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## Duties of the senior accountant

F W. Thornton

A. P. Richardson

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DUTIES OF  
THE SENIOR  
ACCOUNTANT

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F. W. THORNTON

# DUTIES OF THE SENIOR ACCOUNTANT

BY

F. W. THORNTON

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## EDITOR'S NOTE

Several years ago F. W. Thornton and W. B. Reynolds wrote a series of articles for *The Journal of Accountancy* under the title, "Duties of the Junior Accountant." After publication in the magazine, these articles were supplemented by other matter prepared by the same authors and the whole text was published in book form by The American Institute of Accountants, to which the copyright had been donated by the authors.

*Duties of the Junior Accountant* met with an instantaneous welcome and the sale far exceeded expectations of authors or publishers. It was evidently a book needed for the instruction and guidance of the younger members of accounting staffs. Many firms bought a copy of the book for each junior member of their staffs and it was also used largely as a text-book in colleges and schools.

It was not astonishing that the book was so well received, because it was practically the

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EDITOR'S NOTE

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first serious attempt to provide a text of that kind. The sales, however, were not purely temporary. Ever since the first edition of the work appeared the number of copies sold each year has remained fairly steady in good times and bad, and today *Duties of the Junior Accountant* is in constant demand. The book has run into printing after printing and the end is not yet.

It has now been the good fortune of the American Institute Publishing Company, Inc. to induce Mr. Thornton to prepare another text on the closely related subject of the *Duties of the Senior Accountant*. There have been numberless requests for a book of this kind which can be carried about without being burdensome and at the same time can convey to the senior accountant advice upon many of the points which will arise in the course of his work in the field and in the office.

The present book is as brief as it could possibly be made. The author felt, no doubt, that in a book of this kind there was no room for unnecessary verbiage. He felt that it was his pleasure and duty to tell, in a very few words, his opinion of what should be done. Those who

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EDITOR'S NOTE

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are familiar with Mr. Thornton's style will remember that he does not waste words. Here is a brief, clear and most interesting series of lectures on what the senior accountant in these modern days should do.

Mr. Thornton's experience has been wide and varied. He was for many years a managing accountant on the staff of one of the largest accounting firms in the world. His activities have carried him into a hundred fields of effort, and no one in this country is better qualified to take the senior accountant to one side and tell him confidentially exactly what he should do in the situations which are apt to occur.

A. P. RICHARDSON, *Editor.*

## PREFACE

Usually accountants are graded, roughly, as juniors, semi-seniors, seniors, managing accountants and principals or partners. These grades are not exactly defined, and can not be, because men develop gradually from juniors to the higher classifications; they do not jump abruptly from one grade to another.

The seniors are those accountants who may conduct an examination independently except for a final review. They may have charge of work needing perhaps one, ten, or even more assistants or of a section of a larger examination conducted under the supervision of an accountant of higher rating.

During the progress of juniors toward seniority they should learn by observation much about the duties of seniors, but, unless those seniors under whom they work are considerate enough to give them instruction in senior work, they will not have opportunity to observe some of the most important things that the senior



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PREFACE

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does. Hence the present attempt to supplement the knowledge that a junior may gain in the course of his routine work.

There is no lack of excellent text-books dealing with accounting theory and practice. This book is intended to smooth the way of accountants properly trained in the art of drawing from figures all that they can tell, who for the first time are called upon to take charge of work, much of the detail of which is to be done by subordinates. The book is not intended to instruct anyone in accountancy.

F. W. THORNTON.

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**DUTIES OF THE  
SENIOR ACCOUNTANT**

## ARRANGING WORK AND STAFF

Upon being assigned to a piece of work the first duty of a senior is to make a survey of what is to be done, the objects to be attained and the procedure necessary.

If a certified balance-sheet is to be given it will not do to assume that a simple verification of assets, even on the basis set forth in the Federal Reserve bulletin, *Verification of Financial Statements*, will necessarily be sufficient. Aside from scrutiny of profits the client often has in mind some feature of his business to which special attention is wanted. Regardless of the kind of audit required the senior should ascertain from his own firm and from the client whether or not there are any points outside the preparation of the balance-sheet and profit-and-loss account to which he should give attention.

If a balance-sheet is to be prepared for the

purpose of financing by short-term bank loans, the liquidity of assets and the amount of liabilities maturing during the term of the loan are of first importance. If financing is to take the form of long-term bonds, the prospects of profits, as they may be indicated by past results, become as important as the statement of present assets and liabilities, since repayment at maturity will be made largely out of assets not presently existing but to be acquired out of future profits. And if financing is to be by sale of new stock the profits become more important than the balance-sheet, since the return of his capital to a stockholder is not contemplated. His expectation is limited to profit to be earned.

The "stockholder" referred to means the owner or the successive owners of shares of capital stock.

Audits of smaller corporations are usually for general purposes, not primarily for financing or for the certification of accounts. The work may include the preparation of balance-sheet and profit-and-loss account for the information of the client company and for exhibition to its

bankers, a general review of the accounting, and comparative and statistical exhibits to give information as to departmental economies, so as to assist in directing the business in the most profitable way, with some check of the clerical accuracy of the books and of the integrity of the client's staff.

There are also special examinations directed to some single feature of the accounts—counts of securities and agreement with some authorized book or list; check of cash payments; verification of instalment accounts; analyses of single accounts; and many others, each requiring work special in kind and amount.

At the outset consideration must be given to the order in which work is to be taken up. There may be a preferred order that seems the most logical and desirable; but availability of books and records may indicate quite a different order of work. Generally the order in which the work is actually done will be a compromise between these two.

After giving consideration to these matters the senior can so arrange the work of his staff

that desired special data will be gathered in the course of the routine work.

All correspondence with the client since the date of the last preceding audit should be read and understood before work is begun. If there be a permanent file containing copies of trust agreements, charter, etc., separate from the current working papers, it should be examined. Finally, the working papers of the last audit should be looked over—these may give suggestions as to the work to be done. They must not be taken as a model to be followed blindly; the last audit may have been made when conditions were not the same as now; the last senior in charge, even, may not have been perfect. The present senior is responsible for the present audit, no matter how prior audits have been conducted.

Where work is to be done in a place distant from the auditor's home office the need for observance of these rules is great, since failure to do all the work and gather all needed data may require a needless trip away from home to get the missing information.

A little modification of this procedure may



be permissible where the same senior has conducted several consecutive audits of the accounts of a company, but a close adherence to these rules will take little time and will add to the degree of safety.

If, in the opinion of the senior, work not hitherto done be needed and if such additional work may take much time, it is desirable that the home office or the managing accountant be informed before the additional work is begun. If work hitherto done seems to be unnecessary it should not be omitted unless there is a clear case for its omission. If any contemplated changes materially modify the character of the examination, they should not be made without approval of the home office or the manager.

Having arrived at a conclusion as to the nature and amount of detail work to be done the senior must make requisition for the needed staff. In deciding upon the number required, consideration must be given to the questions as to what books and records can simultaneously be spared for the auditors' use and the number of men who can use them with advantage; the working space that can be had;

and the time allowable for completing the work. When time is restricted it may be necessary to put the client's staff to inconvenience. If so, the head of the client's office must be consulted.

It seldom happens that the entire staff can be set to work with advantage at the commencement of an examination. Clients will justly resent having to pay for the time of men waiting until work can be assigned to them. For this reason the senior should make his request for staff in such a way that not all the men will be assigned to the work at once, but that they may begin only when there is a probability of work for them to do. Spreading the call for assistants in this way is likely to be helpful to the accountant's own home office; it is generally much easier to assign two or three assistants on each of three or four consecutive days than to assign nine or ten together at one time.

From the home office the senior may obtain a list of the assistants he is to have. If he knows them and knows their respective capabilities he will assign them to the branches of the work for which he thinks they are best adapted. A

man physically slow should not be assigned to counting large quantities of securities or to work involving the rapid handling of vouchers; such a man might be extremely efficient in analyzing accounts.

If the senior does not know the capabilities of his men he should obtain all possible information on the subject from the home office. Later in this book will be shown the source from which the home office draws its information; at present it is desired merely to emphasize the value to the senior of the information to be got from the home office records.

Although not in order of time it seems desirable now to say that as the work approaches completion, assistants may be released to the home office a few at a time, in the same manner as that in which they were put on the work; and the senior should never fail to advise the home office, as far in advance as possible, of the dates of the coming release of assistants from the work.

If the work be out of town and the home office be advised sufficiently in advance of the release of members of the staff it will be possi-

ble for the released men to be sent directly to another out-of-town engagement without the delay and expense of return to the home office.

When assistants are assigned to work that is to result in schedules for the working papers, instructions as to the form and contents of the schedules should be given. If left to arrange schedules in accordance with their own ideas assistants are likely to leave out some things that are wanted and to put down things that are valueless, whereupon seniors' time is wasted in revision of schedules.

Although assistants may have been assigned to take subordinate charge of sections of an examination, the manner in which they are to work is to be prescribed by the senior. Thus, if vouchers are to be checked, the senior must decide whether it may best be done by one man working alone or by two men, one calling and one checking. The method of handling vouchers will be determined by the senior, and will depend partly upon the manner in which they are filed. For example, if sufficient reference to the voucher numbers be found in the general ledger it may be practicable to vouch capital

additions directly to the general ledger, or, better still, to the auditor's schedules made up from the general ledger. In other circumstances it may be necessary to vouch to a voucher register. The senior decides.

## BEGINNING AN EXAMINATION

Absolutely complete detailed audits are now almost unknown; except in the cases of very small organizations, where no adequate system of internal check is practicable, charitable institutions and clubs, even so-called detailed audits are usually examinations in which detailed work is "sampled"—a definite proportion of the items being checked. The senior fixes that proportion, and he fixes, too, the particular sections selected to be checked and the manner of checking.

At this time the senior must arrange for a systematic record of work done by the assistants. Such a record in the last preceding working papers will be worth examination; the record now to be made should assist the senior who may have to make the next future examination. However, precedent is not binding and is useful only as a suggestion. Often these rec-

ords remind a senior of work that is desirable but might have been overlooked; they may omit something that ought to be done. Each sheet of the audit working papers may well show who made it up, who checked it, the date prepared, the origin of the figures.

Having assigned the assistants and prescribed the methods of work, the senior is not yet at liberty to leave the staff and take up his own personal share of the accounts. In every case, without exception, he should actually do some of the detail work in each section, working always with the assistants who will be engaged on that section. In this way he must set the pace—not so much the speed at which the work is to be done—although that is not without importance—but he must show how much scrutiny is to be given to documents, how much detail is necessary in calling postings, what vouchers are acceptable.

A company constructing buildings with its own labor may carry steel, brick, cement, lumber and other building material in stores, transferring by journal entry to the asset accounts when the material is used. Labor used in con-

struction may be transferred from payroll account by journal entry, some reference to the payroll appearing on the voucher. Fixed assets may be carried in suspense or stores account until they enter into actual service, the transfer to fixed asset account being by journal entry.

In all these cases the journal vouchers prepared in the office of the client are not of themselves sufficient as a verification of the asset. If the vouchers be properly executed and bear all the details that the auditor needs for his schedules, junior assistants are apt to accept them without further inquiry. The senior in charge should prescribe how far, in view of all the circumstances, the entries are to be followed up. A well kept stores ledger, properly test-checked, is usually the best help to a satisfactory verification.

Payrolls for construction should be examined. They always show separately the time for each construction gang and the particular piece of construction on which the gang is working.

Before commencing a recurring examination the senior should obtain particulars of the time spent on the preceding examination and the



amount of the fee and expenses. As the work progresses comparisons should be made.

When a recurrent examination, for which many comparative schedules are required, is in prospect the senior may save time by having prepared in advance skeleton exhibits, showing the figures for the comparable period and leaving space for the figures of the new accounts.

If the examination be that of a company with subsidiaries, the preparation of skeleton accounts in advance has the further merit of assuring agreement in form for all subsidiary accounts, thus making consolidation easier.

Voucher cheques may be offered in support of entries of capital additions; these are not satisfactory unless accompanied by bills for the goods or, in many important instances, formal contracts for work performed. Voucher cheques might be paid without filling in the details of the goods purchased and, if so paid, would be duly honored. Upon their return it would be easy to fill them in so that they would appear to have been paid for machinery or other permanent assets, whereas they might really have been payments chargeable to expense. A senior

should work with his staff on the detailed vouching until the character of the vouchers is established, after which the assistants may be instructed which they are to accept and which are to be questioned.

Other similar liabilities to error may arise in checking customers' accounts. Some customers may have a running balance and may be shown to have paid late items leaving older ones unpaid. The presumption is that the older ones may have been paid and the money diverted or that the items are disputed and not collectible. This will be obvious to a senior, but an assistant may overlook such conditions if they are not plainly indicated. Only by taking some part in the detail work of each section can the senior be reasonably sure that the assistants, however conscientious they be, are doing their work as it should be done.

Systematically inadequate vouchers and questionable entries will have a far better chance of passing without notice if they are scrutinized only by relatively inexperienced assistants.

Upon the whole, the senior will find the trouble of doing some of the routine work

highly recompensed by the lively understanding of the accounts that it gives.

After the assistants have been fairly started on their work, attention may be given to the work to be done personally by the senior. This is to be interrupted at intervals so that the senior may inspect the work being done by his subordinates.

The senior should start his work by obtaining a trial balance of the general ledger either before or after closing, according to circumstances. If before closing, he should immediately prepare a six column analysis. From this a general view of the condition of affairs is obtainable.

Cost accounts should have the senior's attention at an early stage of the examination—on the character of these accounts may depend the character and amount of work to be done by the staff. This early examination should be directed to the methods of costing, to find whether the distribution of expenses and costs is proper; whether the items charged into costs include any charges that should be taken directly as expense, and whether any class of items taken into expense should really be taken into cost.

If an examination be that of an industrial or

mining company and the plant be easily accessible, it will be worth while for the senior to visit it. Such a visit, accompanied by an operating officer, gives a lively understanding of book figures, needs for depreciation provisions, character of renewals and additions, deferred maintenance, discarded plant and inventories. The visit should be made after the examination has progressed so far that the senior has a rather comprehensive idea of the assets as shown by the books.

While the senior may and should use knowledge so gained to guide him in his accounting work, he must not permit the client to lead him into the position of one who approves the accounts on the basis of his physical inspection of the assets.

Examinations of corporations whose accounting is subject to regulation by public authorities should be preceded by an examination of the prescribed forms. Insurance companies, public utilities and public banks are all under some control as to their published accounts.

• III •

## INVENTORIES

One of the difficulties in valuing inventories arises in dividing "joint" costs. There are many industries in which it is necessary to manufacture two or more products in an uncontrollable ratio because the raw material used is split up into several differing parts. One can not manufacture sulphate of soda without making hydrochloric acid; one can not slaughter cattle and produce only beefsteak. One may know the cost of the sum of the products, but the cost of each, separately, is not ascertainable.

Where joint products are manufactured it will be found that the distribution of cost between the several products is not made by a simple arithmetical process but is largely a matter of good judgment. This judgment is primarily that of the client; but if one of a set of products be so costed that it does not sell freely and accumulates in the inventory, it indicates that

the joint costs are improperly divided, with a resulting overvaluation of inventory. An improper division of costs can not result in undervaluation of inventory but must lead to overvaluation, since only items overvalued are slow of sale.

If methods are found to be correct, some of the staff may be assigned to do the "sampling" of the cost entries.

Before any assistants are assigned to the checking of inventory, the attention of the senior should be given to the methods of taking and valuing it. If a proper inventory record be kept and testing samples of it indicates its integrity, some of the staff may be assigned to compare book with physical inventories, but this should not be begun before the senior has examined and approved the methods by which the record is written up.

It is a part of the duty of the senior to ascertain as far as he can whether proper provision has been made for depreciated or obsolete material.

It is quite permissible for the senior to consult with the client as to methods of taking

and valuing inventory. On proper instructions he may even supervise the actual work of taking inventory, provided that he does not take responsibility for either quantities or values, except as to their agreement with the records.

As to quantities, it is common for a client to have in his warehouse goods that do not belong to him. As to values, there does not live a man who can judge correctly of the values of all kinds of merchandise. The custom-house appraisers have many specialists to value merchandise, and even they often err. The senior should remember that he is an auditor, not an appraiser, and he must not lead the client to expect from him a certificate that the inventory is correctly valued.

The client may, however, demand of the accountant that, without taking responsibility for amounts of goods or values per unit, he certify that, using quantities and prices given by the client, the extensions and footings of the inventory sheets are correct, that the quantities agree with inventory records, and that prices do not exceed cost.

The necessary checking of extensions is, of

course, performed mainly by the staff. No accountant with the experience qualifying him to act as senior needs any instruction here as to the manner of checking or test-checking the extensions.

The best protection against grossly inflated inventory is to be got by justifying the percentage of gross profit by comparison with profits of prior periods, by comparing the percentage of gross profit with the percentages of profit on a large sample of representative individual sales, by the comparison of quantities with the quantities shown in a permanent inventory record, if one be kept, and by checking prices with purchase invoices. Finally, as an extra protection, certificates as to quantities and values should be obtained from those persons who actually took the inventories and from the officer in charge of that work.



· IV ·

DETAIL WORK TO BE DONE  
BY SENIOR HIMSELF

Careful examination of profit-and-loss accounts should always be made by the senior himself. They are more difficult of verification than most asset accounts and are of the greatest importance. If an asset be inflated \$1.00 it means, on the balance-sheet, the addition of \$1.00, no more. But it implies an inflation of profits of \$1.00, which may be taken as an indication of profits in the future one dollar a year greater than the truth. If 7% be taken as the rate at which to discount future earnings, this means that the value of the business, as a going concern expected to run for, say 40 years, is overstated \$13.33. This is the amount by which the value of the capital stock is overestimated by an overstatement of \$1.00 of earnings in one year, where that year's earnings are taken as a measure of future earnings.

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## DUTIES OF THE SENIOR ACCOUNTANT

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It has been stated here that the primary interest of a stockholder is not in the prospect of the return of his capital, but in the profits to be gained. If \$100 be invested in capital stock, with the expectation that the company will earn 7% and will go out of business and return the capital at the end of 100 years, the amount invested in prospective earnings is \$99.88½, and the amount invested in respect of the return of capital is 11½ cents—that is, the present value of \$100 to be received in 100 years discounted at 7% is 11½ cents. The relative importance to stockholders of the profit account is evident.

When the profit-and-loss account has been drafted, the senior should apply certain rough checks to supplement the detail work of the staff, so as to detect any large deception that may have been hidden so well as to escape the notice of the staff.

The percentage of gross—*not net*—profit should be justified as already described; the regularity of monthly sales or, in the case of “season” trades, the regularity of the seasonal variation should be examined and large differ-

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**DETAIL WORK TO BE DONE BY SENIOR HIMSELF**

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ences investigated; both growth of inventory items disproportionate to the corresponding sales and the relative volume of returned goods should be studied; the treatment of values of returned goods should be ascertained.

Where selling commission is given, even though the individual payments have been vouched, the rate of commission authorized should be compared with the volume of sales subject to commission and the total paid should be approximately reconciled.

If much interest be paid the total amount should be compared with a figure obtained by computing interest at the rates paid on the average amount of interest-bearing debt, and an approximate agreement should be sought.

The schedule of accounts receivable should be made up by the staff so as to show by periods the amounts in arrear—say those three, six or twelve months old, respectively. The senior should compare the total amount with the corresponding amount at the same date in prior years; then, comparing total sales for the two years, some idea of the propriety of the present total may be obtained. If the present

total be excessive and if the excess be attributed by the client to slow collections, the arrears shown on the auditor's schedule of accounts receivable will demonstrate whether that explanation is satisfactory or not.

All these tests to be made by the senior are for the purpose of discovering any systematic error or deception that may have been too well hidden for the assistants to detect it in the course of their detailed checking.

It has been judicially decided recently that if accounts receivable have been padded heavily by the insertion of a quantity of imaginary sales entered in an irregular manner, and the excess valuation has been accepted by the auditor and carried into the balance-sheet, the auditor may be chargeable with negligence, because the irregularity of the appearance of the entries should have put him on guard.

If the procedure outlined here were followed, such an inflation would be found:

- 1—From the excessive gross profit ratio
- 2—From the irregularity of monthly sales totals

- 3—From the excessive amount of accounts receivable.
- 4—From the disagreement between actual and book inventory

even though the junior staff engaged in detail checking had failed to note the irregularity of the entries.

Small errors and inflations are not to be detected in this way; the object is to make certain that the accounts are not grossly wrong. The detail work of the staff must be depended upon for detection of smaller errors.

Briefly, the statement of what a company claims to have should be met with the question: Where did the company get it? Conversely, the claim that profits have been made should be met by the question: Where are the proceeds? If the auditor can satisfy himself that the records answer these questions satisfactorily he is not likely to be seriously deceived.

The senior should not fail himself to examine the general ledger, giving attention not only to open accounts but also to any accounts that have been closed during the period. Before

concluding the work he should examine all journal entries made after the date of the closing of the books but before the completion of the examination.

The minutes of the client company, articles of incorporation, and documents relating to bond and stock issues should be examined and notes should be made of provisions for sinking funds, limitations of conditions under which dividends may be paid and other matters which may affect present or future accounts. These notes will be matter for the permanent files.

If the stock of the client corporation be listed on a stock exchange the listing application, which contains a full set of accounts, should be examined and a copy retained in the permanent file.

The accountant has been warned against overvaluations; but undervaluations may be almost equally bad. The duty of a public accountant is to state things as they are. Gross undervaluation may have the effect of creating secret reserves, which constitute a resource that may be expended without the same checks as those which surround ordinary expenditures. Things may be done with them that would not be

allowed if appropriations from known funds were necessary.

Undervaluation of inventories produces distortion of profit-and-loss accounts, showing too little profit in one period and perhaps too much in another, destroying the value of comparative statistics and perhaps injuring stockholders. The senior accountant should make an effort to draft his accounts in conformity with actual conditions, and at least carry to his reviewer a clear proof of any material undervaluation that he may find. Fixed assets carried at cost are not necessarily considered as undervalued although cost of reproduction may have increased. If they have been depreciated excessively, however, cost less excessive depreciation does constitute an undervaluation.

In dealing with intentional undervaluation, tact is needed when taking up the matter with the client. It may be impossible to bring him to accept the auditor's view; reference to the home office or reviewing partner or manager is then indicated.

Duties of a senior accountant may be said to include a cross-examination of the figures.

## ASSEMBLING SCHEDULES

When the staff completes any of the schedules they should be handed to the senior for review, indexed and filed in order. By the time the detail checking is finished there should be schedules covering every item shown on the trial balance after closing.

As schedules are received from members of the staff they should be reviewed without delay and the totals compared with the corresponding general ledger trial balance items, the trial balance being marked to show what items have been scheduled so as to indicate at all times what schedules remain unfinished.

Some of these schedules may appear to be needless, as in case of schedules of bonds, capital stock and some fixed assets that have not changed since last audit. They are really indispensable, as they show what is not a certainty



without them: that the items do remain unchanged.

Schedules should be so assembled that all sheets which will be consolidated to represent one item in the balance-sheet shall be marked with the same letter with sub-notations—such as A-1, A-2—for the separate sheets representing the balance-sheet item carrying the distinctive letter A. Finally, a summary sheet of the several A sheets is prepared, showing how the balance-sheet figure is obtained from the sub-schedules.

Some accountants display a tendency merely to copy a client's books and then consider that they have made an audit. Such schedules cost the client money, and, if not otherwise checked, they are of no material value in the verification of accounts. Schedules should be prepared with some definite object—not to clog the files with unverified copies of clients' books.

Precise directions for the preparation of schedules to the profit-and-loss account can not be given. In this matter the senior must exercise his judgment and try to have prepared such schedules as he thinks will explain matters in

which his client or his principal are apt to be interested. Schedules showing monthly sales, with comparative totals for the preceding year, will be of value; similar comparisons of expense items are often useful; schedules showing ratio of expenses to business done are always in order.

True overhead expenses, which by reason of their character can not be expected to follow closely fluctuations in amount of business done, may be compared with similar expenses in other periods, but they should also be so examined by the senior that he may judge whether their amount is reasonable or there is cause for further examination.

Profit-and-loss schedules should be made up into a package separate from the balance-sheet schedules and should be indexed.

An excellent specimen of working papers and their arrangement is contained in the book *Audit Working Papers* by J. Hugh Jackson. (American Institute Publishing Co., Inc., New York.)

When papers are assembled, the senior must look over them and attach to the sheets any

certificates that have been received, such as certificates of bank balances, of securities held on deposit, notes payable, trade acceptances, merchandise in hand and in storage, inventory certificates and others. A list of certificates needed but not yet received should be attached to the working papers and kept there until the last certificate has been received and attached to its schedule. It will probably happen that the junior staff will have gone to other work before all certificates have been received, and the senior in charge will be held responsible for obtaining and filing the certificates.

If the work be an examination of a branch of a very large business, the whole being under the direction of a managing accountant, the senior in charge of the work at a branch must arrange and index his papers to correspond exactly with the papers from other branches. If this is not done it will be difficult or even impossible for the managing accountant to consolidate the results of the audits at several branches. The managing accountant prescribes the forms of schedules.

Assuming that the senior has made an ex-

amination of all the accounts of a business, he must make up the exhibits and write the report, after which both report and exhibits must be reviewed by a partner or branch manager of the accounting firm. This is done usually before any of the accounts or the report is typed in form for delivery. The working papers, properly indexed and bound together, and the drafts of report and exhibits are laid before the partner, and the senior is present to answer questions.

· VI ·

REVIEW BY PRINCIPAL

Always there will be some parts of the audit work that are weaker than others—customers may have been asked to verify their accounts and may have neglected to do so; certificates may have been withheld; cost and inventory records may have been imperfect; doubts may exist as to the reasonableness of reserves. In all such cases the senior should not attempt to “get by” with the least amount of trouble, but he should point out persistently any weak features of the examination which he may think exist.

A senior who is once detected in the act of smoothing over defects in order that the partner who reviews the work may not know of them is forever barred from complete trust and will find promotion limited.

Partners' time is valuable; the senior should try to present his work and explain his ideas

about it as briefly as possible consistent with a clear exposition of the facts. At the same time, if there be any questionable matter involved in the work he must, if necessary, force it upon the attention of the reviewer. If trouble should come later because of such a matter, the excuse that the partner was too busy to listen would not be accepted.

When accounts have been made up correctly in accordance with the records, the senior's work is not completed. If the work has been done properly the senior should have formed definite opinions as to the amount of faith that may be put in the records and the system of accounting, the faults and weaknesses of methods in use and the possibilities of improvement. These conclusions should be laid concisely before the reviewing partner.

Some reviewing partners hold on their desks, unopened, the working papers, report and exhibits and, before taking up the formal review, ask questions of the senior in charge. Such questions may be: "Is the company prosperous?" "Has any branch of the business shown marked increase or decrease?" "Is that branch a profit-

able one?" "Are collections reasonably good?" "Who signs cheques?" "Does the president spend much time in the office?" "Is the internal check good?" "Is the current financial position as good as last year?" "Are there any weak points in the audit?"

These questions are asked partly to get an idea of the matters that need most painstaking review and partly to test the thoroughness with which the senior has grasped the situation.

In answering such questions it will be well not to refer to the working papers; the senior should be able to answer most of such general questions without help. His ability to do senior work will be measured by the readiness, correctness and intelligence with which such questions are answered without help from records.

Before submitting to a reviewer any report and accounts, it is worth while for the senior to give to report and accounts a little private review, dropping for the moment consideration of routine detail and asking himself questions such as those recited above. Not more than half an hour should be needed to do this.

When this has been done the senior should

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make up a memorandum showing briefly the points needing special attention by the reviewer, noting on the list the schedules that will be required to give information on those points.



## DIFFERING WAYS OF DRAFTING REPORTS

Some accounting firms have their reports written by the accountants who have actually supervised the examinations, and these reports are afterward reviewed and perhaps revised by a partner of the firm. Other firms have the reports written by report writers—men who do not actually make examinations but, because they write good English and are experienced in writing reports in a manner approved by their firms, are assigned to make up the reports from information supplied by the accountants who have actually had charge of work.

Faults of the first system are that reports by several seniors are apt to be of somewhat uneven quality and that more work is placed on the shoulders of the partners—which is hard on partners but good for reports. Some of its merits are that a report written by an accountant who

did the work will probably be more accurate in statement, more alive, less monotonous than a report written at second-hand by a report writer. The senior benefits by practice in writing reports; his style improves; he realizes better what a report should contain, and in the course of future audits is better informed as to the data that may be useful.

The errors that creep in when a tale goes from one person to another are well known.

The second system produces smooth, even reports, very well written, rather conservative and perhaps liable to be monotonous. Things that would occur to a senior writing his own report may not be brought out; the report writer, not having first-hand knowledge, is apt to be over cautious and to omit things of real value. If the senior have, in the first place, written a full report as a suggestion to the report writer the case becomes similar to that where a partner reviews the draft of the working accountant; but there is interposed between the working accountant and the partner the mind of a writer dealing only with second-hand information.

It is best for a senior to write a complete report in all cases, whether it be submitted to a partner, to a report writer or not to anyone. Ability to write a good report is a qualification that every senior should have.

After many days, perhaps weeks, of work the client gets a report or certificate, nothing more. The report should be of sufficient value to justify the expenditure of time and money. It is not enough that conventional items should be dealt with in a conventional way; it is even worse when seniors follow closely the form and even the wording of an earlier report, changing only the figures. During the entire examination the senior should be looking out for information which may be of use to the client; when he gets such information he should see that it goes into the report.

There are a few cases, especially in examinations of insurance companies, where set forms of report are required. These are cases where the auditor is not employed primarily to give advice but only to state that certain rules have been complied with, that the cash is correct, that the clerical work is accurate and that the

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entries are supported by proper vouchers. Even in these audits the set forms are used only with reference to some of the items and the auditor is free to comment appropriately about other matters. Such reports are not called certificates, but they are certificates in substance, hence their conventional form.

· VIII ·

PREPARATION OF TYPED REPORT

When papers, report and exhibits have been reviewed, perhaps revised, and finally approved by the reviewing partner or manager, they are to be typed for delivery. The senior attends to that; he delivers to the stenographic department the papers to be typed, gives the clerks any explanations they may require, and advises them of the time when the report and other papers should be ready. In arranging for typing where there are voluminous exhibits, the practice, followed by some seniors, of getting together all the exhibits before any are given out to typists, then rushing them into the department, is bad for everyone concerned. Exhibits should be fed to the typing department as soon as they are ready, so as to allow as much time as possible for typing.

After typing and proof-reading, the exhibits will be returned to the senior. It is his duty to

have all typed footings checked and personally to check the form of figure statements and the language of the report. After that is done, he signs one copy of each statement as being correct in all respects and returns all the copies to the department to be bound for delivery.

Then he must dictate letters transmitting copies to those who are to receive them, personally obtain the copies for mailing and present the copies and letters to the reviewing partner for signature. With the typed copies for signature there positively must be presented to the signing partner the drafts which he already has seen and reviewed.

Not until the signed copies and letters of transmittal have been delivered to the mailing department does the responsibility of the senior end. Up to that time it is his duty, not that of his staff, to see that:

Schedules are complete and support the exhibits

Necessary certificates are obtained

Papers are properly indexed and bound

Exhibits are prepared and report written

After partner's approval, papers are properly filed

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PREPARATION OF TYPED REPORT

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Exhibits and report are delivered to the stenographic department

Exhibits are properly typed and typed figures checked

Report and accounts are bound and signed by partner

Accounts for delivery to client are mailed with letter of transmittal

This work may not be assigned to any other person, unless at the request of the reviewing partner.

After every large piece of work is finished it is the duty of a senior to report to the home office on the work of the assistants engaged on it. This emphatically does not mean fault-finding. It means that the home office should know the special abilities, traits and dispositions of each of the assistants, to the end that if any of them show capability for more responsible work they may be promoted, and that they may be assigned to work for which they are qualified.

Sometimes a senior finds a junior who is unusually good and keeps that knowledge to himself, trying to retain the junior working un-

der him and taking all credit for the junior's work. This plan may succeed for a little while, but it will be found out in time. It is dishonest, of course.

Nothing is more valued in a senior than the habit of reporting intelligently on the ability and industry of juniors, together with a willingness to instruct juniors in senior work. There are not enough good seniors; there are too many unsatisfactory juniors.

Inclusion in a report of matter that was known to the client before audit is generally unnecessary and wasteful if the report be made for the information of the client only. A different case arises when the information, while known to the client, is not known to bankers or others for whose benefit the client wishes the information to appear in the auditor's report.

Sometimes matter that is fully known to the client should appear in the report, because it is needed to disclose existing conditions; accounts receivable, for example, may have developed a largely increased trend toward arrears. This should be mentioned in the report.



Report and accounts should contain (1) matter partly known to the client that he wishes to have assurance that the auditor has verified; (2) matter that may be fully known to the client but that he wishes to have the auditor verify for the benefit of others; (3) new matter that the auditor has uncovered that may be of interest to the client or to others who may receive a copy of the report; and (4) matter that is needed to make full disclosure of existing conditions, no matter whether the client knows of it or not.

There are examinations when no report is made but a certificate is given to accounts prepared by the client. In such cases the work of drafting accounts is reduced to a minimum, while the drafting of the certificate becomes of the greatest importance.

In preparing the certificate the senior needs all his skill. A certificate should be as brief as it can be made consistently with entire clarity and should be worded so as to cover all that properly may be covered and no more. It should not be susceptible of misinterpretation. Certificates that contain technical qualifications

the scope of which is not immediately apparent are improper. It might be that obscure qualifications in a certificate would protect the auditor against legal liability and would please some clients. The senior should refuse to draft a certificate in a manner which might deceive an investor who had only ordinary business knowledge of accounts and read the certificate with ordinary business care. An accountant can not always word a certificate so that a person quite ignorant of accounts or one not giving ordinary care to its reading would be entirely safe against misinterpretation, but the risk should be reduced as much as possible.

## PERMANENT FILES

Some accounting firms keep a "permanent file" of working papers for each important client. This is a series of records that will be needed year after year, filed separately from current working papers so as to save time in search for information. The papers so filed are records of original organization, authorization for stock and bond issues, schemes for depletion provisions, long-term contracts, sinking-fund provisions, matters in litigation and any other matters that in the opinion of the auditor should be known to auditors at all future examinations.

If, during any examination it be found that, since the last examination, securities have been issued or cancelled, changes made in the organization, subsidiaries acquired or disposed of or long-term contracts entered into, the senior

should put copies of the relative schedules or documents in the permanent file.

As such papers may be needed in the far future, when the matters are not fresh in the memory, these schedules and notes should be particularly clear and fully explained. This is the more necessary, because they are not, like the ordinary working papers, accompanied by other schedules that form an explanatory context of figures.

## COLLABORATION WITH OTHER SENIORS

It may happen that part of the work of audit may have to be done in another district or even in another country in which the auditing firm has an office. This work will be done by men, assigned by that other office, who are not directly under the control of the senior in charge of the entire examination. It is the duty of the senior to advise that other office of the amount and nature of the work to be done and the date limit for its completion.

In specifying the work to be done by a distant office it is necessary to give (1) a statement of the exact work to be done and schedules to be prepared if conditions permit, and (2) a statement of the object to be attained and the use to be made of the schedules, so that, if conditions do not permit exact compliance with

ideal requirements, the distant office may be sufficiently informed to make the best use of such material as may be available.

It follows that if work be done for a distant office the instructions received should correspond with those given above, and the work done should be arranged so that it can readily be used for the desired ends, even if it can not follow exactly the preferred standard set forth in the instructions. If any change be found necessary, the office for which the work is being done should be advised at the earliest possible date, not after the work has been completed. In any case the preferred standard should be followed exactly if that be possible.

Similarly it may be necessary to assign part of the staff directly under the control of the senior to work within the home district but in a locality distant from the place where most of the work is done. Assistants so assigned should be the best on the staff; their instructions should be of a nature similar to those given to an office in another district—that is, specifications to be followed exactly if possible, with an explanation of the use to be made of the work

to be done, so that if conditions compel some modification the results obtained may be the best possible for the purpose in view.

Seniors having charge of audit of one out of several interlocking subsidiaries must arrange their work to correspond as exactly as possible with that of other seniors having charge of the audit of other subsidiaries. Thus, if there be an intercompany balance between two subsidiaries, and one has shipped and charged goods to a second, while the second has not yet received the goods nor taken up the purchase, or if there be any item in dispute between the two subsidiaries, it will not do for each of the seniors to make up his accounts without ascertaining the treatment of such items by the other, leaving it for the manager in charge of the consolidated audit to trace and adjust discrepancies. The two seniors must agree on the treatment of such matters and make up their accounts to conform one to the other.

If a subsidiary (No. 1) have shipped and billed to another (No. 2) goods that have not been received nor taken up by the second subsidiary a satisfactory plan is to show the ac-

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counts of No. 2 exactly as per the books and to show on the accounts of No. 1:

Intercompany balance with Sub.		
No. 2 per our books	XXXXX	
less inventory in transit	<u>XXXXX</u>	
		XXXXX
Inventory in transit		<u>XXXXX</u>

If there be a difference in the intercompany accounts due to a disputed item, the accounts of the subsidiary (No. 1) claiming a credit that is disputed by the other subsidiary (No. 2) should show:

Intercompany balance per our		
books	XXXXX	
less disputed items	<u>XXXXX</u>	
		XXXXX
Disputed claim against Sub. No. 2		<u>XXXXX</u>

and a journal entry should accompany the working papers of the company No. 1 suggesting to the managing accountant adjustment as follows:

Debit profit-and-loss (or expense, or surplus, as the circumstances may indicate)	XXXXX	
Credit intercompany account		XXXXX



the amount being that needed to bring the accounts into agreement.

In a consolidated statement it is of no consequence which subsidiary yields its claim to the other; the adjustment must be made in some way, and this is the easiest. Much correspondence and argument may be needed if an attempt be made to bring either subsidiary to the auditor's view of the matter. That is not necessary, and the actual adjustment on the books may well be left to the two subsidiaries, to be made at their convenience. At the same time an explanation should be included in the working papers so that the managing accountant in charge of the consolidation may make the adjustment in a different way if he desire. Entries on the working papers, such as those shown above, will permit any adjustment that the managing accountant may prefer while indicating the manner of adjustment that commends itself to the senior in charge of the subsidiary audit.

If the seniors auditing two subsidiaries both make the adjustments, each adapting his accounts to the accounts of the other subsidiary, the

case is worse than ever. It is an effective rule to make all adjustments on the books of the company claiming credit which is not allowed by the other; but the two auditors must agree as to the manner of adjustment and must agree on the amount of the adjusted intercompany balance.

Finally it should be impressed upon the subsidiaries that a difference between them in their intercompany balance is no more excusable than a difference between two departments of a single company. Such differences are not uncommon, especially where the subsidiaries have once been independent companies having employees with some pride in the organization.

When the senior has been promoted to the grade of manager he may have a vivid experience of the exasperation and delay caused by incompatible reports from several seniors auditing several subsidiaries of a corporation. It seems a pity that seniors can not obtain that experience until they are beyond the grade of men making the incompatible reports.

The reports made by seniors in charge of audits of subsidiary branches are similar in content to reports and accounts rendered to

clients, the written report being rather more informal and outspoken in character, not necessarily typed and, of course, addressed to the managing accountant in charge of the consolidated audit, and not to the client. Indeed, such reports to the managing accountant may sometimes contain opinions as to the character and efficiency of the clients' officers and other confidential matter. They are to be a frank and confidential communication to a superior in rank and dealing with all matters affecting the audit.

## DIFFERENCES OF OPINION

If a senior in charge of a section of a large audit think some change in the figures necessary to bring about a true statement of affairs, he should not in his statements change the figures as shown by the books, but he should add to his working papers a statement of changes proposed, the reasons for changes and for each desired change the journal entry that would be needed to bring it about. Further, the draft accounts should be prepared leaving open columns for adjustments and for final adjusted figures. The manager in charge of the consolidated audit will then decide whether or not the changes should be made. Accounts made up subject to such adjustments should be arranged so as to leave plenty of room for the adjustments; balance-sheet and profit-and-loss accounts may well be written on alternate lines so as to give space for entering changes, and in

the case of items known to be subject to several changes additional empty lines may be left.

Depreciation provisions are a fertile source of disagreement. Comparisons of rates with those used by similar companies are of some value but are far from conclusive. The treatment of heavy repairs must be considered; conditions affecting wear are not always the same; quality of assets when new is a factor; the extent to which the assets are strained in the effort to speed production is important; obsolescence may make a difference.

All these things should be considered and the data digested before a senior takes up with a client any proposal to change depreciation provisions.

One rough test that is of occasional value is found in tracing over a long period the growth or decrease of the book value of net fixed assets—assets at cost, less depreciation reserve—and comparing the change, whether increase or decrease, with the growth or decrease of business done. This, however, is not trustworthy where a company has started business with new fixed

assets and has not yet reached the point where annual replacements may be expected to be approximately equal to the annual depreciation reserve.

In any case the net investment in machinery and plant should not for a long period increase faster than output. If it does there is ground for inquiry.

Reserves for bad debts are also a cause of trouble with clients. The senior auditor is not a credit expert, but he is not—or should not be—unable to draw obvious conclusions from ledger figures. If, say, \$10,000 of accounts a year become two years old, and the client says they will eventually be collected, the senior should ascertain what amount per annum is being realized from accounts over two years old. If the sum realized each year from such accounts is less than the annual amount falling into two-year arrears the asset needs a corresponding reserve.

Of course the two-year period is merely illustrative. The age at which accounts become seriously doubtful differs with different kinds of business.

Inventory valuation is another point on which differences of opinion arise. Where clients refuse to accept suggestions from accountants that valuations be changed, the accountant can not take a rigid stand unless valuations can be shown to exceed cost or demonstrable market value. If the differences arise on questions of quality and market value the client's judgment must have precedence and the accountant must protect himself by disavowal of responsibility for prices.

If inventory prices exceed cost, except in the case of inventories of securities held by dealers in securities, the senior should not make up accounts including such valuations until the matter has been considered by his home office or accounting superior.

An exception to this rule is found in the audits for the purpose of sale or incorporation. Such sales are made on the basis of the most correct ascertainable values. When fixed assets have been subjected for a long period to depreciation and renewals or where they have been purchased when the level of prices differed from that presently existing, there is recourse

to appraisal. Values so obtained may be accepted, but the accounts must clearly show that appraisal values are used.

In similar cases some current assets, especially inventories, may appear on the books at cost, although prices may have risen or fallen. Here, too, appraisal values may be used under the conditions already mentioned.

On incorporation of a business formerly conducted as a partnership it is usual to take up the assets at market—not book—values, although such values may exceed cost. If only capital stock be received by the former owners in exchange for the assets, no taxable profit accrues and the owners take up the capital stock at a value equal to that of the assets as shown by the books before incorporation.

Inventories of securities in the hands of brokers and dealers in securities usually are taken at market value. If taken at cost the difference between cost and market values should be shown on the balance-sheet. In all cases, without exception, the basis of valuation of such assets should be shown on the balance-sheet.

Whenever there is a difference of opinion



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DIFFERENCES OF OPINION

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and the accountant contemplates putting in the report any unfavorable criticism of any matter whatever, the client must first be made aware of the apparent cause for criticism, and the justification of his position made by the client must be fairly recorded and presented to the reviewing partner.

## AUDITS OF BANKS, BROKERAGE HOUSES, AND SECURITY DEALERS

An exception to the rule that the number of men employed at the beginning of an audit should be less than the full staff engaged after the audit has made a good start is to be found in audits of banks, brokerage houses and security dealers' accounts. In these audits the work begins with verifications of bonds, stocks, mortgages and other evidences of values and of cash on hand, all of which must be attended to with the maximum of speed. In theory it is to be done instantaneously; in practice, as quickly as possible.

Instead of beginning with only a part of the staff it is necessary to use the whole staff from the first, and, for the relatively short time occupied by the count of securities, etc., to borrow men from other work.

If a bank is to be examined the senior in charge should obtain the trial balance of the general ledger—whether balanced or not at the time work is begun—and from it ascertain what items there are to be verified physically. Assistants will be assigned to cover simultaneously all cashier's cages and to verify and list securities on hand. There are so many branches of this work that the senior can not take part in the actual count but must spend his time in supervision only, keeping constantly before him the trial balance, so that nothing may be missed.

After the count of cash and securities the work continues with a balancing of securities with the lists of counted securities, customers' statements, lists of collateral, etc. This involves posting the data to security balancing cards. It can not well be done by juniors inexperienced in this particular kind of audit. It is assumed that there are among the assistants at least half the number accustomed to bank and brokerage audits. If any of the assistants, regardless of their general accounting ability, are not accustomed to this work the senior must see that

each one works jointly with an assistant who has the necessary experience.

During this period the senior may take a small part in the posting work, but he should give most of his time to supervision, especially to ensure that all lists of securities counted, held as collateral, owned by customers, out for transfer and "failed to receive or deliver" are duly posted.

After all security balancing cards are posted there may be some that do not balance. No card that at first does not balance should be adjusted, even if error in posting is found, except by the senior in charge. After all errors discoverable without referring to the client's books have been corrected, there may remain differences still unexplained. Data for the explanation or correction of these may be obtained from the books of the bank or brokerage house. Such corrections should all be made by the senior, whose duty it is personally to investigate any failure of the security cards to balance.

It will be found, if the audit be large enough to employ about ten assistants, that time and

trouble will be saved if the senior, during the count and balancing of securities, give his entire time to making certain that all is being done that should be done, since an omission to verify at once any item that should be verified can not be rectified properly at a later date.

This is by no means a statement of all the work to be done at the beginning of a bank or brokerage audit; it is rather an indication of the way in which the senior in charge should arrange the work. For full detail of the procedure in a bank or brokerage examination, books dealing with that subject may be consulted.

As the physical verification of cash and securities should be completed at night, or on a Sunday or holiday, and before the client again begins active business, these audits demand overtime work, limited only by the capacity of assistants to continue. Whatever overtime is made the senior should always be present. It is not safe to leave the work, even for meals, unless another senior can take up the supervision, or unless all assistants suspend work for the meal.

After the work of verification of securities, etc., the audit may proceed in the same way as any other work.

Seniors are advised not to take charge of work of this kind until they have had some experience of it under the supervision of others. Of course, a competent senior, if given time enough, could make a satisfactory examination. But one is not given time; the verifications must be made without hesitation, not omitting anything, and some of the things to be done are dissimilar to anything that is needed in an examination of a commercial business.

## WHEN DECEPTION OR FRAUDULENT ACCOUNTS ARE MET

If a senior upon his first general examination of trial balances should find indication of intentional fraud by the client company, such as financing by sale of securities with an exorbitant amount of the proceeds given as commissions to officers or salesmen, merchandise sold on a trick chain system where customers are led to believe that if they secure more customers they will get their own purchases free, expenditures of a clearly personal nature charged as corporate expenses, inflation of values of fixed assets and issue of securities against such inflated values, or other deceptions of a similar kind, it is the duty of the senior in charge to make a hasty further examination of the doubtful matters and then to bring the matter before the client for explanation. If, after the client has stated his case, there remain doubt of the hon-

esty of the accounts the senior should promptly consult his home office so that the audit may be dropped if the home office so instructs.

This does not mean that dishonest accounts should not be audited, but merely that there is danger in auditing such accounts if the report is to be rendered only to the dishonest client. Such a report may be as severe as the facts warrant; it may point out every wrong; it may be such that the client would not dare to publish any part of it. Nevertheless the client could publish the bare statement that the accounts had been audited by . . . . ., an undeniable fact, but carrying some implication that the auditor approved the accounts.

In other circumstances, audit of dishonest accounts may be desirable and necessary. If the client to whom the report is to be rendered be someone outside the dishonest corporation, such as a banker contemplating a loan, or a creditor, an audit should be made and with special care to detect improper accounts. Such a company may be compelled against its will to submit to audit and may use every effort to deceive the accountant.



Similarly, if the audit be that of a branch or subsidiary company and the fraud be confined to the branch or subsidiary or to an employee of either, the audit should be made and the report sent to the parent company.

It is not desirable, even if no irregularity is suspected, to make an examination of a branch or subsidiary company unless the instructions provide that at least one copy of the report be sent directly by the auditor to the parent company.

Finally, no criticism of accounts reflecting on the good faith of the client or of any employee of the client should be made, even to the home office, until the client or the employee has had an opportunity to explain or justify the acts not approved. It is not for the senior to take the attitude of a cross-examiner. If a client defend anything that has been done the senior should note the defense, drop the discussion with the client and deal with the matter after consultation with his home office. After all, the clients may be right; sometimes they are. One should not offend them needlessly.

Fraud by an employee, unless the client is involved, should be taken up first with the client.

## OVERTIME AND PROMPTNESS OF COMPLETION OF WORK

Members of a staff under the supervision of a senior should not make or charge overtime without the authorization of the senior.

Overtime is objectionable. Most overtime results from failure to estimate correctly the time required for completion of work with a given staff.

Delays in the work of audit, in getting report and exhibits typed and in securing the attention of a reviewing partner occur regularly. If a senior so calculate the time of audit that if no unforeseen delay occur the accounts will be ready at a promised time, he will find either that a distressing rush of overtime will be necessary at the end or that the accounts will be late. Both of these things are probable.

If the first computation of the possible date of completion be based on expected overtime

the situation is indeed bad when unexpected delays occur. There is then no chance to make up for the unforeseen obstacles.

On the other hand, by allowing for some delay from unknown sources and basing the calculation on the amount of work that can be done in scheduled hours, a senior can give assurance that work will be done at a given time with a comfortable margin of resource if more interruptions than had been expected intervene. Overtime should be a pinch hitter, not a regular member of the team.

In every case promises to complete work at a specified time should have some qualification to protect the auditor if, after every effort, he be prevented from fulfilling the promise.

As, toward the close of an examination, the senior has much work to do with schedules made up and being made up by the staff in regular working hours and as his supervision of juniors is particularly needed at that time, it becomes necessary for him to do some of his work after the staff has ceased work for the day.

On work done out of town, this is more

necessary because the account and exhibits ought to be substantially complete while the staff is still available. Matters developed in getting out the report and exhibits may indicate need for other data or further checking which can not well be done after the staff has been released.

*If working out of town the senior must not leave for home until he has at least completed tentative drafts of report and exhibits.*

All this implies that the senior will have to work longer hours than the other members of his staff. This is one of the less attractive conditions of his rank as senior.

## EXPENSES OF STAFF

When working out of town the expenses of the members of the staff are paid by the accounting firm and usually are charged to the client. Allowances for such expenses are made in various ways; some firms allow a fixed per-diem amount, varying according to the cities in which the work is done, plus car and taxi fares, baggage transportation and telegrams; others have similar per-diem rates but allow some elasticity; and some follow the somewhat penurious plan of the United States government—"actual and necessary expenses". This last plan causes work for the home office and some friction.

When the first and second plans are operative the senior should see that (1) the rate is high enough to permit the staff to live in comfort and with no loss of dignity, and (2) that

the staff does actually live comfortably and in a reasonably dignified way.

Expenses outside the per-diem allowance must be supervised by the senior; none should be allowed that could not be defended if the client, who in the end pays, should question their propriety. They include taxi and car fares, transportation of baggage, tips, telegrams and telephones, postage and expressage on firm papers and similar payments, but not such personal expenses as cost of laundry work. Expense accounts should be initialed by the senior before being submitted to the home office.

Padded expense accounts are not unknown. Apart from the moral wrong, those who do the padding are foolish even from the gross-money point of view. Let the small amount of dirty money gained in this way be compared with the injury to the accountant's prospects of promotion. The home firm knows. Scrupulous honesty is not a negligible qualification in a man set to scrutinize the accounts of others.

## INTERNAL CHECK

By "internal check" is meant the arrangement of the work of a client's employees in such a way that the entries made by one employee are directly or indirectly checked by other entries made by other employees. Some clients have their own auditing staffs.

Even though a satisfactory system of internal checking has been installed, entire reliance upon it is not safe for client or auditor. The simple fact that the system is well designed ensures only that fraud will be difficult for any single employee unaided by others.

Assuming that a good system exists, there will still be danger if those employees who are supposed to be a check one upon another be especially intimate or if the head of an office have established himself as an unreasoning dictator, his subordinates compelled to follow his orders with or without explanation. If the

outside auditor ask questions of subordinate bookkeepers and find them afraid to answer reasonable enquiries, referring the auditor always to the head of the office, the internal check is untrustworthy.

Of course, the character of the employees is important. The question whether fraud could be made profitable is to be considered. Watchfulness by the heads of the business is needed.

In an office where there are securities, the temptation to misappropriate them seems to be greater than the temptation to take actual cash, and the detection of such stealing is less easy and less prompt than the detection of money shortage.

Bonds would be missed when the coupons fell due—that occurs only semi-annually. There should be a good internal check on the custodian in all cases where securities are kept, but especially so when the securities are active—when they are frequently bought and sold. Securities held for long-term investment may be deposited with a bank as trustee or put in a safe to which only officers of a company have access, but that is not possible if the securities



are active or where they are held for safekeeping for others who may at any time call for them.

Internal check is also indicated where merchandise of small bulk and high value is kept and where merchandise, although not of high price, is of a kind tempting to the employees. In a factory making silk stockings, for instance, petty thefts may cause serious loss in the absence of internal check to keep account of quantities passing from one hand to another. Such internal check on merchandise is based primarily upon the permanent inventory record.

Internal check on those who handle money is of two principal kinds, check on those who have custody of money that has been recorded on the books and can be misappropriated only by false entries or open shortage and check on those who may receive money and retain it, failing to record its receipt. In the first case methods of internal check based on paper entries may be a sufficient safeguard if the check is faithfully carried out; in the second case there is little safety in anything but constant watchfulness.

It may be assumed that some employees will study the methods of check so as to circumvent them; therefore if the methods can be varied from time to time additional safety will be obtained. A senior making an audit should consider these things. Misappropriations in business organizations are not nearly as frequent as most people think—not nearly as common as in political life. When they do occur they are demoralizing. It is better to prevent them than it is to detect and punish the offenders.

There arises the question, important to the auditor, as to how far internal check can be used as an auxiliary to the auditor's own examination. It will not do to accept internal check as a substitute for audit; a certificate must not be based upon figures verified only by the client's internal check or even by the client's auditing staff, if there be one; but the amount of detailed checking may well be reduced where the internal checking system is good and the observation of the senior leads to the firm belief that the check is properly carried out. For example, if the customers' ledger

be kept by a clerk who does not handle money, if monthly statements are compared with the trial balance and mailed by another clerk who also does not handle money, if the control account is in order, less detailed checking of the customers' ledger will be needed than would be proper if the ledger clerk handled collections and mailed the statements himself.

The importance of internal check becomes magnified where tabulating machines are used in the accounting; for example the income from rental of motion-picture films may be divisible between producer, distributor, star actor and scenario writer. There will be many thousands of items to be divided weekly; the tabulating machine does the work as no clerks could do it, but great bundles of tickets with little holes punched in them do not lend themselves to ready audit. Here the reliance upon the integrity of the tabulating machine work must be great. Only limited verification can be made in a reasonable time by the auditor unaided by the machine. Internal check is valuable here.

It is almost impossible to lay down definite

rules for the general acceptance or rejection of figures vouched for by internal check; it may be said, however, that, before the auditor may certify anything, the work he does must be not less than the minimum that would justify him in certifying irrespective of any internal check.

It will be clear that there is here an opportunity and duty for the senior to exercise discretion, not burdening the client with unnecessary detail checking, not certifying anything without adequate evidence. So far as internal check is designed to prevent bookkeeping errors it may be deserving of a high degree of trust; in the matter of fraud it is less trustworthy, since there may be an inducement to defeat its purpose.

## THE SENIOR AND THE CLIENT

To the average client the senior represents his firm; except in cases of unusual importance the dealings are between the client and the senior. Partners of the larger firms do not frequently come into direct contact with some of their clients. The senior, then, has on his hands the responsibility of representing worthily the firm for which he works.

Clients stay with an accounting firm because of their estimate of its representatives—because they like them, because they believe them to be competent and most of all because they believe them to be incorruptible. They leave accounting firms for opposite reasons.

If a client be well disposed toward an accountant, he can help greatly with the audit; his staff can and will prepare schedules, copies of agreements, carbon copies of customers'

statements and other matter that otherwise would have to be copied by the accountant. Vouchers, invoices and other documents will be got ready and arranged for the auditor's use and an effort will be made to render the work rapid and pleasant.

Assistance should be reciprocal; vouchers should be kept in order; books kept clean, office rules observed, work arranged so as to give the least trouble to the client's staff. Consideration for the client may be shown in other ways. He may be kept advised of the progress of the work and consulted if any unusual profits, losses or expenses are found. If numerous small questions which need the attention of the client arise, it is undesirable to discuss each one as it appears, thereby breaking in frequently on his time. It is preferable to list them, ask the client to appoint a time for settling them and then take up all or as many as possible at one time.

When discussion of such matters does take place it should be on the most friendly plane. There is no excuse for a petty or captious attitude—it is not dignified, not professional, not

just. The client should be made to feel that the auditor is his friend ready to be of service.

Besides maintaining good feeling with the client, the senior should give attention to cultivating the goodwill of the client's employees. They can be of much help to the auditor if they choose, making the examination more thorough and at the same time less costly. It is through their good offices, as much as through the goodwill of the client, that the accountant may receive copies of schedules and other documents and have his work facilitated in other ways.

Friendly employees will bring out auxiliary records, not part of the double-entry system, which assemble exactly the data needed in preparing reports. They may point out methods of easy reference. Sometimes they will suggest inquiry into matters that otherwise might be overlooked. They may give the auditor copies of accounts that they have themselves prepared.

Employees of a client should never have the impression that the accountant looks upon them with suspicion. A detective or ill-natured demeanor on the part of an accountant is fool-

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## DUTIES OF THE SENIOR ACCOUNTANT

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ish and tends to defeat his aims. Such an attitude is unjust to employees who presumably are as honorable as the accountant.

On the other hand, an unfriendly staff may not only refrain from extending facilities but may even throw obstacles in the accountant's way or try to lead him into error.

Trouble is saved and clients are pleased if a senior, about to decide upon the final form of report and accounts and upon adjustments of book figures, takes them up with the client, arriving if possible at an agreement with respect to them.

The accountant should not accept favors from clients even though offered innocently. Such favors may not be intended to sway the accountant and may not in effect influence him, but they have an unpleasant appearance and may, quite unjustly, subject the accountant to suspicion.



## THE POSITION OF SENIORS IN AN ORGANIZATION

There are not enough good seniors; probably there never will be. There is also a scarcity of capable managing accountants and the really good senior is soon taken into the higher rank.

As accountants rise in rank, the requirements other than those of technical skill become more insistent. Agreeable personality and the art of dealing amicably with clients have an importance in direct proportion to rank.

Willingness to assist juniors beyond the mere ordinary requirements, readiness to do extra work when associate employees are sick, promptness in completing work, absence of irritability, willingness to coöperate with other seniors, all are qualifications for promotion not less important than technical knowledge.

In dealing with clients the senior must consider himself as occupying a dignified and im-

portant office. He must not allow the prominence or importance of any client to overawe him in the exercise of his profession. He represents his firm.

That seniors should insist on proper behavior of juniors in clients' offices is well enough recognized. It is less well acknowledged that part of the duty of the senior is to insist that his junior staff be provided with reasonably comfortable working conditions and be treated with proper respect. The interests of the accounting firm are not served by allowing clients or the employees of clients to treat juniors disrespectfully.

In his dealings with both his juniors and his superior officers, the senior who would advance his rating will the more easily do so if he take upon his shoulders all the burden properly to be borne by him and as much more as he can comfortably carry—at a pinch all he can carry, albeit not comfortably.

In all the better accounting organizations even reasonably good seniors are kept employed through good business and bad; it is the juniors and mediocre seniors that are employed only

during the busy season. For this reason the senior is more distinctly a part of the firm organization and has the stronger obligation to support his firm's standards of work. Seniors are the hardest worked of all the men in any accounting organization. The junior does his day's work, under direction, somewhat mechanically, perhaps, and forgets it when the whistle blows. The manager and partner have worries enough, but they do not have a great amount of actual clerical calculation to do. The senior must do quite as much actual computing as any of his juniors and must also bear some of the same kind of worry that besets the manager. The responsibility is good for him if he is ever to become a managing accountant or partner.

## APPENDIX

Certain duties and responsibilities are imposed by law on public accountants. These are by no means to be considered as defining the duties of accountants; they set a standard far below that which accountants have set for themselves.

The laws of most states provide for the discipline of certified public accountants guilty of fraud, deceit or gross negligence. The profession expects from its members far more than freedom from these sins.

Accountants can not be too strongly advised to adopt for themselves those rules of conduct and professional integrity that the professional organizations of accountants have adopted. It is the duty of accountants to do full justice, not to confine themselves to bare legal requirements, which are a minimum below which punishment is provided.

It is well, however, for public accountants in charge of engagements to be familiar generally

with the leading court decisions affecting the profession and it is suggested, therefore, that senior accountants at least read the reported decisions in the following cases:

*Ipswich Mills v. Dillon, et al.* (157 N. E. 604)

“Accountant’s working papers held to be his own property.”

*Ultramares v. Touche, et al.* (243 N. Y. S.

179) “Accountant held not liable to parties other than his client for losses on account of his negligence but fully liable if fraud were proved.”