Journal of Accountancy

Volume 69 | Issue 3 | Article 1

2-1940

Editorial

John L. Carey

The JOURNAL *of* ACCOUNTANCY

OFFICIAL ORGAN OF THE AMERICAN INSTITUTE OF ACCOUNTANTS

JOHN L. CAREY, *Managing Editor*

[*Opinions expressed in* THE JOURNAL OF ACCOUNTANCY *are not necessarily endorsed by the publishers nor by the American Institute of Accountants. Articles are chosen for their general interest, but beliefs and conclusions are often merely those of individual authors.*]

VOL. 69 | MARCH, 1940 | NO. 3

EDITORIAL

Arthur W. Teele

ARTHUR W. TEELE, treasurer of the American Institute of Accountants, died suddenly on January 30, 1940, at his home in New York. He was seventy-two years old. Until a few hours before he had been working at his office with customary vigor. It was characteristic that of the last day of his life he devoted several hours to thought and discussion of the Institute's financial affairs.

Mr. Teele was one of that small group of men who early in this century threw themselves without reservation into the task of building a profession of accountancy in the United States. He and his fellow workers spared no pains, refused no sacrifice of time, energy or money in the prosecution of their self-imposed job. The magnitude of their accomplishment is evident today.

Mr. Teele had served on almost every important administrative committee of the American Association of Public Accountants and of the Institute. As treasurer, he was a member of the Institute's executive committee for thirteen years. His influence was positive and constructive. He had deep convictions, but no prejudice. If his colleagues argued, he sat apart like a judge. He could find merit in a cause contrary to his own preferences. His integrity was never doubted. Small wonder that he commanded the respect and admiration of every man he met.

He was a man's man, and his vitality was inexhaustible. Outside his profession he was as active as within. Everywhere he was a leader. Accountancy gained prestige because he was a part of it. His loyalty was unshakable. He had friends in numbers in which most men count their acquaintances.

Some student of the future, delving into the history of American accountancy, may piece together the records of the career of Arthur Teele. He will be truly inspired if some instinct stirs him to exclaim, "There were giants in those days."

Economic Effects of Depreciation

CONSERVATIVE depreciation methods have been chiefly responsible for the ability of American corporations in recent years to replace and improve their plants without borrowing from private savings. Private savings, which have been substantial, can find few profitable outlets. The idle money breeds idle men. If a large part of the money which flows out of the production process in the form of wages, salaries, interest, rents, and profits is hoarded, the goods produced cannot be bought at the prices asked. The economy will go on part time.

This is a thumb-nail digest of Stuart Chase's argument in his article, "Capital Not Wanted," in the February *Harper's*, based on the Securities and Exchange Commission inquiry into "idle money" before the Temporary National Economic Committee last May. Spokesmen for U. S. Steel, General Electric, and General Motors testified that their companies had had no recent need, and could forsee none, to go to the public markets for financing. The figures spread on the record showed that depreciation reserves principally, plus depletion reserves and profits retained, provided more than sufficient internal resources for replacement, modernization, and even expansion of plant facilities. Statisticians called to the stand testified that the same condition was generally true of American business as a whole.

Mr. Chase sees our society again impaled on the paradox of plenty, through insufficient circulation of the available supply of money—too much saving by both producers and consumers. He gives the accounting profession a large part of the credit, if that is the word, for winning the battle for systematic depreciation allowances (which he indicates has been so completely won that allowances have been excessive). He blames nobody for the unfortunate results to which he believes they have contributed. He says that the impasse "cannot be corrected by putting Mr. Stettinius or Mr. Roosevelt or the American Institute of Accountants in the dog-house."

The solution, he says, must be new industries requiring large capital; a shifting of national savings into housing and public investment (presumably government works) where depreciation reserves are not so massive; or a drastic decline in the ratio of savings to national income—more consumers' goods, relatively less capital goods. "It is impossible to operate a matured economy with financial methods appropriate to a rapidly expanding one."

It will be recalled that the argument for the ill-fated undistributed-profits tax was based in part upon a similar economic philosophy. The tax was designed to minimize profits retained in the business (which constitute, according to Mr. Chase's analysis, one of the three major sources of internal financing), and encourage their distribution to stockholders who might be expected to use them in large part for the purchase of consumers' goods.

Now depreciation reserves, even more than undistributed profits, appear as a kind of villain of the piece. Is it not conceivable that some ingenious economists may see these reserves as "fat" to feed upon, and seize upon the T.N.E.C. testimony to support their pleas for lower prices, higher wages, and higher taxes?

Accountants will find it difficult to believe that depreciation generally has been excessive. For one thing, they know that the Treasury Department has been a brake on overdepreciation. They will find it even more difficult to believe that unfortunate economic effects could flow from a practice which seeks to protect investment in plant by charging its cost to earnings over the expected useful life of the productive instrument.

Accountants should know more than anyone else about depreciation and its effects. Here is an aspect of the question which may prove to be of great significance to the whole economic community. We suggest that it deserves the careful consideration of the accounting profession.

Streamlined Financial Statements

IN THE hope of dispelling the popular notion that modern corporations resemble the unlovely octopus, greedily sucking nourishment from labor and consumer, students of the social and economic scene are seeking means of telling the public the truth. They find, of course, that accounting provides the principal source of information. But they assume, no doubt correctly, that the public does not understand the customary financial statements and will not make the effort to do so. So it is being suggested that corporations publish brief, simplified versions of their accounts which employees and other interested citizens may readily comprehend.

M. S. Rukeyser, economic commentator for International News Service, in a recent address before the Rochester Chapter of the National Association of Cost Accountants, suggested that what was commonly described as "profit" was really an element of cost, namely, the cost of capital, or wages of the "iron men, or tools" provided out of savings of securities holders. He recommended a streamlining of corporate accounts to clarify uncertainties in the minds of stockholders, customers, and employees of corporations.

The Bureau of Economic Research of the University of Notre Dame has developed a short-form operating report which should win Mr. Rukeyser's approval. It contains only eight items, each described in simple nontechnical terms: gross income, salaries and wages to employees, salaries and wages to officers, interest, taxes, depreciation, goods and services purchased from others (including raw materials, supplies, and selling and overhead expenses), and net income—described as "wages (or rent) for tools."

This is, of course, much less information than an intelligent investor would need to judge how well the company was managed, but for the general information of employees and the public at large, the short form of statement has much to recommend it. One or two questions occur to us.

"Wages of tools" as a euphemism for profits gives rise to some uneasiness. The concept is appealing and undoubtedly has merit, but is it quite fair to the unwary reader to indicate that profit is an expense similar to interest, or even if it is, to permit an inaccurate assumption that it is a necessary cost of operation? In other words, the statement might indicate to some that all corporations break even every year, though all pay "rents for tools" which vary erratically from year to year. What, by the way, happens when there are losses? Is there a negative "wages of tools"?

Perhaps a fair rate of return on capital invested could properly be described as "cost of capital, or rent of tools," but any extraordinary increment, it seems to us, should be shown as a net figure apart from apparent costs of operation.

The Notre Dame short form includes a column showing the percentage of total income represented by each item of outgo. We suggest that the final figure, representing "cost of capital," should be shown also as a percentage of return on total capital invested.

The value of the simplified type of statement would be increased if it could cover a longer period than a year, say ten years, perhaps in cumulative form. Many businesses have ups and downs which result in sharp variations in income from year to year. Often it will be found that over a longer period the return on capital invested is far more modest than the results of isolated years might indicate.

In principle we heartily commend the efforts of corporations to show, by statistical summaries supplementary to the customary financial statements, the significance of the results to employees, consumers, or investors. Such companies as United States Steel, Monsanto Chemical, Johns-Manville, Goodyear Tire & Rubber, Provident Mutual Life Insurance Co., and Consolidated Edison Co. of New York, have conducted successful experiments in this field. So long as it is clear that the statistical summaries are supplements to, not substitutes for, the "official" accounting statements, and that their purposes are limited, they should be of great value to all concerned.

Competitive Bidding

"The acceptance of a company's published figures is an inherent risk of business and in the last analysis must be considered as such. Auditors can and do exert a powerful influence for the reduction of this risk. I think they should do more. They can only do more when they are paid for doing more. Part of this is their own fault because they have seen fit to put their services on a competitive basis and not kept them on a strictly professional plane. The ever-present chiseler is found even among the auditors, and some businesses have encouraged them."

These words of Albion R. Davis, controller of the American Hide and Leather Company, appear in the *Robert Morris Associates Bulletin* for January, 1940. Coming from an officer of a company which is undoubtedly a client of public accountants, and addressed to bankers, who are prominent among "consumers" of accountants' reports, this sharp statement is an effective challenge.

The accounting profession knows what it suffers from competitive bidding and it is determined to rid itself of this malignant growth. Difference remains only about the method. Some would wield the knife recklessly; others would apply atrophic acids over a period of time.

A fair cross-section of present opinion on the subject appears in the December, 1939, issue of the official bulletin of the Texas Society of Certified Public Accountants, which is almost entirely devoted to quotation from letters of members who support or oppose a suggested rule against competitive bidding.

The contributors all agreed that competitive bidding was a detriment to the profession; that it lowered the general standard of practice; and that it reduced the accountant's services to the status of a commodity. The chief obstacles to banning competitive bidding were found to be (1) difficulty of enforcement, (2) the fact that a Society ruling would not affect nonmembers, and (3) that certain members of the Society, because much of their practice lay in the field of municipal accounting, where in Texas the custom of bidding apparently is firmly established, would be forced to relinquish membership.

It was stressed that education of the public was as important as imposing restrictions upon the profession.

In other states positive action has already been taken. On October 6, 1937, the Connecticut Society adopted amendments prohibiting competitive bidding. On September 10, 1938, the Virginia Society did likewise, with the reservation that the quotation of minimum per diem rates should not be construed as competitive bidding. Other societies which had taken action even before 1937 were those of Arizona, Colorado, District of Columbia, Louisiana, and North Carolina. On June 1, 1939, the Central States Accounting Conference adopted a resolution approving in principle the abolition of solicitation and competitive bidding. On September 12, 1939, the Illinois Society adopted a resolution proscribing this practice.

The council of the Institute resolved on April 11, 1938, that any member who offered a competitive bid in any state where the governing body of certified public accountants has adopted rules prohibiting it would be considered guilty of an act discreditable to the profession, and subject to discipline under the by-laws.

That this procession of events is already serving to educate the public is apparent. Many prospective clients are beginning to understand that there is a difference between "audits and artichokes," and that competitive bidding degrades the profession and drastically limits the quality of service rendered.

Accountants as Directors

A RECENT article in the *New York Times* suggests that many corporations are giving serious consideration to the possibility of electing "working" or "paid" directors. There are scattered indications that the practice is spreading.

Early this year William O. Douglas, at that time chairman of the Securities and Exchange Commission, together with Richard Patterson, Jr., who was assistant secretary of commerce, furnished impetus to the trend by strongly advocating that professional directors be added to corporate boards.

We suggest the wisdom of selecting certified public accountants as professional directors. Who is better qualified than they to interpret the financial and statistical reports on which corporate boards depend so largely for information? Who has better all-round knowledge than they of the mechanics of business and finance?

In England, the accountant-director is a familiar personage, defined as follows in a recent issue of *Accountancy:* "He is a person skilled in accounts of all descriptions who by his knowledge and experience of business finance and business forecasting is able to see from accounting information the elements of strength and weakness in a business, and to point to the conditions making for stability. He has a special ability to advise the board on such questions as the methods of accounting most suited to the company. From his experience he will be able to advise on the periodical accounting statistics which will be of most use to the board, and from his special knowledge he will be able to point out to his codirectors the trends of the business."

Obviously the accountant-director could not be the auditor of the company as well. The objections to such a dual position were set forth in some detail in an editorial in THE JOURNAL of April, 1937.

Interstate Practice

MUCH has been said and written in recent years about the desirability of freedom in interstate practice in accountancy. In theory, nearly everyone is against impediments to free passage across state lines by certified public accountants in the conduct of their professional practice. As recently as last September, the Advisory Council of State Society Presidents adopted a resolution expressing the opinion that it is in the interests of the accounting profession and of those whom it serves for certified public accountants and their regularly employed assistants to have freedom in entering a state to carry out public accounting engagements originating outside the state.

The problem is not of immediate personal concern to most certified public accountants because it arises only in those states in which so-called restrictive accountancy laws have been enacted, which constitute a small minority. In most states a nonresident accountant may freely enter and perform any professional services for which he may be fortunate enough to be engaged, so long as he does not hold himself out to be a certified public accountant without having secured a C.P.A. certificate of the state concerned.

In the states which have enacted restrictive laws, however, prohibiting their own citizens from practising accounting without securing licenses from the authorities, it naturally becomes necessary to impose similar regulations upon nonresidents who may wish to perform accounting work within the state. The result has been the adoption of rules and regulations which vary widely among these states. In some cases the rules have been reasonable and have imposed no heavy burden upon reputable certified public accountants from other jurisdictions. In other instances, however, the rules sometimes result in inconvenience and even hardship to certified public accountants whom everyone concedes to be qualified and reputable. Such incidents cause irritation. They give rise to talk about retaliation. They contribute an impulse towards delineation of a vicious circle.

This problem is of ultimate concern to every accountant. A recent questionnaire, issued by the American Institute of Accountants committee on state legislation, revealed that nearly 75 per cent of those who replied had had occasion to cross state lines in their practice within the past five years. This is definite indication that accountancy, unlike law and medicine, is not a localized profession. Obstacles to reasonable freedom in interstate practice may stifle the development of accounting practice as a whole.

A correspondent of THE JOURNAL, who resides in the middle west, has contributed the colorful phrase, "Balkanizing the United States," to describe the tendency towards erection of state barriers.

The recent action of the Arizona State Board of Accountancy in voluntarily reducing the registration fee for out-of-state accountants from $25 to $10 is highly encouraging. It shows growing recognition that the interests of the profession as a whole are more important to the individual accountant than what may appear to be immediate local self-interest.

Societies and boards in other states would do well to consider carefully the advisability of removing from laws or board rules unreasonable obstacles to the admission of certified public accountants from other states.