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J. O. McKinsey

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Modern Tendencies in Accounting Practice*

By J. O. McKINSEY

To comprehend clearly the present trends in accounting practice it is necessary to understand the past developments in accounting and to see how the accounting profession has reached its present position of influence. The present trends are largely the result of influences which had their origin many years ago. These trends are influenced to a considerable extent by the conditions under which the profession of accounting was first established. I shall ask you, therefore, to bear with me while I sketch very briefly the development of public and private accounting practice during the past half century. Much of what I shall say is already familiar to you, but I think it worth while to remind you of certain significant facts which it is desirable for you to have in mind that you may better understand what I wish to emphasize in the latter part of this discussion.

There is much mystery concerning the historical development of accounting. Although some form of records have been kept by business men since primitive times, it is fairly clear that modern accounting had its origin in England. At least it was there that public accounting first developed into a profession. There is some historical evidence to the effect that the first auditors were representatives of the government who listened to reports of government officers concerning the operations of these officers during past fiscal periods and gave approval if they thought the reports correct. Gradually these auditors began to examine the records of those who were reporting to them to see that these records agreed with the reports. It was thus that the term "auditor" came to be applied to those who have now become primarily inspectors of accounts.

Later private auditors commenced to investigate the records and report on the financial condition of private concerns. We do not know the details of how this development came about, but we do know that the practice of the first public auditors was confined largely to the investigation of bankrupt companies for the benefit of creditors and court. Gradually the public auditors or accountants, as they came to be called, began to investigate com-

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panies for the benefit of prospective investors, creditors and governmental agencies. We are not interested here in the details of this development but it is important for us to see that the primary objective of the public accountant in the early days of the profession was to prepare accurate reports concerning the financial condition of the business for the use of those who were external to the management of the business.

Although we have little information concerning the development of private accounting during this period, except that which we can obtain from the literature written at this time, it is fair to assume that it was influenced very largely by the work of the public accountants. More and more the records of companies were developed so they would provide the information desired by the public auditors. Thus we see that both the public and the private accountants in the early days of the profession in England were interested primarily in the construction of records and the preparation of reports which would provide information for the use of those who were not primarily interested in the administration of the business.

Public-accounting practice had its origin in the United States about 1880. It did not have a very rapid development until after 1895. Its real growth came after 1896 during the period when large corporations were being developed and constant appeals were being made to investors and creditors for funds to operate these corporations and to provide funds for their continuous expansion.

Both commercial and investment bankers urged with increasing insistence that they must be supplied with competent information before they would supply funds for financing business organizations. All are familiar with the work of the American Bankers' Association and the National Association of Credit Men. It is instructive to note that these two organizations did not interest themselves intensively in this subject until after 1895.

This attitude of investors and credit associations led to an increased demand for the services of the public accountant. The public accountant got his second lease on life after the passage of the income-tax law of 1913. He received an additional boom after the passage of the excess-profits and the war-profits tax laws. Although the public accountant in the United States since the early days of the profession has rendered a multiplicity of services to business men, it is clear that the profession owes its growth

largely to the demand for information by those external to the business.

The growth of private accounting in the United States has paralleled the growth of the public-accounting profession. A quarter of a century ago most firms had a bookkeeping department which was under the supervision of the treasurer or secretary of the company. Gradually the bookkeeper has developed into a chief accountant or general auditor and in many cases he has won his independence from the secretary and treasurer and has been given the right to report directly to the president or general manager. During the past ten years the chief accountant or general auditor has, with increasing frequency, developed into a controller who has become one of the chief executives of the organization. While the bookkeeper of a quarter of a century ago confined himself largely to the compilation of financial data to be used in the collection and payment of debts and the preparation of simple statements of profit and loss and balance-sheet for the use of investors and creditors, the controller has become an investigator, advisor and guide of the operations of his company.

For many years private accounting practice lagged behind the development of public practice but in the past ten years the private accountant has in many cases gone beyond the public practitioner in the variety of work he performs and the importance of his duties and obligations. As indicated above the controller now performs a multiplicity of duties in the large organization. It is impossible to state definitely what the duties of a controller should be. It is my opinion that typically he should have jurisdiction over accounting, budgeting, statistics, methods and standards and organization problems. In some corporations the controller has a separate division in his office responsible for the administration of each of the foregoing groups of activities.

The development of the controller function is gradually having an effect upon the work of the public accountant. He is more and more being called upon to expand his activities and to give advice and counsel to his client on all the matters over which the controller has jurisdiction. At one time the public accountant thought his duty was fulfilled when he presented to his client an accurate balance-sheet and statement of income and expense accompanied by his certificate. The performance of this task is still an important function of the public accountant and will always remain so, but the accountant has found during recent years

that his clients value his services most when he can interpret these statements to them and offer suggestions concerning the action which these statements indicate should be taken. The client is no longer satisfied to receive the figures alone. Just as he expects his controller to interpret to him the data he presents periodically, he expects the public accountant to interpret the data he presents and to offer suggestions and advice based upon the broad experience which the public accountant gets by investigating the operations of many different organizations. The public accountant frequently finds that he is asked for advice by the controller concerning the activities over which the controller has jurisdiction. It is natural, as the controller has become interested in establishing a statistical department or in working out budgets for an organization, that he should ask the public accountant concerning the experience of other concerns with these administrative devices. So the public accountant has been forced to take an increasing interest in management matters and to broaden the scope of his activities.

This tendency has been facilitated by the work the public accountant has done with reference to income-tax matters. When the public accountant was primarily an auditor he frequently did not have very intimate or close contact with the major executives of the organization he served, but when he commenced to give advice to his clients concerning income-tax problems he was dealing with matters which were vital to all of the officers and executives of the company. Consequently he was led into conferences and intimate contact with officers and executives. They soon learned to value his advice and to know that he was able to give them many valuable suggestions based on his broad professional experience. It was natural, therefore, for the executives to commence to consult with the professional accountant concerning other than strictly accounting matters. The public accountant, therefore, has become more and more a counselor and advisor to his client.

Another factor which has influenced the work of the accountant is the increasing tendency of investment bankers to request from those who are offering stocks and bonds for sale more comprehensive information than that which is provided by the auditor's report. These bankers have learned that the management of the company is as important a factor as is its financial condition. They endeavor, therefore, to obtain information concerning the

policies, organization and management methods of their prospective clients. Since the public accountant has long been presenting to them auditors' reports and discussing with them the financial condition of their client, it is natural that they turn to him to provide this information. Consequently the public accountant has commenced to broaden his investigation of companies which are seeking additional capital and this has led him into many lines of activity which would have been thought quite foreign to the work of the public accountant a quarter of a century ago.

We can see, therefore, two distinct tendencies in accounting practice: first, the development of private accounting practice to the point where there is a controller who has jurisdiction over a wide range of activities in addition to those of a strictly accounting nature; second, the development of the work of the public accountant so that he assumes responsibility for advising his client concerning those activities over which the controller may rightly exercise jurisdiction.

I wish to emphasize this relationship between the work of the public practitioner and the work of the modern controller because there has been some tendency during the past few years for the public accountant to expand his activities into fields into which in my judgment he should not properly go. We are all familiar with the unknown accountant who over-night has blossomed out as a well-known industrial engineer. Many such were able during the prosperous years following the war to make incomes which were far beyond their highest dreams in the days when they were only accountants. Some of these have held themselves out as willing to give advice and counsel on all matters relating to the administration of any department of a business. I think that we are all willing to admit that no one can be an expert in all fields of business activity. The professional lives of all of us are too short for us to become competent to advise our clients on all matters. Although I think we should recognize that the work of the public accountant should not be restricted to that of the former auditor, it is proper and wise that we recognize reasonable limits for our professional activities. I suggest as a probable solution of this problem that as practitioners we may properly advise and counsel our clients on any matter which may properly come within the jurisdiction of the controller. This means that we may offer our services to our clients in accounting, statistical, budgetary and

organization problems. I think we must admit that this offers us a field that is sufficiently broad to be a challenge to the thinking of all of us. The problems which arise in the establishment and use of budgets alone are sufficiently varied and complex to tax the abilities of the most capable members of the profession.

Although the most important trend in accounting from my point of view is the broadening scope of the activity of the accountant, which has been outlined, there are other tendencies which are significant. Among the most important of these is the increasing tendency towards the establishment of small accounting firms composed of a few partners, who limit their activities to one locality. I have been particularly interested in noticing, during the past few years, the number of young men who have commenced to practise on their own account after serving a reasonable apprenticeship with some established firm. There are hundreds of accounting firms, of which we rarely hear, which are doing creditable and useful work. There is scarcely a week that I do not hear of some firm in my home city concerning which I had not previously known. This tendency is also shown by the extent to which young men are beginning to practise in small cities. There is scarcely any city of reasonable size in which you will not find one or more public practitioners. This tendency will increase the intimate relationship between the accountant and his client which, we have already seen, has been encouraged by the broadening scope of the accountant's duties. In a large accounting organization it is impossible for the partners in the firm to have intimate contact with all their clients. In many cases the work of a client must be left to staff men. Although these men may be very capable they cannot represent their firm in the same way in which the partner does. In the smaller firm the partners usually have direct supervision of all engagements and this brings them in intimate contact with their clients. This encourages the client to consult the accountant concerning many of his important problems.

It is recognized, of course, that there is now and will always be need for some large accounting firms with widely distributed branches which will serve the needs of those large corporations which have widely distributed units of organization. It is not intended that anything said in this discussion shall in any way cast reflection upon the excellent work done by some of these organizations. It is only desired to recognize that the trend of

the future will be toward the establishment of the local firm rather than the establishment of additional numbers of these large organizations.

The present tendency also brings about the practice of employing the accountant on a retainer basis. This plan has long been followed in the legal profession and has promoted an intimate contact between the lawyer and his client. I think that this relationship offers much promise for the public accountant. If he is retained by his client on a yearly basis and studies his client's problems month by month, he soon becomes intimately acquainted with the operations and problems of his client's organization and, therefore, offers more valuable advice and counsel than if he comes in contact with the organization once a year. The client by this plan is able to obtain the advice of a man who knows his business intimately and who can also bring to him the experience he has gained by contact with many other organizations. It can be easily seen that the professional accountant can give to his client in this manner a service the client can not possibly obtain from his controller whose experience is usually limited to one organization. I prophesy that the time is not far distant when accountants both public and private will be members of boards of directors in the same manner in which lawyers are now employed in this capacity. This will naturally raise the question whether an accountant holding the position of a director can properly audit the company which he thus serves. I think there is doubt of the advisability of his doing so.

The change in the relationship between the client and the professional accountant gives rise to a problem of considerable significance concerning the basis of compensation for the accountant's service. It seems long to have been the practice of members of the accounting profession to charge for their services on a per-diem basis. When the accountant was performing primarily an auditing service this was a satisfactory basis. He depended for his returns largely on the profits he made on the services of those he employed on his staff. When the accountant offers his own services to his client as a counselor and limits the number of staff men he employs, it becomes increasingly difficult for him to fix his compensation on a per-diem basis. There becomes an increasing need for him to base his compensation on the value of the service rendered rather than on the amount of time spent in rendering the service. It is not difficult to see that the professional man acting

as a counselor to his client can offer advice which may be very valuable indeed and for which he may properly charge an amount which would seem unreasonable on a per-diem basis. I believe that there is an increasing tendency and an increasing need for the professional accountant to break away from the per-diem basis of charging for his services. I think this will have two beneficial results: First, it will enable the accountant to secure proper compensation for his services without the necessity of building up a large organization or establishing a number of branches. Second, it will enable the accountant to base his compensation on the value of the service rendered and to some extent on the ability of the client to pay. It has long been the practice of other professional men to consider the ability of their clients in determining the amount of their compensation. I think the accountant is justified in doing the same thing. If he follows this plan it will enable the well trained accountant to give competent advice to many small organizations which are not able to pay him an amount equivalent to what he may properly charge the larger organization. The physician and lawyer often render service to the one in need who can not compensate them in proportion to their ability. It seems very much to be regretted that the professional accountant can not to some extent take the same attitude. It seems regrettable that a small organization can not obtain professional advice except from the young and untrained or the incompetent professional man. This plan will also enable the professional accountant to render public service more freely than he feels able to do in many cases at present.

I am not arguing here for the contingent fee or that the accountant should regard his work primarily from the monetary point of view. I do believe, however, if we hold ourselves out as competent to give advice to business executives as to how they may increase their profits, that we should show that we are competent to administer our own affairs so that we can obtain reasonable compensation for our own services and that it is not unbecoming in a professional man to try to make his income as large as is consistent with the service rendered and the ideals and ethics of the profession of which he is a member.

Another trend in accounting practice which is exceedingly interesting is the increasing emphasis on the educational training of those who enter the profession. I think it is unfortunate that in the early days of the development of public-accounting practice it

was regarded as necessary for the future practitioner to receive all his training by the apprenticeship method. The accounting profession has not established as high educational standards for admission of candidates for the certificate of certified public accountant as the other well known professions have established for admission to practice. I think the time will come when we shall require of every candidate for the C. P. A. certificate not only a certain amount of educational training in academic subjects but also a certain amount of formal training in accounting and related matters. The increasing interest of professional firms in graduates of collegiate schools of business and the increasing interest of some of the state societies and of the American Institute of Accountants in the development of accounting education indicate that the trend towards the ideal situation which I have suggested is very definite.

Finally, there is a distinct tendency for the accounting profession to practise the rules of ethics and to follow the customs of good fellowship and fair dealing which are characteristic of a dignified profession. More and more accountants are ceasing to advertise their wares, solicit clients, seek the business of competitors and do the other questionable acts concerning which there has been so much discussion in the past. The leaders of the profession are adopting as their motto, "In case of doubt, *don't*." More and more those who are established in the profession are lending a helping hand to the struggling beginner. It has long been a cherished tradition of the legal profession that the successful practitioner will open his library, his files, and even his store of knowledge and experience to the attorney just entering the profession. May we not hope that a similar tradition may soon characterize our profession also? The way of the beginner in a profession is difficult at the best. If we lend him a helping hand we assist to eliminate the temptation for him to seek clients by doubtful means. So working together we can increase the respect and confidence of the business man in our profession which will result in larger returns to all of us both financially and professionally.

To summarize, I have tried to indicate the following trends in accounting practice:

First, the broadening of the scope of the duties of the private accountant to embrace the activities which are now typically placed under the controller, who should be one of the five or six

major executives in the typical organization and should control a homogeneous group of activities involving the collection and presentation of accounting and statistical data concerning past operations and offering advice and counsel concerning the future plans and policies to be based on this information and also offering advice concerning the organization and procedures through which these plans and policies are to be made effective.

Second, the development of the work of the public accountant to include all those activities which may rightly be placed under the jurisdiction of the controller. This of necessity leads to the accountant's becoming more and more a counselor and advisor.

Third, the trend toward the establishing of smaller units for the practice of public accounting and the limiting of the work of the public accountant to his local community in the same way in which the work of the physician and lawyer is limited.

Fourth, the tendency toward the employment of the accountant on a retainer basis where he renders continuous service to his client.

Fifth, the tendency towards compensating the accountant on the basis of the value of the service rendered and the ability of the client to pay, rather than on a per-diem basis.

Sixth, the tendency to place more value upon the educational training of the public accountant and the probability that in the not-distant future educational requirements in the nature of both academic and professional training will be established for applicants for the certificate of proficiency in accounting and for admission into professional associations.

Seventh, the tendency of members of the profession to follow more strictly its code of ethics and rules of professional conduct and to seek advancement by coöperation rather than by competition.

I believe all these tendencies are real and enduring and that their continuance will result in a never-ending improvement in the great profession of which we all are proud to be members.