TWO PROFESSIONS IN CONTACT

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Both law and public accounting are professions. Both professions render definite services to society, each in its own way. And they have very different historical backgrounds. It is not surprising, therefore, that these professional men should have differing ideas about situations they have in common.

The attorney has had a specialized education; he is a statutory officer of the court. Part of his social service, therefore, follows from his being a part of the machinery for the administration of justice. It is his duty to be the advocate of his client, whether plaintiff or defendant.

The certified public accountant also has had a specialized training and, like the lawyer, has been tested by a technical examination. Both are subject to discipline, when necessary, by their professional associates. The C.P.A. has no official function; yet he renders a definite social service, for he plays an important part in the operation of the financial machinery of our economy. In auditing and certifying financial statements he is not an advocate for his client's side. Instead he is an independent middleman standing between a business enterprise and investors. His responsibility seems more like that of a judge than that of an advocate. His service fee is paid by the client whose statements are audited. Yet undisclosed third parties (usually investors) benefit substantially, and without fee, from the auditor's examination and his report on a company's financial affairs.

Different as these two professional men are in training and function, they often share several areas of contact. Consequently there is need that they understand each other as well as may be. To the extent they do so, by that much will the possibility of friction be decreased. The two could often be of greater service to society by joining hands for the occasion than if each steadfastly maintained a characteristic point of view.

A century ago British lawyers and accountants joined hands in bringing into being a series of important corporation statutes. Not only were these laws a joint product of many minds, but also they integrated law and accounting in a way that reflected a clear vision of the public interest.

In original conception, these Companies Acts were reform legislation. But they were more than that. They were designed to put the formation and financial administration of joint stock companies under the control of statutory law and under the scrutiny of the investing public. These laws served another important social purpose: they again made possible the creation of limited-liability joint stock companies.

A century earlier, unintelligent and often fraudulent company promotions had fostered an era of wild speculation in shares. It was, of course, followed by high losses to a great many investors. These excesses interfered for the next one hundred years with the effective employment of peoples' savings. For the earlier solution was prohibition of the formation of joint stock companies. At long last this prohibition was recognized as a handicap to increased production. The Companies Acts which appeared between 1825 and 1862 were reform legislation designed to reform prior reform legislation.

This seems to be a demonstration of the fact that men can learn as much from mistakes as from successes, and an indication that lawyers and accountants, by combining their talents, can be powerful forces for social good.

It is particularly significant to accountants that their technology was called upon to serve as an important instrument for implementing this social and industrial legislation. Companies formed under this permissive legislation were required to keep appropriate accounting records. And "appropriate" was considered to mean the use of double entry bookkeeping--a methodology first expressed in the English language some 300 years earlier out of prior use in Italy and in the low countries.

In addition to keeping accounts, the statutes required that balance sheets made from these systematic records must be audited and then furnished to the government and to all shareholders. The present continuing and expanding benefits to economic society from this legislation a century ago reflect great credit upon the clear thinking about social welfare of the men of these two professions--although one group was only then beginning to show the characteristics of a profession.

Other areas of contact are found in our own country. One of these was pin-pointed in 1913 and the next few years when income taxation as we know it was in its formative stage. Two men, one a lawyer, the other an accountant (Cordell Hull and George O. May), made important initial contributions to this legislation. But not all features of the statute which emerged were equally satisfactory to accountants and lawyers. One relatively small point will illustrate their differing points of view.

The statutory deduction for uncollectible debts limited the amount to such as was convincingly a bad debt of a known individual. The custom already established in business and accounting treated as bad debt loss a carefully estimated percentage of total credit sales or of total accounts receivable. This practice had become customary because of three facts:

(1) Experience with credit sales and uncollectible accounts showed a rather consistent ratio of credit losses to credit sales;

(2) Subsequent review of the accounts of specific individuals as they became clearly uncollectible usually validated the advance estimates;

(3) If the estimates and the later proven facts varied significantly, the businessman would change his percentage slightly to compensate in the next period.

This difference in points of view was one of preference for different kinds of evidence in support of bad debt deductions. The lawyer naturally would think of debt in terms of a definite person subject to legal action. The accountant, whose thought was focused upon accounts as statistical categories, would readily agree that the use of prior bad debt experience was an acceptable basis for now creating an expense item. For such an estimate would measure a present loss figure although the total was scattered among many as yet unknown individuals. He considered the calculated net income using such an estimate as nearer the true figure for the current year. It was of much less interest to the accountant what specific persons would later not be able to pay their debts.

It was only a few years, however, before thoughtful people perceived the tested logic of relating recognition of bad debt expense as closely as possible to the time that sales on credit were made. The result was that the well-established accounting conception presently replaced the earlier legal conception in the tax statute.

Another and perhaps more important area of contact centers about the word "assets." Attorneys and the courts usually have considered assets as property available to pay debts, or alternatively as property in excess of debts and capital stock and, therefore, available for legal dividends. In both situations the idea is related to financial solvency.

The public accountant, in most situations, thinks of assets as property dedicated to productive uses in a business enterprise. The company's ability to pay its debts is, of course, of collateral interest at times and for certain interested parties. But the accountant likes to consider that the essence of the concept of an asset is best sought in the everyday significance of property use rather than in its occasional special significance in connection with debt.

The essence of the contrast can perhaps be put this way: lawyers tend to think of assets as a form of value; professional accountants tend to think of assets as representing cost invested in the specific items. Attorneys tend to think of a dividend base as being measured by surplus assets, i.e., the excess of the value of all property owned above the amount of debts and capital outstanding. Accountants tend to think of a dividend base as being measured by prior and current earnings not needed for reinvestment in the business. Usually the sum thus considered available would be only part of the whole of surplus.

Such differences in points of view lead to this kind of question: Is it inherent in one point of view, and not in the other, that the effect of asset reappraisal should be excluded from the basis for cash dividends? The issue thus posed is too complex and technical to be discussed in any great detail at this time. Yet it may be appropriate to make some general observations about this area of contact between the two professions.

First note that each view is strongly influenced by the profession's conception of what kind of issue is within its responsibility. Lawyer: Is the proposed dividend legal? Will the value of the property remaining after payment of the dividend be sufficient to protect the rights of the creditors of a limited-liability corporation? The C.P.A.: Is the proposed dividend within the sum of available past and current profits? If the answer is affirmative, will the creditors still have a measured margin of investment to protect them after the dividend is paid?

We might note in passing that (1) the financial wisdom of declaring any dividend still would have to be decided by the company directors; (2) that financial considerations usually would indicate that the directors' action should not reach to the limit implied in the position taken by either lawyer or accountant.

The second general observation growing out of this kind of difference in view is that a need clearly exists for men in the two professions to understand each other, particularly in areas where their services to society happen to touch. It is reassuring as to the reasonableness of men to note that there is evidence of improved understanding within the specific area just considered. This is shown by statute changes.

In the 1930's many state corporation laws were changed after considerable discussion. The result written into statutory law was the requirement that the amount by which company assets had been reappraised should be separately reported in the financial statements and not used as a basis for cash dividends.

Thus the point of difference indicated above between lawyers and accountants has been suitably resolved. The statutes now indicate that cash dividends may not rest upon "surplus assets" if part of such surplus had derived from asset reappraisal. Accountants hold to the same idea but put the restriction in different words: cash dividends should be restricted to earned surplus.

As a further footnote to the thought that people often believe it is the function of the balance sheet to report "values," the following two items may be of interest. Somewhere I read that a recent British court case (as late as 1949) developed the fact that the market value of certain assets was 60,000 pounds more than was shown on the balance sheet. In the decision, the court stated there seemed "some lack of care in indicating to shareholders through the medium of the balance sheet what the real value of the property was." In the same notes I also found this sentence as representing the view of a lawyer of that time: "the certificate phrase 'true and fair value presented by the balance sheet' can, in relation to a fixed asset, refer only to 'the value thereof at the date of the balance sheet.'"

Despite lawyers' views in this matter, accountants prefer not to take a value-point-of-view of assets. The accounting view of the nature of the balance sheet of a business concern not in liquidation is that the assets are possessed for their productive capacity and are therefore best reported at the amount invested therein rather than at their salable value or at replacement price.

Income tax reporting is another area where legal ideas and accounting concepts make contact. We should consider this at least briefly because it is now being widely discussed.

The major difference of opinion here is related to the question who may engage in tax practice. The view of many attorneys is that income tax practice by accountants is unauthorized practice of law. C.P.A.'s on the other hand hold that accounting is a technology and that their income tax practice is technical assistance in complex calculations derived from technically kept accounting records.

These differing views have created a specific issue: namely, whether C.P.A.s may represent tax clients before the Board of Tax Appeals (since 1942 called the "Tax Court"). If this body is in fact as well as name a true court, it will have to follow established, formal court procedures; and only attorneys-at-law can plead there. However, if this body exists for factual review and arbitration of tax assessment, C.P.A.'s should be permitted to contribute to its deliberations. Accountants believe it would be better if the body were not fully judicial. Then disputed matters related to the determination of enterprise income could then and there be amicably analyzed and settled by the two parties directly concerned--the government and the taxpayer.

This controversy has existed for some years, and little progress has so far been made in reaching into the basic problem. In the public interest, a better solution seems called for than a mere change in the name of the reviewing body.

Since both accounting and legal considerations may be involved in any important tax situation, it seems clearly unreasonable to restrict to either attorneys or C.P.A.'s an appearance before the body that is to hear the theory and practice of a situation analyzed. In order to give rational support to a restriction to one profession, attorneys should also become proficient in accountancy; or C.P.A.'s should also become proficient in law. It is doubtful whether either group wishes to become proficient in the collateral field. Yet any other degree of collateral knowledge, acted upon independently, would surely not be in the public interest.

The basic question is one of appropriate professional competence, appropriately applied. Involved here also is the matter of availability of appropriate ethical standards and the existence of disciplinary controls so the public may have assurance that their chosen agent would conduct himself as a professional man.

Perhaps attorneys consider the possibility of a later infiltration into professional accounting by so-called "tax consultants" and "tax experts" who are not under recognized professional discipline. Do most attorneys realize that only C.P.A.'s can become members of the American Institute of Accountants and come under its discipline? Do they realize the extent to which members of state societies of C.P.A.'s and members of the American Institute of Accountants are real professionals? C.P.A.'s consider themselves professionals because they are

(1) trained experts in their field,
(2) thoroughly independent in their judgments,
(3) subject to definite discipline under cause,
(4) serving an important social purpose.

A most penetrating and constructive examination of this controversy was recently presented by E. N. Griswold, Dean of the Harvard Law School. His paper is reprinted in the Journal of Accountancy for April, 1955.

A few of his more significant points are these:

1. Attorneys will not wish to seem to be merely reaching out for tax clients.

2. Tax practice is very largely a matter of accountancy as such.

3. The American Institute of Accountants will not be suitably protecting the public interest if its action goes beyond support for men with recognized professional standing who are under professional discipline.

4. Attorneys will not be suitably protecting the public interest if they succeed in excluding C.P.A.'s from tax practice.

These ideas are supported by similar suggestions in a statement of principles prepared in 1951 by a national conference of lawyers and C.P.A.'s. From these carefully considered views, a strong movement toward full agreement could follow from open acceptance by everyone in both parties of a very simple proposition: that self-designations, such as "tax expert," "tax consultant," shall be prohibited as misleading to the public by reason of an intimation of professional status which is not a fact.

Quoting Dean Griswold: ". . . it would be a very sound development if the American Institute of Accountants would conclude that it should undertake to speak only for C.P.A.'s, representing no one else; then I think agreement should not be too difficult."

The conclusion seems clear that better mutual understanding would be in the public interest. It should not be impossible to agree as to types of practice and mutual boundaries. Ways and means can be found of cooperating where necessary for the determination of enterprise income and tax due, and for presenting conflicting theories before the review body. Where probable judicial interpretation of the law is in dispute regarding a material amount, it is of course beyond the province of accountants to argue the issue to the court.

Although the present debate may seem quite sharp at times, we may confidently believe that the common sense of reasonable men will prevail in due time, after all angles of the issues have been opened to consideration.

The above examples of resolution of conflicting views suggest that ultimate resolution of this issue also is probable.