services which accountants are rendering to private individuals who want to know all about a business in which they are or may be interested.

I have been amazed at the quantity and quality of accounting literature which has been produced during the last six years. If it had not been for this paper I suppose I would not have had

the pleasure of reading more than a small proportion of highly creditable and interesting books all dealing with the present wide ramifications of our profession. It makes one proud to realize that so many important contributions are being made. Most of these books and articles deal with the constructive possibilities of service—the sort of service which is unlimited in scope. If our logical expansion lies in more attention to details, more skill in criticism and suggestion, no better equipment can be secured than a library of perhaps 200 books on accounting subjects. They contain accumulated knowledge and experience of the profession as a whole. If they can not be read by all they can be digested or summarized by some one in each accounting organization. Lawyers, doctors and engineers of the highest standing and largest practices are those who have made the best use of the literature of their professions.

CONCLUSION

In weighing necessary and unnecessary limitations I decided that the profession is in a highly satisfactory condition where our work is not for general consumption, and somewhat unsatisfactory where certified published balance-sheets are concerned. Most of the limitations appear to be necessary and permanent. I am afraid that most of our most brilliant work will be unknown and unsung by the multitude. After I completed the first draft of this article, I decided that my personal conclusions required authoritative corroboration. I quickly found plenty, so much in fact that time and space will not permit the reference which I would like to include in this paper. Something has started. I am not enough of a prophet to define the end, but I can interpret the trend. The best summary of this trend is found in the report of the Robert Morris Associates committee on coöperation with public accountants which says, in part:

“Our efforts should be directed toward prevailing upon our customers to submit to a general or detailed audit and under any circumstances we should not permit the submission of a statement which does not make a satisfactory presentation of the various items. There is hardly anything in connection with the analysis of a certified statement that would be of more assistance to us than to prevail upon our customer to give the accountant permission to talk to us freely. This sounds as though it might be difficult to accomplish, but actual experience does not bear this out.

The trend, as I interpret present conditions and demand, is towards detailed audits and more freedom of expression by the public accountant.