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Guides to successful accounting practice: a selection of material from the Journal of accountancy's Practitioner's forum

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Guides
to
Successful
Accounting
Practice

EDITED BY BERNARD B. ISAACSON, CPA

Guides to Successful Accounting Practice

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A Selection of Material from *The Journal of Accountancy's*
Practitioner's Forum

EDITED BY BERNARD B. ISAACSON, CPA

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS
270 MADISON AVENUE, NEW YORK 16, NEW YORK

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The American Institute of Certified Public Accountants
Library of Congress catalog card number 59-11168

INTRODUCTION

The Practitioners Forum was inaugurated as a regular department in *The Journal of Accountancy* in June 1954, under the editorship of Dixon Fagerberg, Jr. In April 1957 I assumed the duties of editor.

As defined by Mr. Fagerberg in the column's first appearance, the purpose of the new feature was "to provide a convenient medium for practitioners to *pool*, to *compare*, and to *share* the best fruits of their combined experiences." Although the scope and coverage of the department have inevitably broadened—reflecting the wider range of services which practitioners are rendering to clients—I have attempted to keep the emphasis on problems which arise in the conduct of an accounting practice.

This volume is the result of five years of pooling, comparing, and sharing. It would not exist if it were not for the extremely able pioneering of the first editor. Both of us have been dependent on the vital assistance we have received from the grass-roots—the individual practitioner who has taken the time and trouble to contribute material based on his own actual experiences.

These practitioners have provided time-saving ideas and suggestions as well as procedures which they have tested and found useful. The subjects cover almost every phase of the management of an accounting office. Internal forms are illustrated and explained. Various types of reproduction equipment are discussed and evaluated.

The question of fees is fully—and I think frankly—treated; extensive coverage is also given to admission and retirement of partners, and to examples of the staff problems we all face. In all cases the material has been selected and edited to incorporate items of lasting interest and value into a reference guide for the practitioner.

I should like to give particular acknowledgement to the following contributing editors for their help in gathering the material for this volume:

JOHN L. FAVALORO
LESLIE A. HEATH
J. T. KOELLING
RICHARD C. REA

CHARLES S. ROCKEY
LOUIS A. RYAN
ROBERT E. WITSCHY
ARTHUR E. WITTE

Other contributors are listed separately, and I take this opportunity to thank them for giving the profession the benefit of their experience.

I sincerely hope that those who use this book will find it useful in some aspect of their accounting practice. If this is the case then the job will have been worth the effort.

Wilmington, Del.
April, 1959

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OFFICE PROCEDURES

Organizational Work And Control Program

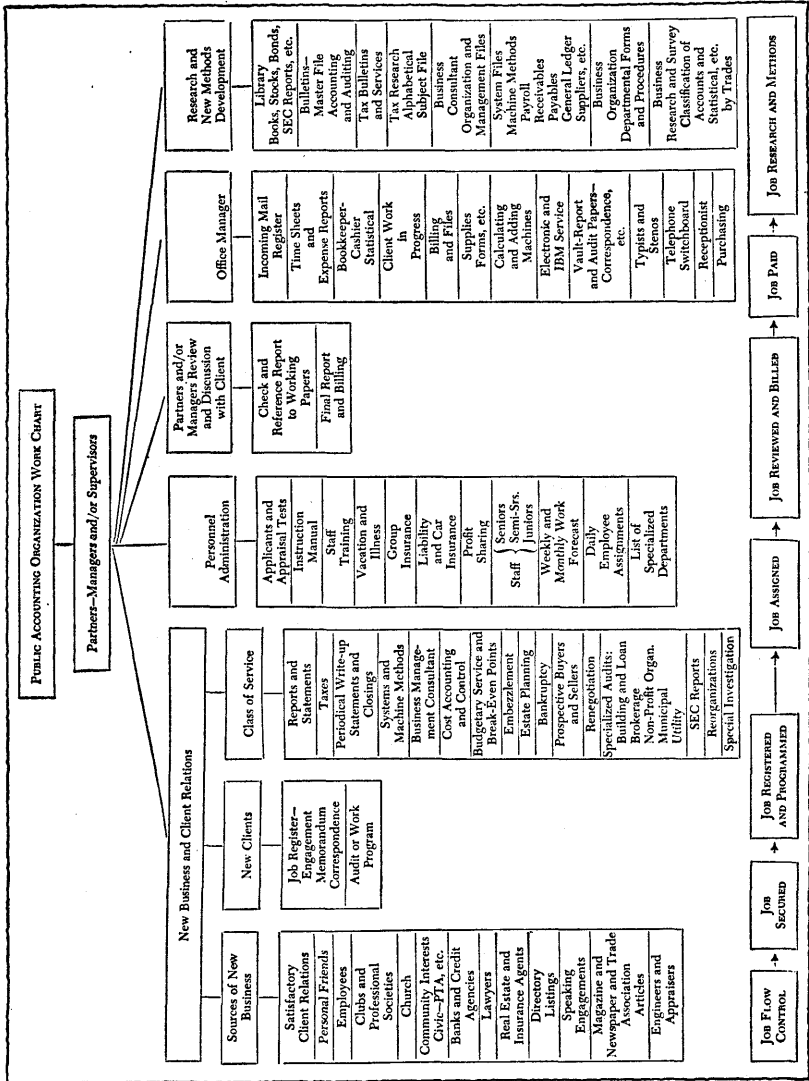
Every practitioner should have an organizational work chart and job flow control chart that should be used to show the delegation of responsibilities to employees and partners making up the organization. Such a chart gives the smaller practitioner a better over-all grasp of the methods, procedures and responsibilities of the profession. It can aid in the preparation of filing systems and in the efficient administration of the business function of an accounting office.

A small practitioner is wise not to undertake more work than he can handle with a few assistants, so that his work program is always current and overtime is eliminated almost entirely. When he has unassigned time, he and his assistants can spend it on research studies for their clients. They may develop profit-sharing or pension plans, new systems, or improved personal financial records. These may be used later in connection with inheritance, federal, estate, and gift tax returns.

A CPA should give his clients more than they expect of him, and in most cases they expect to be billed and usually pay without any

additional prompting from him. If he is constantly in close touch with their needs, his client turnover is practically nil. Standard forms and procedures are the tools and the machinery of any well-organized office. They should be used to make an accountant's office more efficient and to help reduce his overhead.

Figure 1—Public Accounting Organization Work Chart



The Use of a "New Client Data Sheet"

The moment a new client is secured by an accounting firm, a responsibility is assumed. Tax returns must be filed on time, and work scheduled to meet specific deadlines.

Many firms have a checklist called "New Client Data Sheet" which is filled in at the time of engagement by the client. This form serves many purposes. It details the various items that are vital to the proper scheduling of work. It also serves the purpose of setting up a routing slip for use within the accountant's office so that the proper internal records are prepared.

The form shown (Figure II) will serve as a guide for the explanation of its use. Many of the items are self-explanatory.

The person responsible for making the initial contact with the client prepares the form, which is approved by a partner. On the form, indication is given as to the type of work to be done and whether it is to be monthly, quarterly, semiannual or annual.

The form can then be utilized by the person in charge of scheduling, who makes up a regular schedule card for use in the preparation of engagement sheets, or in any other method used by an office for scheduling work. The necessary tax returns are itemized, showing whether state returns are needed as well as the federal, and the fiscal or calendar year of the client is indicated.

The description of the new client's business is given and is usually necessary so that, if an office maintains a record of various types of businesses, it can easily be entered on the master list. Such a description is necessary also because many firm names are misleading and it is well to have an exact description in each case.

It is important to arrive at a satisfactory fee arrangement at the first meeting with the client. This should be recorded on the form so that no misunderstanding will arise later.

Where there was a previous accountant, it is always wise to have that accountant's name and the reasons for the change. This saves many embarrassing situations and gives the office a reference should work papers be necessary or should the previous accountant have to be consulted. The clerical routine is itemized and is turned over to the clerical staff for completion. Each client is given a file number which identifies that client's work thereafter. An alphabetical listing is made in the file room and a file index card is also prepared. This makes for an easy reference to the various files.

Some offices have an addressograph plate for each client so that

**Figure II
NEW CLIENT DATA SHEET**

NAME _____ Date _____

T/A _____ Originated by _____

ADDRESS _____

CITY & STATE _____ Approved by _____

WORK TO BE DONE: M Q SA A

| | | | | |
|----------------------------|--|--|--|--|
| Accounting _____ | | | | |
| Financial Statements _____ | | | | |
| Audit Report _____ | | | | |
| Payroll Reports _____ | | | | |
| Close Books _____ | | | | |
| System _____ | | | | |
| Special _____ | | | | |
| _____ | | | | |
| _____ | | | | |

Telephone No. Home _____

Telephone No. Bus. _____

Date Work to Begin _____

Period of Initial Work _____

Discussed With _____

Description of Business _____

TAX RETURNS: Federal State

| | | |
|-------------------|--|--|
| Corporation _____ | | |
| Partnership _____ | | |
| Individual _____ | | |
| Information _____ | | |

Fiscal Year _____ Calendar Year _____

CLERICAL ROUTINE: NAME FILED

| | | |
|---|--|--|
| _____ Client's File No. _____ | | |
| _____ File Index Card _____ | | |
| _____ Alphabetical Insert _____ | | |
| _____ Addressograph Plate* _____ | | |
| _____ Christmas Card List _____ | | |
| _____ Tax File Card _____ | | |
| _____ Telephone Index _____ | | |
| _____ Client's Work Schedule _____ | | |
| _____ Engagement Sheet _____ | | |
| _____ Listed for Partner's Report _____ | | |

Fee Arrangements _____

Approx. Yearly Fees _____

Previous Accountant _____

Reason for Change _____

State License (?) _____

City License (?) _____

Recommended By: _____

Send Note of Thanks _____

Send Letter of Confirmation and Thanks _____

* If listing for Addressograph Plate is other than name as shown above, show how Name and Address should appear:

news items and newsletters can be sent. The Christmas card list is an excellent idea so that the client is not forgotten at Christmas time, nor any of the persons in the organization who should receive Christmas cards. The tax file card is prepared and given to the person in charge of seeing that tax returns are properly scheduled and go out on time. The telephone index is given to the receptionist or to whomever is in charge of the master files for clients. The client's work schedule is prepared and if an engagement sheet is necessary for work to be done immediately, it is prepared then.

If there is more than one partner in the firm it is always well to submit to those who are not familiar with the engagement the name of the client and any information that seems necessary. By this means all the partners are aware of new clients coming into the firm.

It has been the practice of one firm, whenever a client is secured, to try to determine who recommended them. They then take the time to send this person a note of thanks, and they feel that it is not only plain common courtesy, but good business. The person receiving it is quite appreciative of the note and is apt to refer other clients, if for no other reason than that the firm took time to say "thank you."

In some cases a letter of confirmation is sent to the new client concerning special arrangements that have been made. It is wise to indicate the fees that have been agreed upon.

A reminder that a state and city license may be necessary has saved many embarrassing situations for the accountants.

Each practitioner will find that there are many situations in which items should be added to or subtracted from this new client data sheet. In any case, detailing the items and scheduling them for the routine check-offs in each section of the office is important. It can be highly recommended for every practitioner whether large or small.

A Loose-leaf Sheet for Easy Co-ordination of Client Work

It is possible for staff members of small and medium-sized firms to keep an effective running inventory of client work completed and still in process.

Recently a small firm devised a loose-leaf form which contains the vital data on each client, and provides a quick reference record

enabling others in the office to know what any absent staff member does and has done on all regular engagements.

Note that the form's purpose and content are self-explanatory—and practically self-operating. Observe further that the client's work request and the basis of the charges for the work are clearly established at the very outset.

Figure III—Client Information Record

| | | | |
|-----------------------------|----------------------------|--------------|----------------|
| Name of Client: | Fiscal year | | |
| Address: | Title | | |
| Owners' names: | Title | | |
| | Title | | |
| Regular fee or rate charged | | Assigned to: | |
| Date of first engagement | | | |
| Comments | | | |
| | <u>Date work completed</u> | | |
| | (X)* (O)† | 1955 | 1956 1957 |
| Annual audit | | | |
| Bookkeeping | | | |
| Income tax returns: | | | |
| State | | | |
| Federal | | | |
| Intangible returns | | | |
| FICA returns: | | | |
| 1st qtr | | | |
| 2nd qtr | | | |
| 3rd qtr | | | |
| 4th qtr | | | |
| U.C. returns: | | | |
| 1st qtr | | | |
| 2nd qtr | | | |
| 3rd qtr | | | |
| 4th qtr | | | |
| Annual fed. | | | |
| Domestic corp. | | | |
| Corp. registration | | | |
| Ad valorem | | | |
| Sales tax | | | |
| J. | | | |
| F. | | | |
| M. | | | |
| A. | | | |
| M. | | | |
| J. | | | |
| J. | | | |
| A. | | | |
| S. | | | |
| O. | | | |
| N. | | | |
| D. | | | |
| Other: | | | |

* "X" indicates that we are charged with the duty to perform this item.
 † "O" indicates that we do not do it unless specifically asked to.

Setting Up and Maintaining A Systems and Services File

A complete office should have some place to go to find the latest ideas on equipment, forms, systems, services, etc. Much of this information comes through the mail in advertisements and is worth saving. Sometimes it seems easier to throw it away than to work out a system for filing it.

The very nature of the material precludes filing it with regular library material, but here is a system that can be used whether a firm has an indexed reference library or not.

Equipment needed:

1. One file drawer.
2. Twelve vertical file pockets with 3½" capacity.

How to set up file:

1. Number the file pockets from one to twelve in bold black numbers on the upper left corner of the exposed edge.
2. On the right corner paste typed labels as follows:
 - (1) Accounting and bookkeeping machines
 - (2) Duplicating machines and methods
 - (3) Files and filing systems
 - (4) Voice reproduction and mailing machines and ideas
 - (5) Reviews of books and other references
 - (6) Services to clients
 - (7) Services to accountants
 - (8) Adding and calculating machines
 - (9) Standard bookkeeping forms
 - (10) Ideas for CPA practices
 - (11) Accounting aids (i.e., key sort, etc.)
 - (12) Samples of annual reports
3. Take present pile of unsorted material, mark each with number corresponding to above list and file. The number insures that the item will be returned to the same place.

How to maintain file:

1. Incoming literature is read by partners. Anything of interest is marked "save" and placed in file box.
2. Filer collects, eliminates duplicates, codes material with proper number in upper right corner and files accordingly.
3. The file must be culled periodically to eliminate duplications and out-of-date material.

Techniques for More Effective Scheduling in CPA Offices

Public accounting offices are the reporting centers for thousands of enterprises. Both in numbers of reports and diversity of information handled, the load has multiplied in the last decade or so. Without systematic methods of scheduling work, deadlines can not only catch up with, they can overwhelm even the most dynamic of accounting organizations.

Needle-Sorted Punch Cards for Accounting Offices. The needle-sorted punch card system is one excellent means of speeding the administration. Its requirements are simple, viz.—(1) the cards; (2) a manual notcher; (3) a sorting needle; and (4) a container.

One corner of the cards is cut diagonally so that they can be kept in proper position. Each hole is given a special meaning or significance. The card is then notched at the appropriate hole or combination of holes. Sorting the cards can be done very quickly. The sorting needle, which resembles a knitting needle, is thrust through the hole selected and holds as many as three hundred cards at one time. The cards which are unslotted are lifted away and the slotted or wanted cards drop off. This process is repeated until all of the required information is assembled.

Let us now examine such a card (Figure IV below).

Figure IV

| | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
|--|--|---|---|---|---|---|---|---|---|---|---|---|--|---|---|---|---|---|---|---|---|---|---|---|--|---|---|---|---|---|
| | J | F | M | A | M | J | J | A | S | O | N | D | J | F | M | A | M | J | J | A | S | O | N | D | I | 2 | 3 | 4 | P | R |
| | SERVICES | | | | | | | | | | | | TAX RETURNS DUE | | | | | | | | | | | | PYRL. TX. | | | | | |
| | NAME: Johnson & Johnson | | | | | | | | | | | | ADDRESS: 25 Shopping Center, Boston 1, Mass. Ca 7-7777 | | | | | | | | | | | | TEL. 7-7777 | | | | | |
| | PRINCIPALS: Carl Malone | | | | | | | | | | | | BY: Retail Hardware | | | | | | | | | | | | BRANCHES, ETC. | | | | | |
| | CL.: | | | | | | | | | | | | OFFICE MANAGER: Jack Johnson | | | | | | | | | | | | OTHER: William Johnson - store manager | | | | | |
| | ATTORNEYS: William Williams | | | | | | | | | | | | TEL. Ca 7-9999 | | | | | | | | | | | | INS. BROKER: John Johnson | | | | | |
| | ENTITIES: Partnership | | | | | | | | | | | | STATE: Mass. | | | | | | | | | | | | FY ENDS: 12/31 | | | | | |
| | MEMBERSHIP: SH. PAR \$ | | | | | | | | | | | | SH. PAR \$ | | | | | | | | | | | | SH. PAR \$ | | | | | |
| | BANK(S): First National Bank of Boston | | | | | | | | | | | | FED. INC. REG. EST. 115 | | | | | | | | | | | | FED. INC. REG. EST. 115 | | | | | |
| | MEM. STATE INC. 58, 2567 | | | | | | | | | | | | P. L. C. A. 110 | | | | | | | | | | | | OTHER (AND OVER) | | | | | |
| | SERVICES: Annual closing - 4/15 | | | | | | | | | | | | P. L. C. A. 110 | | | | | | | | | | | | OTHER (AND OVER) | | | | | |
| | FEE: \$300.00 | | | | | | | | | | | | MEMOS: quarterly | | | | | | | | | | | | BILL ADV. ARR. | | | | | |
| | REMARKS: Catch up quarterly | | | | | | | | | | | | MEMOS: quarterly | | | | | | | | | | | | CONFIRM/OVER RE OTH. | | | | | |
| | J | F | M | A | M | J | J | A | S | O | N | D | C | P | I | B | E | T | B | T | O | A | B | C | D | E | F | G | H | |

On the top line are the name, address, and telephone number of the client. There follow further essential details, including the names of the principals, the office and store managers, the bank, attorney and insurance broker; organizational and fiscal year data; tax deadline dates; state and federal employer identification numbers; and finally, the services required to be performed by the CPA.

For sorting purposes this information is converted into the punched slots on the border. This conversion utilizes the letter code illustrated in Figure V.

Starting at the lower left-hand corner and proceeding clockwise, the card accommodates the information in this order: name of client; deadline months (regardless of what the deadlines may be); nonpayroll tax-return deadlines; payroll tax deadlines; fiscal year; declaration of estimated tax; space reserved; nature of the entity; and dates when client is to be billed.

Figure V

Letter Guide
(slot first three letters of name)

| <i>Number</i> | <i>A-M</i> | <i>N-Z</i> | <i>1</i> | <i>2</i> | <i>4</i> | <i>7</i> | |
|---------------|------------|------------|----------|----------|----------|----------|---|
| 1 is | A | or | N | X | | | |
| 2 is | B | or | O | | X | | |
| 3 is | C | or | P | X | X | | |
| 4 is | D | or | Q | | | X | |
| 5 is | E | or | R | X | | X | |
| 6 is | F | or | S | | X | X | |
| 7 is | G | or | T | | | | X |
| 8 is | H | or | U | X | | | X |
| 9 is | I | or | V | | X | | X |
| 10 is | J | or | W | X | X | | X |
| 11 is | K | or | X | | | X | X |
| 12 is | L | or | Y | X | | X | X |
| 13 is | M | or | Z | | X | X | X |

One firm took the following steps in the construction of the form: (1) prepared a checklist of the information required; (2) drew the lines and printed the data on a card; (3) ordered a plate made up; and (4) printed a supply of cards.

Many of the abbreviations used were unconventional—a kind of private language. Therefore, a glossary of terms was compiled (Figure VI).

While the cards are often very useful for getting quick information, the real payoff comes when the cards are sorted at the beginning of the month and the monthly Engagement List is prepared.

Figure VI

Glossary of Abbreviations

| | | | |
|---------|--|--------------|---------------------|
| ADV | ADVANCE | IB | Individual business |
| ANN | Annual | INC | Income |
| ARR | Arrears | INS | Insurance |
| AUTHOR | Authorized | J—D in order | Months of year |
| BT | Business Trust | MTG | Meeting |
| C | Corporation | N | Name |
| CL | Clerk | NO | Number |
| CN | Confirmation | NOS | Numbers |
| CofC | Certificate of condition | O | Other |
| CONFIRM | Confirmation | OTH | Other |
| DIR | Director | P | Partnership |
| DR | Depository receipt | PR | President |
| E | Estate | PYRL | Payroll |
| ES | Estimate | RE | Real Estate |
| EST | Estimate | SH | Shares |
| FED | Federal | T | Trust |
| FICA | Federal Insurance Contributions Act | TEL | Telephone |
| FY | Fiscal Year | TR | Treasurer |
| H | Home state | TX | Tax |
| I | Individual | UNEMP | Unemployment |

Engagement Specifications. Early in the month the office manager ascertains those jobs that will have to be done for the period ending that month and prepares first a list of the engagements, and then *engagement sheets*.

A printed engagement sheet is filled out for each particular job. The straight accounting, audit reports, and financial statements are put on yellow sheets, all of the tax returns on pink sheets, and payroll reports on green sheets. When a special engagement is arranged for, which is not part of regular scheduled work, the office manager prepares what is known as a supplemental engagement sheet.

The engagement sheets act as a checklist for the auditor in charge. Each accountant has a folder in which he keeps the engagement sheets he is responsible for.

As soon as the partner has made the assignments, each man looks over the engagements that have been assigned to him and then starts scheduling his work for the coming month. With this method, the partner in charge does not have to spend much time on scheduling monthly engagements. His efforts may then be devoted to seeing that the larger jobs and the annual audits, which take a lot more planning and preparation, are properly assigned

and scheduled. Where there is conflict of jobs and several juniors or semiseniors are needed by various seniors, the partner is in a position to decide what jobs need priority assistance and how soon it can be arranged.

After a man has completed an engagement he turns in the engagement sheet for that particular job along with his work papers, and then the various procedures are followed through until the job is completed, typed, reviewed and sent to the client. The engagement sheet is then given to the office manager, who files it alphabetically.

Some such procedures as these, with appropriate variations, are needed by all accounting offices, large or small.

Install Now, Refine Later. Those in charge of accounting offices who still rely on memory and file checking should take the time *now* to initiate a system for scheduling assignments. Improvements and refinements in the first forms adopted will inevitably show up. Later, these can easily be incorporated into a more perfect system tailor-made to fit the peculiar requirements of each practice.

One office has now abandoned the needle sorting of the cards except for pulling those cards which indicate assignments during the current month. With these cards pulled, the information can quickly be seen and transferred to the month's engagement lists. Meanwhile the cards are kept in better condition (they do not stick together) for constant reference.

Other Byproducts of Monthly Assignment Scheduling. Attention to assignment scheduling can also lead to byproducts important in administering an accounting practice. For instance, another practitioner incorporates in his firm's engagement sheets a time-cost budget which facilitates a monthly analysis of all substantial variances from "standard."

One group of variances is considered to be attributable to either good or bad performance in planning or executing the work. This group includes:

1. Insufficient familiarity with the job.
2. Too high-grade a man on the job.
3. Too low-grade a man on the job.
4. Time gained from unusual smoothness of the job.
5. Time lost from errors or carelessness on the job.
6. Time lost from physical or mental condition of the man given the assignment.

7. Reviewer's time lost from changing or correcting the original accountant's work.
8. Time lost in the typing department.

A second group of variances is not chargeable to performance by the accounting organization but simply to unfortunate circumstances the results of which necessarily have to be absorbed and cannot be charged to the client. Among such circumstances are interference on the job; starting before the client is ready; poor working conditions; unforeseeable interruptions or delays; and others of this general character.

A third group of variances is imputed to the job itself. These are chargeable to the client. Typical of such variances are:

1. Budgetary estimate too high or too low.
2. Extra work requested that was not allowed for in the budget.
3. Combining more than one period's work.
4. Unusually good bookkeeping by client's staff (hence a lower bill).
5. Unusually bad bookkeeping by client's staff (sometimes requiring part of the bookkeeping to be done by the accounting firm).

Plainly, in these days of increasing emphasis on the "continuous flow" as opposed to the "batch" concept of output, public accountants, too, must take positive steps to assure efficiency in their own production lines.

A Classification-of-Services Code for Charging Time

Many problems of managing an accounting practice are closely related to the growth stage of the particular practice.

In one "large-small" firm no one can perform any service for a client unless an *engagement sheet* is first prepared.

To record the classes of services performed on each engagement, a code is very useful. It simplifies each man's task of daily recording on his weekly time sheet the type of work he has performed. Then, at the conclusion of the engagement, it yields the partner who prepares the billings the kind of information he needs for a correct description and pricing of the services rendered.

Now, let us examine such a code. Later we shall illustrate its use.

Code for Charging Time. All job assignment sheets carry a

seven-digit number, i.e., 0000-000. The first four digits indicate the *client permanent file number*.

The last three digits indicate the *period and class of services* performed. The first digit indicates the year, i.e., 4 designates the year 1954. The second and third digits indicate the period or class of work, as follows:

| | | | |
|----|---------------------------------------|----|--|
| 01 | January | 55 | Tax return—Year Ending in 1955 |
| 02 | February | 56 | Tax return—Year Ending in 1956 |
| 03 | March | 70 | Analysis or Report—Special |
| 04 | April | 71 | Attorney Consultation for Client |
| 05 | May | 72 | Audits—Special |
| 06 | June | 73 | Board of Directors Meeting |
| 07 | July | 74 | Budget Work |
| 08 | August | 75 | Casualty Insurance Consultation |
| 09 | September | 76 | Cost Analysis Work |
| 10 | October | 77 | Credit & Collection Work |
| 11 | November | 78 | Deliver & Review Report with Clients |
| 12 | December | 79 | Embezzlements |
| 15 | Annual Engagement | 80 | Employee Hiring & Interviews for Clients |
| 16 | Annual Report to Secretary of State | 81 | Estate Planning |
| 21 | Semi-annual Engagement—1st Six Months | 82 | Instructions to Bookkeepers |
| 22 | Semi-annual Engagement—2nd Six Months | 83 | General Management Conferences |
| 25 | Closing Books | 84 | Gift Tax Work |
| 31 | Payroll Returns—First Quarter | 85 | Life Insurance Consultations |
| 32 | Payroll Returns—Second Quarter | 86 | Loan Arrangements |
| 33 | Payroll Returns—Third Quarter | 87 | Promotional Conferences |
| 34 | Payroll Returns—Fourth Quarter | 88 | Renegotiation of Contracts |
| 41 | 1st Quarter Engagement | 89 | Retyping of data—Client's Fault |
| 42 | 2nd Quarter Engagement | 90 | Retyping of data—Firm's Fault |
| 43 | 3rd Quarter Engagement | 91 | Reworking of data—Client's Fault |
| 44 | 4th Quarter Engagement | | |
| 54 | Tax return—Year Ending in 1954 | | |

| | | | |
|----|-----------------------------------|----|----------------------------------|
| 92 | Reworking of data—Firm's Fault | 95 | Tax Research & Consulta- tion |
| 93 | Systems Work | 96 | Inventory Supervision |
| 94 | Tax Examinations | 99 | Licenses |

The code's usage can be clarified by taking a concrete example. Let us say we have a client who is on a monthly audit basis. The code starts off with the client's number, which may be 2345. Then the first of the code digit numbers represents the fiscal year in which the client's year ended. For example: 4 indicates that the client's fiscal year ended in 1954, 5 in 1955 and 6 in 1956. The second and third digits indicate the period or class of work done as follows: 01 represents a monthly audit for the month of January, 02 for the month of February, and so on through 12, which represents the month of December.

Where an audit is done once a year, the number 15 is used to show that it is an annual engagement. If semiannual audits are performed, the numbers 21 or 22 are used. The first 2 indicates that two audits are performed a year and the second 1 or 2 means that it is the first-half or second-half audit. Where quarterly engagements are performed, the 41, 42, 43 and 44 are similarly indicative.

Should any special work be done, in addition to the regular annual, semiannual or quarterly engagement—such as preparing special cost analyses—the auditor shows the client's number 2345 and the code number 576 which shows that he performed special cost analysis work for the fiscal year to end in 1955 and that this was additional to his normal regular quarterly audit. The numbers 70 through 99 cover many of the typical "special" jobs.

There will be situations in practices throughout the country not covered in the specimen code above. However, the essential idea can be used since the categories may be adjusted to each particular situation.

Recording Staff Time With a Bookkeeping Machine

Medium- and larger-sized firms who recommend machine bookkeeping to clients will find many uses for it within their own offices.

Recording staff time chargeable to clients is a large part of an accounting firm's record-keeping.

Recently a practitioner made a study of the recording of staff time with a bookkeeping machine, and installed such a machine in his office.

The machine bookkeeping system has:

1. Greatly reduced the work required to post time records.
2. Simplified the job so that almost anyone in the office can be taught to do it.
3. Given up-to-the-minute balances of unbilled time as soon as each week's posting is completed.
4. Proved accuracy of posting immediately, with easy checking to find differences.
5. Shown each staff member's nonchargeable time up to date, telling how effectively each staff member has been utilized.

Objectives for the System. An analysis showed that a time record system had to meet several needs:

1. An accumulation of unbilled time to date for each client, engagement, staff class (partner, senior, semisenior, etc.).
2. An accumulation of nonchargeable time for the year to date for each staff member. It was not necessary to break down nonchargeable time according to its nature, but the system should be able to do so if necessary.
3. An annual accumulation of total time worked by each staff member, broken down by chargeable and nonchargeable, to see how much each had contributed to the firm's income. This information was to be available more often if necessary.
4. A weekly report for the office manager as to chargeable and nonchargeable time for each staff member for the week.
5. A weekly hours-worked report for the payroll bookkeeper as the basis for overtime pay.
6. A simple weekly time report from each staff member. He was not to be burdened with preparing a separate supporting slip for each client and engagement.

Equipment Used. Several methods of meeting these objectives were investigated, considering the size of the firm and the number of entries to be made in the records. Finally a simple two-register bookkeeping machine was installed—an Olivetti which cost \$1,200 (other manufacturers have similar machines). Such a machine

would provide speed, simplicity and adaptability to other possible work.

Card Filing System. To supplement the machine, a ledger card file would give quick access to information. For this reason, the practitioner installed an inexpensive Diebold visible posting tray to house the machine-posted time record cards.

Cards are overlapped in wide rows in the file, with headings and right-hand (balance) columns visible. The visibility greatly speeds up finding cards for posting. Since each time sheet may list several clients, not necessarily alphabetically, speed in finding cards means that items can be posted in whatever sequence they appear on time sheets. All chargeable items on a time sheet are posted at one time, without rehandling sheets.

The visible balances make it easy to get information or to prepare summaries, since the cards need not be removed from the tray.

Shading of the next column to the left signals that a card has been removed. This signal speeds up refileing after posting and helps to get the card back in the right place.

Time Record Cards. A separate time record card is used for each client, engagement, and staff class.

If necessary, a separate card is used to accumulate time by staff class for each portion of the engagement, such as auditing, writing reports, preparing tax returns and traveling.

The use of separate cards makes possible any number of breakdowns of time without exceeding the totaling capacity of the book-keeping machine.

A separate card is also used for each staff member, to accumulate his nonchargeable time for the year.

The time record card has columns for week ending date, staff member (code number posted), time worked (this week), old balance, to date.

The card makes no provision for dollar values of time spent. It is more economical to extend the balance to date whenever required, rather than to extend each entry before posting.

A different card color is used for each staff class. This speeds up finding cards for posting, since there is a color change between each client and the proper card color can be seen instantly. The card colors also help to show up mispostings. One digit of the staff member's code number is his staff class. A discrepancy between the number and the color is easily spotted when the card is handled.

Time Sheets. The time record clerk takes three steps before machine processing:

1. Arranges the sheets in groups by staff class.
2. Checks off time sheets on a pre-printed list of names to see that all sheets for the week have been received.
3. Foots and crossfoots the sheets by eye.

Weekly Time Summary. Before posting to the cards, the book-keeping machine is used to make a listing (in duplicate on a blank proof sheet) of each group of time sheets by staff class. This listing, the weekly time summary, shows staff member number, total chargeable hours, total nonchargeable hours.

Totals of both chargeable hours and nonchargeable hours are printed after listing each group of time sheets by staff class.

The weekly time summary has several uses:

1. It serves as a proof that the week's time has been posted correctly to the time record cards. The totals must agree with the totals from the posting run.
2. After proof, one copy goes to the office manager as his weekly report of hours worked.
3. Another copy goes to the payroll clerk as his overtime record.

Posting to Time Record Cards. Each item on the time sheet is then posted to a time record card. Two runs are made for each group of sheets by staff class:

1. Chargeable hours are posted. The machine is cleared. The total is proved with total chargeable hours for the staff class on weekly time summary.
2. Nonchargeable hours are posted to the card for each staff member's nonchargeable time. The machine is cleared. The total is proved with total nonchargeable hours for the staff class on the weekly time summary.

A proof sheet behind the time record card shows each posting, for checking back if necessary.

In addition to the proof of totals posted with the weekly time summary, there is also a proof that the previous balance has been picked up correctly. The machine procedure provides for picking up the old balance twice, at the beginning of each posting and at its end. If the amounts picked up agree, the machine prints "00"

on the proof sheet. If the amounts disagree, it prints the difference. The proof sheet is scanned after posting to see that "00" appears on each line.

After proof, the time sheet is filed in a folder for each staff member, for use at the year-end.

Weekly totals of chargeable time are posted to an unbilled time control card for each staff class.

Recording Billing. When an engagement is billed, the relevant cards are removed from the unbilled file. Each is marked "billed" with the date, below the last line posted. The balances on all cards pulled are listed with an adding machine.

The balance on each card is then posted to reduce the balance on the unbilled time control card for the staff class. The machine total of postings is proved with the adding machine tape.

The cards for the billed engagement are then used for costing and are filed in a closed file.

Annual Time Summary. The remaining task for the time record system, to accumulate time worked for the year for each staff member, is done very easily with the machine.

The folder of time sheets for each staff member is used for an annual time summary. The machine prepares a listing on a blank proof sheet showing staff member, chargeable time, nonchargeable time.

Further Bookkeeping Machine Applications. Mechanizing time records can have an additional value. In the process of simplifying a burdensome system, the accounting office is obliged to assess and improve all procedures for controlling and costing time spent on engagements.

Based on the up-to-date time data, a machine system can be developed for preparing monthly management control reports covering status of unbilled time, utilization of staff personnel and cost of engagements billed to date. In addition, a firm may be stimulated to overhaul its cost system so that it reflects costs more realistically.

As many clients have found, the value of a systems survey such as this is not just in mechanizing one phase of office work. Even more important are the evaluation of the existing system and the steps taken to make it an integrated whole.

Steps Toward Library Control For the Small Accounting Office

One of the housekeeping items consistently relegated to the "should" or postponable category in many small offices is the task of setting up rudimentary controls for the firm's books and pamphlets.

The following steps toward library control will prove themselves, and two people can install them in one or two days' time:

1. Count books. Purchase about three times as many small cards as there are books (two-thirds for immediate use, one-third for future supply). Also purchase a box for the cards.
2. Make a two-way card index for each book: An A-Z one by *author* and a decimal one by *subject*. The framework of the subject index might be:

100 Accounting
200 Cost Accounting
300 Auditing
400 Economics
500 Management
600 Texts on Specific Businesses
700 Manuals, References, Directories
800 Open
900 Open

3. Assign a filing number for each book. Thus a book on fisheries would be 600-37 if it was the 37th book purchased in the "600" or business series.
4. Write the filing number inside the front cover of each book; and type or write the same number on each of the two cards.

The operation of the controls is easy. When a book is taken from the library, the person's name and date are written in pencil on the back of the corresponding decimal card. When the book is returned to the library, the name and date are crossed off the card and the book put back in its regular place.

Retention and Destruction Of Records for a CPA Firm

Clients often ask how long they must keep certain records. The question is posed so frequently that one practitioner prepared a conservative schedule which he now mails to all new clients.

He discovered useless papers in his own files, yet reference to old files is frequent enough so that he prefers not to use warehouse space which is inconvenient and otherwise unsatisfactory. In order to keep twenty-five years of files with him and still reduce filing space, he adopted the following schedule of record retention:

Figure VII

| <u>Present Clients</u> | | <u>Former clients</u> | |
|---------------------------|---------------|---|--------------|
| <u>Documents</u> | <u>Keep</u> | <u>Documents</u> | <u>Keep</u> |
| 1. Tax returns | Indefinitely | 1. Working papers of regular former clients with certified reports | Ten years |
| 2. Working papers | " | 2. Working papers of regular former clients with noncertified reports | Five years |
| 3. Audit report | " | 3. Tax returns | Indefinitely |
| 4. Correspondence file | " | 4. All other papers | Five years |
| 5. Interim pencil reports | Last one only | | |
| 6. Confirmations | One year | | |
| 7. Copies of inventories | " " | | |
| 8. Typed interim reports | Two years | | |

The firm keeps a record of the papers destroyed and the date of destruction in case a question should arise in the future. A partner must approve the list before the files are destroyed.

Files normally are pruned every summer, although sometimes two or three years go by before it is done. But when someone remarks that more file cabinets are needed, the current files are attacked with renewed vigor before additional equipment is bought.

The schedule is conservative, but it has been adequate and it removes the bulky papers without making it necessary to do a page-by-page analysis of each file.

Filing, Storage, and Disposal Of Accounting Office Records

Filing and storage of accumulated papers ranks high among the office problems of public accountants.

There seem to be two schools of thought on the subject, one holding that set rules can be laid down as to how long each type of document should be retained, the other maintaining that it depends entirely on the peculiarities of each client's file.

Obviously, there is no universal answer. The only solution appears to be that each firm establish its own policies, based on careful

reasoning and consideration of the firm's own experience. What is most needed in formulating such policies is a checklist or syllabus. A modest one appears below, intended purely to help each firm define its own filing and storage policies.

Figure VIII—Filing

- I. File classifications
 - A. By entities concerned
 1. Nonclients (administrative files)
 2. Clients
 - (a) Corporations
 - (b) Partnerships, estates and trusts
 - (c) Individuals
 - B. By usage or frequency of reference
 1. Active files (all active clients)
 2. Inactive files
 - (a) Nonclient and/or administrative matters
 - (b) Active clients
 - (c) Former clients
 3. Storage files
 - (a) Nonclient
 - (b) Active clients
 - (c) Former clients
 - C. By nature of subject matter or form of documents
 1. Correspondence files (letters and memoranda)
 2. Report files
 - (a) Typed copies
 - (b) Rough draft (pencil) copies
 3. Work paper files
 - (a) Current
 - (b) Permanent
 4. Tax files
 - (a) Current
 - (b) Permanent
- II. Basic plan of arrangement or grouping of client files
 - A. Alphabetically by clients, each set of client files being together and normally comprising the four classes shown in "I-C" above.
 - B. By type of documents, per "I-C" above, arranged alphabetically by clients. That is, all correspondence files are in one drawer, arranged alphabetically by clients.
- III. A few principles of filing
 - A. Keeping track of the files
 - B. Specific rules
 - C. Separation of unlike files
 - D. Cross-referencing
 - E. Identification
 1. Alphabetical, or
 2. Numerical

Commentary on the Highlights. The classification and basic arrangement of files (I and II) apply to practices of all sizes. A larger firm can and usually does expand the subdivisions. In point is the division of clients into corporations, partnerships, estates, individuals. In a small firm this would represent excessive refinement, and would tend to make particular files harder to find.

The grouping of files by like types of documents (II-B) might at first seem to be a startling innovation, but it has advantages. Usually only one or two particular files of any client are needed on any one occasion; seldom are all the files needed at once. Because different kinds of files (I-C) vary considerably in length, width, thickness, and format, they are much neater, more compact and homogeneous if each class of material (correspondence, reports, work papers, tax returns) is filed together in separate cabinets or sections, arranged alphabetically by clients. This separation of unlike files puts a premium on cross-referencing, but it's worth the price.

Most will agree that few things in life are more infuriating and embarrassing than being unable to find a file. At all times, files should be in one of three places: (a) the file cabinet, (b) the basket of the secretary or file clerk, in transit back to the file cabinet, or (c) being used or worked on. Files not being worked on should never be put into desk drawers or briefcases. In the small firm not employing a file clerk, "out" cards are the *sine qua non*, but getting into the habit of using them is not easy. Strict rules are in order. Here is a fairly comprehensive specimen:

"Each and every file removed from any file drawer at any time of day or night, for any purpose whatsoever, and whether for a brief or a long period of time, must be replaced by an 'out' card, on which is recorded the name of the file, the date taken and the signature of the person removing the file. When finished with the file, return it to the top basket on the secretary's desk. She will replace the file, remove the 'out' card, and cross off the recording thereon."

Storage and Disposal Plan. Figure IX shows a simplified plan for systematically storing and disposing of accounting office records.

The policy indicated for each class of material, and the reason for that policy, are outlined in the next four paragraphs.

Correspondence. The table indicates that the hypothetical firm keeps its correspondence in the active files ten years, then has all

Figure IX

| <i>Class of Material</i> | <i>Period to be Held In Years</i> | | | |
|--------------------------|-----------------------------------|-------------------------|------------------|----------------|
| | <i>Office</i> | <i>Storage</i> | <i>Reproduce</i> | <i>Destroy</i> |
| Correspondence | 10 | No | Microfilm | Never |
| Typed reports | Indef. | Former clients only, 10 | Microfilm | Never |
| Rough draft reports | 2 | 2 | No | Burn |
| Nonpermanent workpapers | 2 | 2 | No | Burn |
| Permanent workpapers | Hold | No | Yes | Never |
| Nonpermanent tax files | 3 | 2 | No | Burn |
| Permanent tax files | Hold | No | Yes | Never |

the material (letters and memoranda) microfilmed. Reasoning: correspondence is not destroyed because it is felt that, more than any other material, it explains entire situations, peculiar circumstances, personal views, special interpretations, and between-the-lines background information not found in any other recorded medium.

Reports. The rough draft reports are treated the same as the nonpermanent work papers: held two years in the office, an additional two years in storage, then burned. The typed reports are never destroyed because they are gold mines of information, and constitute the finished professional product. Relative to their great importance and constant usefulness, they take up little space. Accordingly, they are held in the office for an indefinitely long period, then are microfilmed. The only typed reports placed in storage are those of former clients. After ten years of storage they are microfilmed.

Work Papers. Here is where sheer bulk becomes a serious problem. The key to the problem is a good set of permanent work papers, which is added to year by year from the cross-indexed annual work papers. The permanent work papers are always re-

tained in the office, never transferred or destroyed. If this policy is carried out, wholesale destruction of material is feasible. Fortified by faith in the information contained in the correspondence file, the typed report file, and the permanent work paper file, the office illustrated holds the ordinary work papers in the office two years only, transfers them to storage for another two years, then has them cremated. (Note: Many small firms keep their rough draft reports in the same folder as the ordinary work papers, hence the storage-disposal policy for them is the same.)

Tax Files. An innovation well worth considering is establishment of a permanent tax file to serve the same purpose as the permanent work paper file. It should include all pertinent data on tax bases of assets and securities, on prior tax "cases," on recapitalizations and reorganizations, and the like. The way is then cleared for a much shorter retention period for the year-to-year tax files. Taking advantage of this, the policy indicated by the table is to hold non-permanent tax files in the office until the three-year statute of limitations has run, then another two years in storage until the five-year period has expired. Justification for this policy rests on the fact that copies of tax returns are submitted to all clients, and second, that certified copies may be ordered from the Internal Revenue Service if required.

The cremation of all tax returns over five years old, and of all nonpermanent audit work papers over four years old, really gets rid of bulk en masse. These are the steps assuring the success of the disposal part of the plan.

Plainly enough, the determination of the best storage and disposal policies involves a weighing of opposite risks. Be eventually smothered with paper, or occasionally destroy a document you might later need.

The Uses of the Interoffice Memo

The best memory is a pencil and paper. Everyone who takes the time can use memos to advantage.

As one firm grew, the problem of intraoffice communication became more complex. The members discovered that the only way to make sure that memos were not lost or forgotten was to make three copies. One copy would be kept by the person who originated

the memo. One copy would go to the person to whom the memo was written, and the third copy would go into the client's file. The person who originated the memo would keep his copy in a file for follow-up. The copy in the client's file served as protection in case both members of the staff should somehow fail to follow through. This three-way check practically eliminated the possibility of a memo getting lost.

The firm uses a triplicate snap-out form, 8" x 8½", a standard size. They buy these forms unprinted and have a printer put on a heading similar to a letterhead, with a date line on the right side and two lines on the left side for the name of the party to whom the memo is addressed. Only the top copy is printed, and what appears on the second and third copies is just what comes through on the carbon paper.

After the form was in use for some time the firm discovered that it was performing a number of functions not contemplated when they originally designed it. In fact, it seems as if every year they find a new use for it. The most common ones are:

Quickie Correspondence. It is a very simple matter to dash off a hasty note to a client without the formality of a letter. The firm keeps one copy, sending two to the client. He can reply on one of the copies.

Receipt. Occasionally clients insist on paying in cash. This form serves as a receipt, with the original going to the client and the two carbons into office files.

A Quickie Invoice. There are a number of times, particularly during tax season, when the firm prepares a simple return and does not want to put the billing through the usual routine. They then use this form to make an invoice or statement by hand, giving the client one copy and using the two carbons in our filing procedure.

Work Orders. Whenever anyone brings in work from the field which is to be done by the office staff, this form is frequently used as an instruction sheet or work order. The original and one carbon go with the work. The second carbon for follow-up remains with the person who originated the order. The person who does the work returns it with one carbon, keeping the original for his time record.

Summer Work. During the busy season partners frequently see many things that can or should be done but do not need to be done immediately. They write a note as a reminder to look into the matter during the summer when work is slower. The third copy is kept for follow-up by the person originating the idea, the second copy goes into the client's file and the first copy goes into a pool held by one of the partners. He collects all such work orders from the whole staff. During the summer season these are reviewed by the partners and assigned to a staff member.

CPA Office Traffic: Field for Profitable Experimentation

How many practitioners have made an analytical study of what enters and leaves their offices during a representative week?

Learning this is important. For after all, every accounting office, whether large or small, serves two primary functions: (1) it provides a comfortable and efficient place to work; and (2) it acts as a convenient clearinghouse for various kinds of communication, among them being:

1. Incoming and outgoing persons;
2. Incoming and outgoing letters;
3. Incoming and outgoing phone calls;
4. Other incoming and outgoing information and reports.

How to Do It. Assembling the information is comparatively easy. It closely resembles the taking of a good inventory. The essentials are: Select the representative week to be used as the sample; assign one or more individuals to the various categories; and furnish each with the properly designed but simple form for logging in and logging out the incoming and/or outgoing traffic, as the case may be.

When the logs are completed at the end of the week, the next task is the interesting one of breaking down each class of traffic into who the communicants are and what they seek of your office. The persons may include clients, employees, salesmen, job applicants, students, and a host of other nonclients.

They may seek service for a fee, free advice or service, the replenishment of recurring necessities, and also, alas, may present an array of unneeded products both common and bizarre.

Why Do It? With due regard for proper courtesy, it is important to handle each incoming and outgoing item in the best possible manner if the office is to serve its assumed purpose. Ways and means must accordingly be devised for expediting the important work of the office and for efficiently shunting aside or winnowing out the alarming amount of chaff. The obtaining and the classifying of the factual data will in itself suggest many ways of better controlling the traffic flow.

To demonstrate just one of the many uses of this type of survey, consider the case of a CPA who wanted to move his office to an outlying area to save commuting time. For a year or more he indulged in double-barrelled, Grade-A worrying about whether the move might mean the loss of clients. Finally, he ran an office traffic analysis which revealed that his largest client by far had never even set foot in his office, that the top 70 per cent of his clients by revenue represented only about 10 per cent of the client traffic, and that all the clients put together accounted for less than 20 per cent of the people who entered the front door. He promptly made the happy move.

Choosing Among the Alternative Ways of Communicating. Once all the traffic data are compiled, the paramount questions are: How can the logjams best be broken and how can the total traffic be expedited?

There are bound to be daily exceptions, to be sure, but two working rules are: (1) when handling paper flowing across the desk, it is best *not* to talk to a stenographer, but to *write* decisions or directions on a routing slip; and (2) when communicating with people in a metropolitan area, it is best *not* to go or write, but *telephone*.

Expediting the Paper Traffic. The routing slips are simple affairs. The first column contains the initials of people in the office to whom the item might best be referred. The next three column headings say: Read, Action, File. In many cases a check mark or marks in one of the columns opposite the initials is all that is necessary. Note that this step should not absorb the time of two people, a practitioner and his secretary. Only after the whole stack has been thus processed should he call her in to dictate, in one session, the day's reply letters and new letters as well.

A convenient sorting of the exiting paper is to put each item

in one of three baskets, one being for *filing*, one for the *outgoing mail*, and one for *attention* of someone else in the organization.

At a recent meeting of a nominating committee, about twenty minutes were devoted to discussing the best people to serve as officers and committee chairmen of a local organization for the ensuing year.

Then the gentleman in whose office the meeting was held turned to his intercom and, without calling in his secretary, simply said, "Hazel, will you try to get Mr. K, Mr. M, Mr. R and Mrs. T on the phone." Soon the calls were flowing in and these people were asked if they would be willing to serve during the coming year. When two of them declined, Hazel was asked to call the second choices for the posts. The slate was filled before the single hour-long meeting adjourned.

If the communications had not been so deft, the time required would have been multiplied and, due to the subsequent cross-checking by letter and otherwise, several days or even a week or more could easily pass before the task was completed.

The Fruits of Experimentation. Far more important than adopting a particular idea in administering an office is the *policy of continually experimenting*. No matter what the book or the article or the advertisement says, the only way to benefit is to go ahead and try it.

The best way to get out of the rut is to make new ruts regularly, always to keep some doubt areas alive to grow in. Experiments, not elsewhere but here, not some other time but now, are the progenitors of progress.

The Office Manual: Its Value, and Some Suggestions for Writing It

Fads exist in office and management practices, as they do in all of the other fields of human endeavor.

It appears that the writing of detailed manuals for accountants' offices is a gradually fading fad. The trouble with really comprehensive manuals is that they are tedious to prepare, and plugging loopholes in the text is seemingly a never-ending job.

The right kind of manual will always remain a valuable administrative tool. How can one be easily prepared and kept up to date?

The ideal practical manual for the practitioner's office should not be too ambitious. It should have two parts: (1) a restricted

number of exacting procedures for standardized operations only, like report typing or work-paper indexing; and (2) broader statements of policy, to be applied with prudent modifications as the situation requires.

“But,” someone says, “that is where the rub comes, for the memoranda of our accounting or auditing or administrative policies (Part 2) are harder to get down on paper than the standardized procedures.”

Of course they are—if the job is attempted in one fell swoop. Instead, events as they occur can provide the timetable. Whenever a manual-worthy situation develops, a policy memorandum can be dictated on the proper future handling of this type of problem. Suppose this happens once every two weeks on the average. In a year, a loose-leaf ring binder will contain 26 such memoranda. Thanks to the installment plan, the biggest part of the long-deferred manual-writing job will have become an accomplished fact. Its contents will probably be much more in point than a manual written all at once; and, best of all, keeping it up to date will have become an ingrained habit.

More Formality Can Be The Key to a Better Practice

As applied to life in general, people doubtless think of formality *vs.* informality most often in terms of personal appearance or manner of dress.

In rendering accounting services formality has another meaning—casting the work and delivering it in the *most appropriate possible form*. Viewed in this light, the genesis of accounting as a profession started when transactions came to be set down in double-entry form, by pen and ink.

Quick examples of formality in accounting practice, in contrast to informality, may easily be listed:

1. Disbursing by check, rather than by cash.
2. Preparing advance agenda for meetings, rather than relying on mental acrobatics as the meetings proceed.
3. Issuing typed professional opinions on a business letterhead, as opposed to delivering oral judgments.
4. Maintaining logs and minute books, in preference to drawing on memory.

5. Recording instruments at the county court house, not just letting them go.
6. Filling out a "report instructions" sheet before releasing the pencil report to the typist, rather than merely telling her what the specifications are.
7. Instead of just handing or mailing a report to a client without comment, doing so by letter of transmittal which serves as a professional "bill-of-lading."

Perhaps the one best all-around test of proper formality in practice is: Could a new staff man look in the client file and get all necessary information about the client, without having to ask for supplemental oral explanation?

Professional formality, then, means the ability to formalize. It is not something stilted, stiff, unfriendly or unpleasant. Rather, it is fundamentally a habit of workmanship, and of presentation. It deliberately sets up responsibility for putting professional judgments in visible form, which is the core of professional practice. Proper form tends always to compel a thorough job. The client, in consequence, automatically realizes that he is the beneficiary of professional service—service worthy of more than nominal compensation.

Formalizing, though, is not primarily to impress clients. It is simply good business.

This subject can be applied personally to each practitioner. To the older man who is the principal or partner in an organization, a good measure of any staff man's maturity and professional development is his ability to put the results of an engagement in proper form.

Successful Application Of Professional Ethics

Recently a practitioner gave considerable thought to Section 100 (p. 190) of John L. Carey's book, *Professional Ethics of Certified Public Accountants*. It reads as follows:

"When one certified public accountant succeeds another on an engagement, however, it has long been regarded as good manners for the successor to communicate with his predecessor." He discussed this section at great length in his firm and after much conferring the firm decided to adopt it. They felt that it would be a

good thing for the profession if it became general practice for everyone to use this procedure.

It was not long before they were called upon by a man who had been for years a client of another CPA. They called the other CPA immediately after the businessman left their office and explained the circumstances to him. The CPA was very appreciative of the consideration given, and asked them to hold the matter in abeyance until he had a chance to talk to the client. Two days later the CPA came to their office and admitted that nothing could be done to keep the client and repaid their courtesy by telling his former client that if he had to make a change he could think of no better firm than theirs.

The CPA who had lost the client expressed his appreciation for their attitude and assured them that he would reciprocate. Since they adopted this procedure, many similar cases have arisen. They have found that they have salvaged many accounts of their own, and other CPAs salvaged accounts they might have lost.

As a result, they found that everyone worked better in the community because they knew that another CPA would try to be a gentleman and hold the client for his colleague. They have found that relations improved between CPAs, and that clients were less inclined to change for the sake of reduced fees or for other reasons which would embarrass the CPA.

Effective Budgeting of Available Time

Among the foremost of the many problems faced by the public accountant is the question of how to use his available time most effectively. Here are some budgetary rules for time consumption. The primary purpose of this time budget is the elimination of waste time. Putting it in written form may point up the desirability of wiser consumption, and will also tend to direct the expenditure into those channels which have the highest over-all value.

Taking the calendar week as a complete cycle, and the hour as the unit of measure, the total time available for all purposes is 168 hours. The accountant estimates that sleep, eating and other essentials account for 11 hours of his day or 77 hours per week. His week is subject to great variation, but dealing with the larger portion of the year he estimates approximately 42 hours a week are

consumed on the job. For the remaining 49 hours, he has a certain freedom of choice.

Given these 49 hours, he should next segregate and define certain areas as follows:

1. Professional advancement
2. Increase of income
3. Recreation
4. Individual advancement
5. Public service and charity
6. Home and family

Professional Advancement. Duties to his clientele and to himself call for the devotion of at least six hours per week to this area. Under this heading he should include professional reading, professional writing, teaching, attendance at accounting lectures and courses. For the professional man who has completed his formal schooling, informal but carefully directed conversation with his fellow practitioners is probably the easiest and most pleasant method of increasing the scope of his knowledge. Contact with other professionals is often recommended as one of the virtues of becoming a certified public accountant.

Reading is a much faster method of learning, since the conscientious author has weighed his words carefully, but reading requires more patience and concentration. THE JOURNAL OF ACCOUNTANCY and a regular tax bulletin are certainly minimum reading requirements. And although it might seem unattainable to some, the absolute minimum requirement for time devoted to professional advancement should be set at six hours a week.

Increase of Income. Present clients are the best source of additional income. But every person with whom the practitioner is acquainted has potential value in this area. Continual and frequent contact with as large a body of personal associates as possible is the best hope for an increase in an accountant's income. Ten hours of this budget should be devoted to strengthening relationships with clients and friends on the social level.

Recreation. The tempo of the times and of public accounting being what they are, six hours per week should be set aside for recreation. Physical sport is the most important form of avocation for the accountant. The time devoted to sport or some other form

of recreation, such as music or painting, should certainly be substantial.

Individual Advancement. The most expert accountant will fail to impress either the layman or his fellows if he does not have a sound acquaintance with the world around him. One CPA spends four hours a week with *The New York Times*, and feels that at least four more hours of every week should be devoted to such things as books, plays, museums and music. Adult education courses are a means of scheduling a minimum time in this area and an excellent way to grow as a human being.

Public Service and Charity. This area needs little discussion. Whether one's preference be in the field of public or charitable action, there can be little quarrel with the appropriation of six hours per week in this area.

Home and Family. Saved for last is probably the most important avocational area. The essence of many a man's intrinsic success, his success as a human being, seems to depend largely on maintaining the strongest possible ties to his family. The budget allocates to it the thirteen hours remaining, and the wise man would also set aside all legal holidays and whatever vacation time he can command to be devoted to his wife and children.

The essence of utilizing this budget is in reviewing activities to see that the required minimum time is being spent in each area. A budget of course is valueless if not followed. Certainly any time allocation is impossible of exact fulfillment by human beings subject to human frailties. But if the practitioner can schedule as much time as possible in each area, such as professional lectures, adult education, tennis or handball, concert series, etc., he will have taken a step in the right direction. And more important, an occasional review of the past few weeks will give an indication of possible shortcomings, possible future improvement.

CLIENT RELATIONS AND SPECIAL SERVICES

Getting and Keeping the Feel Of the Clients' Affairs

How can the accountant with a growing practice best maintain a working knowledge of the financial affairs of an ever-increasing number of clients?

There is one superior way, simple yet capable of being overlooked along the way. It is for the principal personally to perform the first services for each new major client.

Any old-time practitioner, when asked about any of his clients of long standing, will display an amazing comprehension of the essentials. Why? Because he knows the whole evolution of the enterprise. He remembers the founders, the first plant, the early products. The facts are easy for him to remember since they form a connected, unbroken story. Once a principal described in detail the financial structure of a ranching enterprise whose accounts one of his staff men had worked on for *twenty years*—but he had set up the accounts when the ranch was purchased *forty* years ago.

The grasp is never quite the same when the accountant enters the scene after the show is on the road. A business, after all, is an adventure as well as a venture. It is a personal, psychological, and

historical unit as well as an economic and accounting unit. In short, a business—like a rock, an animal, a plant, or a word—can seldom be fully appreciated or rightly understood without a sure knowledge of its origin. With such knowledge, delegation is possible without fear of losing that main thread, that permanent feel of various clients' affairs.

A Guide to the Utilization Of the Client's Staff

In many engagements, if not most, the principal device for conservation of the auditor's time is his utilization of the client's staff. Normally, there is a vast amount of pre-audit work which can be performed by the staff of the client before the auditor makes his visit.

The auditor's duty is to check, prove, and verify, and he can perform this duty just as well using schedules prepared by the client as he can using those which he has written himself. An accounting schedule serves two purposes: (1) it provides information supporting items in statements and reports, and (2) it indicates the nature and extent of any verification work which is done. It is always possible to make notes of verification on such schedules as these or to prepare supplementary schedules.

Many times schedules furnished by the client will be carbon copies of statements prepared for some internal purpose. Lists of accounts receivable, accounts payable, trial balances of a subsidiary or a cost ledger, summaries of inventories, and lists of investments are examples of the types of schedules prepared for the client's own purpose, a copy of which could be utilized as a part of the working papers of the auditor.

In other cases the client's staff will prepare schedules especially for the auditors, in which cases only the verification work need be completed by the audit staff.

It may be felt by some that such assistance by the client's staff is possible only in larger companies which have well-organized offices and smoothly functioning accounting systems. This is not necessarily true. With proper tactful handling of the request, it is surprising how much assistance can be secured in the smallest offices with the most limited personnel.

Further, the smaller client, in many instances, will especially welcome the request of the auditor for assistance from his staff

because it will enable him to receive his report more promptly and will help to keep his auditing costs down.

The following list is intended to serve as a guide to indicate the kind of schedules and data that clients may prepare at the request of the auditor:

Trial Balances

- General ledger
- Factory ledger
- Accounts receivable—aged
- Accounts payable

Cash

- Bank reconciliations
- Confirmation requests to be mailed by auditor

Receivables

- Typing of requests for positive confirmations selected by auditor
- Schedules of notes receivable together with notes
- Schedules of receivables from officers and employees

Investments

- Schedules of investments, indicating type of investment, dividends or interest received and interest accrued
- Investment purchases and sales transactions during year

Prepaid Expenses

- Insurance schedules
- Tax and other prepayment schedules

Fixed Assets

- Schedules showing agreement of control with plant ledgers
- Schedules of additions with supporting vouchers
- Schedules of deductions from capital assets
- Analysis of allowances for depreciation
- Analysis of repair accounts showing details

Accounts and Notes Payable

- Statements from creditors arranged for checking against company's records
- Typing of requests for confirmations selected by auditor
- Schedule of notes payable and any collateral held

Bonds and Mortgages Payable

- List of owners, if there is no trustee
- Copies of bond indentures

Schedules of premium or discount amortization
Schedules of interest payments and accruals

Capital Stock

Schedules of ownership of capital stock, by name and number of shares, if there is no transfer agent

Surplus

Analysis of charges and credits during year to each class of surplus

Profit and Loss

Labor summaries and overhead distribution summaries

List of actual manufacturing expenses

Schedules of tax payments

Schedules of certain expenses and revenues which are selected by the auditor

A serious word of caution must be injected in conclusion. Only such work should be done by the client's staff as is consistent with the complete maintenance of the auditor's independent status and attitude. The assistance of the client's staff should be limited, therefore, to purely clerical work which requires no exercise of judgment or professional skill. Schedules and analyses prepared by the client's staff must be carefully reviewed and compared with the source records by the auditor.

Three Questions On Client Relations

A recent survey by a state society yielded interesting information on varying practices in three important areas of client relations: entertaining, referral, and fee-setting.

The first question asked whether the firm encourages and reimburses entertainment expenditures by various classes of employees. The majority of the firms reported that managers and supervisors frequently were reimbursed for entertainment expenditures. A majority also indicated that seniors and semiseniors occasionally were so reimbursed whereas juniors were not so encouraged and reimbursed by the majority.

Recognizing the fact that a majority of an accountant's clientele goes to him by referral, the second question asked practitioners to rank in order of their importance various sources of referral. Present

clients were considered the most important source by a majority of the firms represented. Lawyers, however, ran a close second. Third place went to friends, followed closely by bankers in fourth position. Slightly behind bankers was general reputation, and in sixth place, surprisingly, came other accountants. Brokers or underwriters ranked seventh, with a few firms giving credit to organizations, county assessors, and the telephone directory.

The third question asked practitioners to indicate the basis on which they set their fees. While time spent ranked first as a basis for fees, complexity of work and value to client of work performed ranked second and third, not far behind first place. A substantial number of practitioners placed degree of responsibility as a close fourth. In fifth and sixth positions were client's ability to pay, and time of year work is performed. Almost one-half of the practitioners indicated that time of year work is performed never affects their fee computation.

Approaching Each Assignment With a Practical Ideal

Most practitioners would probably like to enlarge their practices. In seeking that end, there are two alternatives: doing more and more work for each client by going down to lower and lower levels of skill, or doing less and less work for each client by going up to higher and higher levels of proficiency.

The first policy leads to wholesale bookkeeping. The second leads to a truly professional practice eventually ministered to a much larger clientele.

In pursuing the second pattern, the working objective on each assignment should be: Let us try to work ourselves out of a job. Let us perform the engagement so well, and instruct the client's staff so thoroughly, that the same results can be accomplished next year in far fewer hours.

Oral Advice May Lead to Trouble

"Don't give oral advice!" warns an experienced accountant.

If it is followed and is successful, the accountant has no proof that the suggestion was his. Often he receives no recognition.

If it is not followed, he still may be blamed for bad reactions. It is dangerous either way because no one knows (1) the factual basis of the oral opinion, (2) who furnished the alleged facts, (3) what advice actually was given, or (4) what specific step-by-step course of action was prescribed for the client.

The accountant sums up his opinion: "No wonder oral advice so often returns to haunt its giver."

Preserving the Advantages Of the Fresh Reaction

Most clients continue to engage the same accountant or accounting firm year after year, with scarcely a thought of changing. Others believe it is wise, as a matter of basic policy, to change every five or six years in order to assure the advantages of both new insight and a fresh analytical approach.

No one minds being the new appointee, but the accountants being replaced can hardly be blamed for lack of enthusiasm.

In the larger communities, as a general rule, the spur to keep alert and to hold the client is ever present because other accountants are astonishingly ready, able, and willing to take over. This automatic encouragement is frequently not present at all, or is not so strong, in thousands of smaller communities where perhaps only one or two CPAs are in public practice. There, monopoly can encourage lackadaisical service, which again can, in time, affect the good name of the profession itself.

Can such tendency be overcome?

This provokes the further question: what are the "natural" causes of slipshoddiness? Surely one of the causes is the practitioner's gradually, almost unconsciously, becoming overtolerant of substandard practices. This can happen easily through the hypnotic effect of monotonous repetition of the same procedures on successive engagements, whether they be monthly write-ups or annual audits.

That first good look at the client's affairs, that initial reaction, is the one which is likely to be the truest. Abnormalities, unorthodoxies of all descriptions, then make sharp impressions on one's mind. Those first impressions should be set down on paper immediately. The accountant who waits rapidly begins to accommodate himself to the unsound procedures; then to live with them; and finally, it becomes almost second nature to pride himself on being

able to thread his way through the maze of special peculiarities characterizing the affairs and procedures of the client.

If this diagnosis is correct, the prescription for serving a client year after year, yet preserving as far as possible the advantages of the initial reaction, is occasionally to *rotate personnel* and, without exception, to plan succeeding engagements so that the *angle of approach* and the *relative emphasis* will be different each time.

Top Auditing Duty: Inspecting Outdoor Facilities

Fortunate is the man whose duty coincides with what he really likes to do.

Probably every certified public accountant can point to some aspect of his work which he prefers above all others. To some, it is field work: getting out to the ranches, farms, fisheries, sawmills, oil-fields, mines and quarries of America.

Field work, more than merely being necessary, carries with it two special bonuses for the accountant.

First, in touring the layout he always learns much that is not strictly within the scope of the verification. These "extras" of first-hand knowledge have immense indirect value because they make possible realistic, comprehensive reports instead of the wishy-washy kind.

Second, visiting the scene of activity cements client relations. A client is pleased to have his accountant know all about the artesian well on the northeast 40 or about the 50 new purebred cows bought in September. In fact, he's as proud of them as the accountant is of his new electric typewriter.

Compared to the indoor "paper" approach, the value of the outdoor "operating" approach cannot be overestimated. In many situations the latter is the key to the whole audit.

In addition, field work is a poignant reminder that were it not for the outdoor natural resources there would be little accounting to do at all.

Prescribing Accounting Policy: The Practitioner's Unique Task

Forever important, and alike familiar to veteran practitioners

and newcomers to the profession, are accounting and auditing procedures, principles, and standards.

Deserving of as much attention, and peculiarly within the practitioner's province, is the art of prescribing for each client the most suitable accounting and internal auditing policies.

Now what is meant by "prescribing accounting policy?" It is simply the adaptation of sound principles, procedures and standards to each client's particular situation. It exactly parallels the writing of a medical prescription. Who is in a better position than the doctor who is taking the patient's pulse to decide the wisest possible immediate application of the profession's recent research findings, the basic principles laid down in textbooks, and the lessons of his own experience? Here is professional practice at its height. Why? Because here is the bridging of the crucial gap between principles and application which *the practitioner only* is privileged to perform.

Illustrations of Accounting Policy. Here is a random assortment of accounting and internal-auditing policies:

1. Omit the cents on all financial statements.
2. Keep "earned surplus" clean; apply to the current year's income or expense accounts all adjustments under \$1,000. Consult the controller on proposed surplus adjustments of over \$1,000.
3. On all appreciable additions, take depreciation from the first day of the month following acquisition.
4. All items listed will be known as Perishable Tools and shall be accounted as Expense adjustable by Inventory, not as Plant subject to Depreciation.
5. The contents of each room shall be listed in this order: clockwise from the entrance, then from floor to ceiling around each room.

Except for noting that the above 96 words will probably save 96,000 words among the client company's accounting personnel in a year's time, let's press on and see how the prescribing of policy is likely to vary between large client and small.

Application to Large vs. Small Clients. An accountant for a company engaged in earth moving regards a heavy cable much as an ordinary mortal views a shoelace. He expenses it. As a matter of standard policy, he does not capitalize field machinery units which either cost less than \$1,000 or are expected to last less

than eighteen months. Finer gradations, he has found, only produce confusion and "busy work," not economic precision.

Suppose, on the other hand, that this accounting policy was prescribed for a small new insurance agency. The result would be disastrous. Through failure to reflect \$300 of unused printed forms and stamped envelopes as deferred assets, for example, the first month's operation would show a \$400 loss instead of the true loss of only \$100. This could easily spell the difference between deciding to continue the new enterprise or giving it up.

In the small business, therefore, quite refined measurement of asset consumption and of revenue-expense matching must be recognized in the accounting policies. The greater detail required is counterbalanced by the fact that, in many small businesses, the entire accounting task boils down to ten or twelve transaction-summaries (journal vouchers) as contrasted to one hundred and up for manufacturing corporations.

The Two Basic Ingredients. At this juncture let us list the advantages accruing to the company whose accounting personnel follow definite, properly conceived accounting policies:

Many hours and dollars saved;
 Less hairsplitting, petty debate, and bickering;
 More orderly accounting procedures;
 Greater long-run accounting accuracy;
 And cleaner, more comparable financial statements.

These advantages derive from two basic ingredients:

First, good policy is the product of deliberation. Fundamentally, it involves eliminating the two extremes of conceivable policy until the median zone is approached and then hammering out, on the basis of both judgment and experience, exactly what the policy is to be.

Second, once a policy is determined after proper deliberation, it immediately takes on a stable, permanent, *even arbitrary* character. It is tersely put. Whys, wherefores, and whereases form no part of it. It is to be followed without question. It is exactly as the admiral said when he pounded his fist on the table and for the last time heatedly exclaimed to the inquiring young ensign: "There is *no reason* for it! It is just *our policy!*"

Writing the Prescription. Anticlimax though it may be, here are several suggestions in prescribing accounting policies for clients:

1. The client should formally adopt the policy as his own—it is the company's, not the accountant's policy.
2. The practitioner alone may develop accounting policy for the small client, whereas in the larger company it is normally the joint effort of the independent accountant and the company's controller, subject to the review by the company's legal counsel and executive committee.
3. The policy statement should be written as a separate and concise document rather than being incorporated into the debit-this-account-credit-that-account procedural manual accompanying the Chart of Accounts.

One CPA practiced ten years before seeing a Manual of Company Accounting and Internal Auditing Policies written up in this manner, separately, crisply, forcefully. He was so impressed that he then spent a decade wishing every practitioner and company controller would do it that way, too.

Design and Installation Of an Accounting System

One of the things about which CPAs are in general agreement is that they are competent to advise their clients on accounting matters. Recent writings on the subject of management services by CPAs indicate that there is no such agreement on whether the design and installation of accounting systems should be called a management service or some other kind of service.

However, accounting systems certainly are accounting matters, and in a business of any complexity at all the accounting system is contributed to and used by many people who are not considered part of the accounting function. It follows that the design or re-vamping of a complete system must take into consideration at least these factors:

1. Kind of business.
2. Operating organization.
3. Number of operating and record-making locations.
4. Points of responsibility for purchasing, selling, collecting and spending.
5. Points at which original records are made or should be made.
6. Mechanical aids applicable in the entire process.
7. Information needed, when, where, for what aim and in what form.

The results of the investigations and analyses necessary to carry out this operation might well include recommendations for changes in methods of compensation, elimination or expansion of sales territories, realignment of the operating organization to clarify responsibilities and authorities, and other recommendations related to, perhaps, but not a direct part of any accounting operation.

Whether this kind of engagement is called management service or something else is not important. It does seem important, though, that CPA firms so often make audits for years on end without leaving any trace of a constructive recommendation or suggestion for improvement or better use of an accounting system. The CPA firm which keeps its members and staff actively aware of the uses of modern systems, methods and procedures, as management tools, will render a better service to its clients and accelerate its own growth in the field of management accounting.

Practitioners' Approach to a Financial Advisory Service

The problem of whether to handle monthly accounts is one upon which CPAs probably never will agree. It is often looked upon as a somewhat unprofessional type of service, handled by those who do not have sufficient auditing and tax practice, and given the undignified term "bookkeeping service." Let us briefly examine this type of service, and see if its dignity cannot be brought to a somewhat higher level.

First, no certified public accountant should think of himself as offering solely a bookkeeping service. No time should be wasted on a client who wants a set of books only to keep himself out of trouble with the tax collector. The only type of monthly client who should be handled is the man who not only wants his books kept, but in addition wants up-to-date financial statements and professional advice on financial matters. When monthly clients are not accepted unless they want this type of service, it is no longer a "bookkeeping service," but might be called by some a "financial advisory service." The bookkeeping is only incidental to the more important service rendered.

There are many drawbacks to this type of service, but probably it will always be with us. Frequently accountants do it in the early years of practice, and many consider it to be a permanent and useful part of the services they render.

But let those who do it strive to maintain these standards:

1. Avoid the client who has no desire for professional service. If he wants a set of books only because the government requires it, let him go to someone else, not a certified public accountant.
2. Make the bookkeeping only an incidental part of the service rendered. Emphasize up-to-date financial statements (and review them with the client), and financial and tax advice. Make it a real professional service.
3. Avoid the term "bookkeeping service." Surely certified public accountants can do better than this.

ABCs of Insurance Coverage For Business Clients

It is often evident that CPAs could help clients more in securing maximum value for each insurance premium dollar paid. It is not always necessary or advisable to recommend that the entire insurance program of the client be analyzed by an insurance expert; there are frequent mistakes made by small businesses which their accountants should constantly watch for.

The following observations and suggestions were prepared especially for accountants by an experienced insurance broker:

An accountant serving a new client quickly becomes aware of whatever insurance policies may be carried. He should learn what constitutes a sound insurance program for almost any type of business, and how to recognize common flaws. The majority of business men, unfortunately, buy *policies* rather than a *program*. The insurance profession, like the medical profession, in prescribing, must consider the composite picture, not just a few aspects of it, in order to furnish proper protection.

The primary objective is to protect the client from serious losses which his financial structure could not withstand. Only after these exposures are properly safeguarded against can the business man consider the luxury of fringe protection. A typical example of the antithesis of this approach is the following case.

George Jones, the neighborhood druggist, buys a large, new neon sign for which he pays \$1,500, a sizable outlay. A friend, in commenting on the attractive new addition perched high above the parking area, says: "It surely is pretty, George—do you have it insured?" "No, by gosh, I haven't," says George. "Better get a Neon

Sign policy," replies his friend, "I always used to carry one before I sold out."

So later that day druggist Jones calls a customer who has been asking him if he "can't write an insurance policy some time," and says, "I need a neon sign policy." The customer asks the value of the sign and what the words are on it and closes with, "Thanks, you're covered right now." A few days later Mr. Jones gets a policy in the mail, puts it in the safe and files the \$75 invoice, thinking it's pretty high, but forgetting it in the rush of business. On the tenth of the month the invoice gets paid along with other current bills.

The same day that Mr. Jones' friend commented on the new sign and suggested he get it insured, Mr. Jones asked a favor of this friend. It seemed that one of the friend's neighbors, a Mr. Smith, was sick and had asked the druggist to send a prescription out. Jones said to his friend, "By the way, if you are going home, I wonder if you'd mind dropping off this package at Bill Smith's house? I know he is anxious for it and my delivery boy won't be back for an hour."

"Sure," replies the friend and takes off in his car. En route, he is involved in an accident in which three people are seriously injured. Several months later George Jones is served notice of a lawsuit against the friend and Jones jointly in the amount of \$50,000. The damage suit pointed out that the driver of the car (Jones' friend), who, by the way, carried only \$5,000/10,000 bodily injury liability, was delivering a package for Jones and was, therefore, his agent at the time of the accident.

Mr. Jones immediately called his automobile-insurance agent and was advised that he was not covered. The specific type of insurance required is known as "automobile non-ownership liability" (always included in a comprehensive general-automobile liability policy) and would have cost Jones an additional \$6.80 per year for limits of \$50,000/100,000 bodily injury and \$5,000 property damage.

Mr. Jones had bought a luxury-type, fringe protection policy on a \$1,500 neon sign which was in reality automatically covered for fire and extended coverage perils under his equipment policy, and left himself exposed to a \$50,000 claim by not buying a comprehensive general automobile liability policy.

The Most for the Premium Dollar. In order to get the most for the premium dollar, clients should secure the services of a capable and reliable insurance agency. This agency should be allowed to

handle the entire account for several reasons. *First*, this is the only way he can hold the agent responsible for any slip-ups. *Second*, by concentrating his insurance with one firm, he makes the account valuable enough to receive top service from the firm. *Third*, the insurance agency is in a better position to ask favors of his companies to handle "border-line" cases, or actual errors or omissions, if he can show that he writes the entire insurance program for the client. *Fourth*, the agent is in a better bargaining position in securing the most favorable rates. *Fifth*, the client knows immediately whom to call on any insurance question or loss, and there is no danger of duplication of coverage—and premium.

The client should be advised that he will not lose any patronage if he explains to his other insurance agent customers that he has found the consolidation method much more practical, and that if at any time he is dissatisfied with his present agent, he will consider turning over the entire account to one of his other insurance agent customers. The insurance man who isn't broad or fair enough to agree loses stature by objecting or by transferring his business elsewhere.

When the proper insurance program is set up, all of the existing policies are turned over to the insurance agent, who then makes a simple index outline for the client, together with a written report of his findings. This includes checking of rates, values, forms and coverage. Recommendations are made for improvement of the overall coverage, and coverages not presently carried are pointed out, together with comments as to coverages presently carried which might be dropped. This survey and analysis method has proved the most satisfactory from all viewpoints.

If the client has been operating on this basis, the problems for the accountant are greatly reduced, for he can look at the outline of coverages carried and check the policies against it. Then he can read the report and see what protection his client is not carrying which was recommended.

Primary or "Must" Coverages. If a client can turn over to his accountant only his existing policies, here are the coverages to look for:

These are "musts":

1. Comprehensive general and auto liability with adequate limits.
2. Fire and extended coverage on building (if owned) and equipment and tenant's improvements with the amount of

- insurance at least high enough to comply with any average clause requirements (generally 90 per cent average clause).
3. Fire and extended coverage on merchandise. This coverage should, generally speaking, be on a provisional reporting form if the values are sufficient to earn the \$200 minimum premium. The method of reporting should be checked to determine if the value of all property covered is being included in the reports. If a nonreporting form is used, the policy should not contain an average clause unless there is a *very unusual* nonfluctuating inventory.
 4. Fidelity bond on employees, which should usually be a blanket bond, and money insurance (if needed) in same company.
 5. Workmen's compensation.

Other Coverages

These are next in importance, and usually carried:

6. Business interruption.
7. Auto fire and theft (possibly comprehensive).
8. Accounts receivable (if large).
9. Transportation.
10. Steam boiler.

These are luxury lines:

11. Auto collision.
12. Neon sign.
13. Plate glass.
14. Forgery.

There are other forms which are "musts" for certain lines of business—for example, "bailee's customers' goods" coverage for laundries, and "malpractice" for physicians. These are tailor made for certain businesses and are not included in the outline above.

Necessity for Proper Evaluation of Insurance

The evaluation of insurance coverage often receives little attention in audit engagements, since it is not a mandatory requirement for the issuance of an opinion on the financial statements. A certified public accountant is not an insurance expert, but he must not blind himself to obvious inadequacies in coverage. Insurance sud-

denly may become the most important asset a company owns. This is also an area where the auditor may often render valuable services to clients through recommendations for greater protection of assets, reduced insurance costs, or both.

To evaluate properly the program of insurance coverage the auditor must consider the following:

1. *Important Assets Covered.* In determining that all important assets are covered, the auditor must consider not only the broad classifications of assets but also the property descriptions and locations shown in the insurance policies. He must observe that property additions are covered by endorsements when required and that all inventory is covered regardless of location.
2. *Major Risks Covered.* During the review of the coverage for major risks, it is especially important to note that the client is protected against the more common types of liability claims including the following: (a) workmen's compensation insurance, (b) comprehensive public liability, (c) automobile public liability and property damage liability. Protection against claims arising from the ownership or operation of airplanes, boats, etc., must be separately obtained.

Another important risk is that covered by business interruption insurance (sometimes called use and occupancy insurance). Fire and other insurable hazards often cause greater indirect loss through the resulting cessation of business operations than the direct loss to the property. Business interruption insurance has been designed to reimburse the assured for such losses. Insurance companies assert that it is the lack of this coverage which causes the majority of bankruptcies following fire or other catastrophies.

3. *Adherence to Terms of Policy.* When examining insurance policies the auditor should be careful to note that the terms of the policies are being adhered to by the client. Many court cases illustrate the pitfalls inherent in failure to read a policy thoroughly before a loss occurs.

An auditor, without being an insurance expert, but with normal knowledge of the client's affairs, might avert the disastrous results of not understanding the insurance protection.

4. *Adequacy of Coverage.* The auditor must also consider the adequacy of the amount of insurance carried. On physical property insurance the adequacy should be judged by com-

paring the coverage with the appraisal values or current replacement costs and not merely with the book value of the assets.

In doing this, the auditor must also be mindful of the factors affecting the policy's face value such as the coinsurance clause. The coinsurance clause requires that the insured carry insurance to a stipulated percentage of value (usually 80 per cent) or, failing to do so, bear a portion of all losses incurred. The auditor, therefore, should be on guard to see that a client is not misinterpreting a policy with this clause and thereby assuming a risk without knowledge.

The question of how much protection to carry against damage claims of others is not easy to answer. In considering the question, the auditor should think in terms of possible losses large enough to do the client serious harm, not in terms of minor losses. In this connection it might be suggested that the client inquire into deductible or excess-loss-type insurance, where the insured pays losses up to a stated amount, such as in the common automobile policies. Almost all types of insurance are available with this deductible feature; and the same premium, with this clause, will usually provide considerably more protection.

5. *Cost Savings.* While analyzing the insurance coverage the auditor should obviously be alert to possible cost savings. These savings arise most frequently in the following cases:
 - a. Incorrect classification of payrolls for workmen's compensation and liability purposes.
 - b. Length of policy—Most policies may be issued in terms up to five years. Such a procedure results in a considerable savings in gross premiums. The disadvantage may be overcome by paying for a long-term policy in annual installments.
 - c. Lessening of risk—The auditor may note areas of large premiums and advise the client to investigate for possible cost savings. As an example, one industrial company, located in a small town with an inadequate local fire department, recently installed a sprinkler system throughout the plant. The saving in the fire insurance premiums due to reduction in rates is expected to pay for the complete installation in approximately three years.
 - d. Purchase of proper form of insurance—Any risk may be

covered by "specific fire" insurance. When the value of the property at risk, however, fluctuates sharply, it will be much cheaper to buy at least a portion of the coverage as "reporting insurance" if the business qualifies for it. The saving arises under the reporting form of insurance because the premium is computed on the actual value of the property at all times; in contrast, under the specific form of policy, it would be necessary to purchase coverage for the full term in an amount equal to the maximum value of the property in order to be fully insured at all times.

Self-insurance Generally Unwise. The question often arises as to whether a client should "self-insure" a risk. Usually this means no insurance. The only form of self-insurance that will generally prove advisable is founded on the basic principles of insurance, namely, the distribution of risk and the application of the law of averages. Consequently, its proper use is limited mainly to large enterprises that have numerous units to insure.

Conclusion. The time spent in obtaining an understanding of the more common insurance coverages and in making a thorough review of the client's insurance program and policies will be well rewarded by the client's additional satisfaction with the auditor's services.

Digest of Significant Trends In Business Insurance

Today the definite trend in insurance is toward (1) broader coverages, (2) simpler definitions of insurable risks, (3) larger policies, and (4) lower premiums in the form of merit discounts. It all adds up to more coverage value at lower cost and entailing less policyholder fuss.

Specific areas in this general panorama are outlined below.

The Commercial Block Policy. The prime purpose of the "block" policy is to embrace wider coverage in one contract. Being new, it takes various forms. Typically, a commercial block policy covers the merchant's stock in trade on an all-risk basis wherever it may be within specified territorial limits. Most insurance companies permit the inclusion of equipment, furniture, fixtures and tenants'

improvements and betterments. One of the important lines now being written on an all-risk or block basis is the bailee's policy. Formerly this was written on a specified peril basis according to whether the risks were those of laundries, dry cleaners or others whose business involves the care of customers' property. To show the possible extent of sweeping coverages, a few strong agencies now insist that the insurance companies they represent underwrite "the agency" rather than the line.

The Manufacturer's Output Policy. Somewhat similar in nature is the manufacturer's output policy. Subject to specified exclusions, it affords broad coverage on all personal property used in manufacture while such property is away from the manufacturing premises. Raw materials, finished goods, components, and machinery are typical coverages. Originally this policy was tailor-made for automobile manufacturers, but is now available to more than 350 specifically classified types of risks. Premiums are determined on a *reporting basis*, with a minimum premium of \$5,000 per annum.

Group Life Policies. Most accountants and businessmen are acquainted with the great surge in group life insurance during the last ten or fifteen years. Many business executives carrying large amounts of term insurance on their own lives are now finding it advantageous insurance-wise and tax-wise to substitute newly superimposed group life coverage for part of their renewable term life. Roughly speaking, for an executive at age fifty, about \$200,000 of superimposed group insurance can be purchased for the cost of \$50,000 renewable term. Thus \$50,000 of the group coverage could entirely replace the renewable term policy on the executive's life and the additional \$150,000 be spread among key employees at no additional cost. Over and above this, the entire cost of the group insurance coverage is deductible whereas the cost of the renewable term was not deductible.

Insuring Replacements. By replacement insurance the insurance company pays for the replacement cost new of the asset destroyed without deduction for depreciation. It is now being applied very generally to dwelling property and is being written on commercial and business properties with a lower coinsurance clause. Some companies are also writing replacement insurance on furniture, fixtures and equipment.

Insuring the Casualty "Occurrence," Not Its "Cause." Another progressive trend, this one in the field of public liability insurance, is the use of the word "occurrence" in insuring clauses instead of the phrase "caused by accident." This wider, simpler definition closes a loophole and eliminates a cause of misunderstanding. It clearly covers the accident caused by not one sudden event but rather resulting from a condition developed over a period of time. "Occurrence" coverage, for example, would presumably have covered what happened to the immortal "one-hoss shay."

Insurance Rates from Activity Reports. Another new development in the liability field is "composite" rating of policies to determine premiums. This is done by first applying the usual manual rating methods and then relating the entire premium to some *unit of exposure*, such as, *gross receipts* or *payroll*. In such an instance the insured has only one factor to consider in estimating his insurance cost for a given job or period of time. This development has accordingly been warmly welcomed by contractors.

Merit Discounts. Another significant current development in the field of insurance is the definite trend toward discounts when they are merited. Such discounts may be by *time formula* (e.g., a premium on a three-year policy of two and one-half times the one-year rate) or, for large policies, by reference to a table of *size discounts*. Generally, too, premiums may be paid on the three- or five-year annual renewal plan at a substantial reduction or discount over the straight annual rate; or the insurance for three or five years may be put on an installment premium plan, likewise at a substantial reduction. Besides *size*, discounts sometimes apply to "*multiple location*" for larger risks and, in addition, there may be a "*spread of the risk*" credit if the insured's values are sufficiently well distributed.

The developments described above have not materialized evenly, of course. Insurance underwriting has been controlled by a host of bureaus controlling separate lines of insurance and limited further by the laws of the respective states in which the business was written. Therefore, progress along the trend line is bound to be spotty, but the general direction is unmistakable.

Being aware of these insurance trends can be pretty important to the accounting practitioner.

Such awareness alerts the accountant to newer, better coverages that are available—or fast becoming available—to his clients.

It indicates that his own share of responsibility for better underwriting is on the increase, for accurate reporting by accountants is being used more and more in establishing insurance premium rates.

Lastly, it helps him to appreciate that in other fields besides accounting, dynamic progress is being made. In insurance, too, past achievement is just a prologue to the future.

MANAGEMENT SERVICES

First Steps in Offering Management Services

It is now generally agreed among CPAs that they should provide management services; much has been written about why and about which ones the individual should offer. Now an experienced practitioner has some advice on the techniques of getting started in management services.

First, he says, the CPA must identify these services as separate engagements. They must be formalized, and obviously written reports serve this purpose better than oral ones. It is important to avoid the common practice of giving advice gratuitously as a mere byproduct of other accountants' services.

The next step is to set separate fees for management services. Advance determination of those fees will not only abolish misunderstandings but will elevate the performance of management services to the level of other professional services.

These two steps force the CPA to do some ethical "selling." He must demonstrate to clients their need for such services in conducting their business profitably. However, he must avoid exaggerated claims; failure to fulfill them can result in loss of the fee or even the client.

This practitioner feels it is important to emphasize that these services are advisory; the CPA will make recommendations only and not decisions, which are the exclusive prerogative of management.

He now explains why he has selected just three general areas in which he offers management services:

"I believe it is desirable, too, for each of us to select certain services for which we feel that we are already prepared, and give special attention to the needs for each of these services by each of our clients. In this direction, I have chosen three, strictly on a personal basis, which I intend to stress in my own practice.

"The first of these is budgeting and forecasting. I find that all too few small businesses operate with any form of budgetary controls or forecast their operations in an effective manner. For small business, budgets and forecasts need not conform to any conventional style, but can be specially adapted to the type of records kept, the capabilities of accounting personnel, and management's personality.

"The second of these is improvement of accounting systems. I can't think of one business in which the accounting system is completely satisfactory. Changing conditions, growth of the business, advance of machine methods, and turnover of personnel are among the many factors which render these systems out of date rapidly. This sort of service can be almost continuous.

"The third service for which there seems to be an unlimited demand is cost determination and cost studies. While to a certain extent, these are included in accounting systems, I believe that the CPA can make numerous simple, very general cost studies which will be invaluable aids to management. (The term 'cost' includes distribution costs, service costs, and administrative costs, as well as production costs.) These studies may lead to installation of comprehensive systems, for which the CPA may seek more specialized assistance.

"At the same time, I hope to prepare myself to render other services for which I am not at this moment properly qualified. In due time I may be able to enlarge the scope of management services rendered through study and experience in other services."

Consulting Engagements: Suggestions for CPAs and Clients

A piece about consultants by E. M. Ryan first appeared in *American Business* (August 1956, p. 14) and was condensed in *Management Review* (October 1956, p. 832). As consultants themselves, accountants should find it both interesting and profitable to follow his thinking on a subject that so intimately concerns them.

In order to get optimum results, what steps should the company take when about to engage a consultant? Here is the author's answer in checklist form:

1. Determine the extent of the problem and whether it can be handled by company personnel.
2. Write out the full problem (or project), including how the situation is presently handled, why a change is desired, and what the change should accomplish.
3. Ascertain the approximate budget for the job, and clear it before even talking to a consultant.
4. Check with other managements in the area to find out how they have handled the problem and what consultants they would recommend. Your trade association can be helpful in recommending consultants, too.
5. Contact at least two consultants and present the full problem to both. Most consulting firms will gladly present a written proposal covering approaches to the problem, length of time required for the work, and estimated costs.
6. Consider the proposals of the consultants, checking references on their past work. Then decide which firm will do the best job.
7. Assign a liaison man, preferably a higher management official, to work with the consultant. He should be fully acquainted with the project and able to assist the consultant in getting information and co-operation.
8. Completely familiarize company personnel with the plan, what the consultant will be doing, and how it will affect them. This is necessary to obtain full co-operation.

The converse of this—i.e., what clients should *not* do when consultants are engaged—includes seven mistakes:

1. Select one part of a total program that strikes their fancy without seeing that all the other units have a direct bearing on total results.

2. Expect the consultant to correct the faults of persons in the lower-management level without putting the spotlight on their own possible shortcomings.
3. Initiate another program that neutralizes the result of the consultant's program.
4. Fail to follow up the consultant's program and instead allow it to die a natural death.
5. Reject too quickly things that have worked well for others, because they have tried them before with poor results—not realizing it was the way the idea was carried out, not the idea itself, that was at fault.
6. Look upon the consultant as an outsider, and play their cards too close to the vest.
7. Reject recommendations for fear they will be criticized for not having already instituted the programs themselves.

Put differently and even more tersely, the consultant would be happier if management did *not* (1) expect miracles, (2) hover over him, (3) load him down; but *did* (4) more fully appreciate that too many cooks spoil the broth.

It is fitting, we think, to conclude with the more common faults of consultants as seen through the eyes of management. It seems that consultants would be creators of a lot more sunshine for clients if they would remember to (1) do one job at a time, (2) avoid trying to butter up management, (3) steer clear of pie-in-the-sky promises, and (4) be sure to familiarize the man assigned to the job with the *total* project, not just a corner of it.

An Example of Management Services

Management services are usually discussed in broad, general terms. Case histories are rarely written down. Here is a case experienced by a small practitioner who relates all the pertinent facts in the situation, and imparts an understanding of the human aspects as well:

My client's small business was incorporated, and I had been guiding his bookkeeper's hand, preparing tax returns, and giving general advice in accounting and bookkeeping matters over a long period of time.

The first time in many years that John's business showed a loss

was in 1953. The year 1954 was worse; the loss was staggering. In January 1955, when we were preparing his tax returns for the preceding year, John asked me if I would help him decide what to do about the situation. After considerable discussion it became apparent that he believed I had occult powers which would enable me to wave my hand over his bookkeeping records and come up with not only the problem, but also the solution. I didn't know what to say. The first thing that crossed my mind was "How will he pay me for what he wants me to do?" The next question that entered my mind was "Does he really know the amount of work that can be involved in a program of this kind?" His blind faith in me was quite flattering, and his approach was very persuasive, so when he left my office he had actually talked me into "doing something."

I had promised to do something. I puzzled over the matter for several days and then forgot about it in the press of more important matters. About a week later I was walking past John's place of business, and I remembered my promise. I glanced at my watch. It was five minutes after 5 P.M. I would try to hold it down to half an hour. I then went into John's place of business.

I discovered that 5 P.M. to 5:30 P.M. was an ideal time. He was through with his own work for the day, and his men were coming in from the various parts of the community where they had been engaged in their work. I was there to hear their reports, to talk to them about their problems and listen in on his discussions with his employees. I stayed one half-hour and before I left we had arranged that I was to stop in at least two half-hours a week, preferably Tuesdays and Fridays, and he would make it a point to be available at that time.

Then he pressed me to tell him what it would cost. Once again I did not know what to say. I had been expecting the question but was not at all prepared to give him an answer. Who could, under such circumstances? He was all but broke and the future anything but bright. The whole situation was such a challenge to me that I finally said, "Just send me a check for ten dollars every week till further notice and we will see what develops." The next day I chided myself for having let my sentiments run away with my better judgment. Ten dollars a week! Was I soft in the head?

During the ensuing weeks I talked to almost every person in his organization, both in John's presence and privately. I discovered the bookkeeper was sympathetic to the program and consequently I was able to get together quite a file of needed data which the

bookkeeper prepared for me on his own time. During each visit I would give him a list of the information needed and he would have it ready for me by the next time I was there.

As time passed a pattern gradually began to emerge. John was an expert in his field. There was no question about that. But he was not a leader. He would not take command, and would rather do a job himself than order someone else to do it.

In addition to this he did not like to make decisions, and any matter which required a decision he would postpone as long as he possibly could. His desk was piled high with invoices requiring his approval before they could finally be sent out. A long overdue raise in his rates had not been made simply because he could not decide how much of an increase he should make. I made the amazing discovery that he was the lowest paid man in the organization, drawing even less pay than the bookkeeper. When I asked him about this he said he felt the unsuccessful operation of the business was his responsibility, and if he could not do any better than he had been doing he did not deserve to be paid more.

At the end of seven weeks I felt that I had enough information to discuss the situation with John. I hated to do this, but I could see no other way. I did some putting off myself before I finally screwed up my courage to the point of having it out with him.

I decided to get the worst part over first so I discussed with him his inadequacies as an executive and a leader for his men. I went over instance after instance where his company had lost money or stood to lose money because he would not give definite orders nor would he take his men to task when he found them doing careless or inferior work.

Much to my surprise John somewhere found the courage to be more firm with his workmen. I would never have predicted that he would change in this respect, but he did.

Next we discussed his reluctance to make decisions. I went over his pricing schedule with him and helped him work out what would appear to be an equitable set of rates which he was to put into effect immediately. He did, but his bookkeeper told me later that he stayed in his office all day after bills were mailed, expecting a deluge of complaints from his customers. When no one complained he could hardly believe it.

Little by little his business began to improve and in 1956 he made a nice profit.

About two weeks after our last conference he stopped in at my

office and said he wanted to settle his account. He continued to send me ten dollars a week until it was paid.

I have had clients who engaged my services in the management field before this experience and since, but I never had one which showed as little promise at the beginning and gave as satisfactory results at the end and involved such modest fees. When I finally closed out the account I discovered that I had earned a very satisfactory hourly rate after all.

Extending CPA Services to Management— A Case Study

The problem described below demonstrates how the CPA's well-known fact-finding skills, coupled with a reputation for integrity and the ability to organize unusual engagements, are just as applicable to nondollar data as to the more customary dollar-fact situations.

Problem:

A CPA firm was advised by an attorney that a large national corporation had a labor problem which involved fact-finding and, in his opinion, the fact-finding in this particular case could be done as objectively by a CPA as anyone he could think of.

The company had for years recognized a so-called independent union, and a national union maintained that such independent union was company fostered, thus constituting a violation of the labor statutes. A hearing before an examiner for the Labor Board resulted in the finding that the company should desist from supporting the independent union and that the bargaining unit in certain of its plants, involving thousands of employees, should follow a pattern defined by the Labor Board. This included, in substance, all but supervisory employees. The national union and the independent union were both maintaining that they represented the bargaining unit as defined. The company's problem was to decide which of the two unions it should recognize and deal with. The question put to the CPA firm was to determine, on the evidence available, which of the two unions appeared to have the preponderance of membership in the bargaining unit.

Procedures:

The assignment, by its nature, required complete secrecy and independence from the company. The company agreed to make available to the CPAs its employment records, including the original

cards which showed employees' signatures at the time of entering the company's employ. To begin, it was assumed that the independent union might have the preponderance. The secretary of that union turned over all applications in his possession, each of which bore a purported signature of the employee. The CPAs also obtained an affidavit from the clerk of the union as to all resignations up to the date of the examination.

The CPAs were assigned space in part of the company's plant to which only their own staff had access, and it was agreed that in the event of any discussion with the company, a union representative could be present. Extreme care had to be exercised not to disclose to the company the union affiliation of the employees, and not to disclose to the union information concerning those who might not be members of it. A careful comparison was made of the signatures of the purported union applications with the signatures on the company's original employment cards.

In all cases in which there was the slightest question, the union applications were set aside for further identification. Frequently employees had changed their names so that the name on the union application was an abbreviation of a name which was originally longer. These, however, were held for further identification and were not included in the count. The union applications as to which there were no questions were then sorted according to their classification within the bargaining unit.

A tabulation was then made showing the total number of employees within each component of the bargaining unit, the number of members of the independent union included in the bargaining unit, and the aggregate number of employees.

Conclusion:

It appeared that approximately 75 per cent of the employees within the bargaining unit were members of the independent union. The CPAs reported to the management, setting forth the scope and nature of their examination and the results of their findings. They had had to be most careful that the company had no means of learning from the information in their possession who the members of the independent union were—they could not even leave reference or check marks on company records which might be susceptible of interpretation.

The report was then referred to an independent firm of attorneys for advice as to whether or not it formed a proper basis for the company's recognition of the independent union as a bargaining

unit. The CPAs were questioned exhaustively by this firm of attorneys, who rendered an opinion that the company would be justified in recognizing the independent union.

The CPAs' work was performed under extreme pressure over a weekend, so that they would attract a minimum of attention.

REPORTS TO CLIENTS

A Checklist for the First Auditing Engagement

What is an audit?

More, certainly, than a mere verification of financial transactions. The auditor conceives of it as more in the nature of a filtering process. That is, a company causes its business affairs and procedures to pass through a mesh, the mesh being composed of the judgment and intelligence and experience of a team of astute minds. An audit is good in proportion to the thoroughness of the coverage and the quality of the mind or minds through which the information passes.

Writing in the December 1954 issue of the *New York Certified Public Accountant*, William P. Stowe emphasizes that auditing can never be reduced to a mechanical or routine procedure, that the auditor's judgment will continue to be his principal tool. He rounds up particular points not to be overlooked on the first engagement.

The following "brief" is based upon the points developed in his article:

First, Define the Engagement

- I. The services of the CPA, not his reputation, are for sale. Therefore he must ask himself:

- A. Is the client desirable?
 1. Who referred the client?
 2. Client's reason for changing auditors?
 3. Nature of client's business?
 4. Client's financial, business and moral reputation?
(Sources of this information might include: Dun and Bradstreet reports, bank officials, etc.)
- II. Purpose of the examination must be spelled out:
 - A. Routine annual engagement, or
 - B. Special-purpose examination?
 1. Dispute or difference of opinion involved?
 2. Unusual tax situation?
 3. Etc.
- III. The fee arrangement should be clear:
 - A. Per diem rates normally suggested by auditor.
 - B. Exact cost often insisted upon by client.
 - C. The sound compromise: per diem rates, with total fee not to exceed a named maximum.
- IV. Ascertain the report deadline.

Second, Pre-Audit the Audit

- I. Study client's prior audit reports, with special attention to the latest year and to qualifications or exceptions.
- II. Probe the client's accounting methods and system of internal control:
 - A. Diagram normal flow of transactions.
 - B. List records kept and describe nature of each.
 - C. Learn organizational structure:
 1. Review organization chart.
 2. List duties of key employees.
 - D. What are the accounting principles and policies?
 1. Determination of income.
 2. Degree of cash-accrual hybridization?
 3. Basis of stating investments, inventories, fixed assets.
 4. Depreciation policies.
 5. Accounting and reporting cycles. (Are they "natural?")
- III. Program the work.
 - A. Test the assumptions and tentative conclusions derived from I and II above.
 - B. In light of the pre-auditing performed, set up:
 1. Tentative time scheduling for entire engagement.

2. Dates for inventory-taking.
3. Dates when records will be closed:
 - (a) Normal closing for last month of year.
 - (b) "Thirteenth month" closing, i.e., year-end adjustments.
4. Dates when records will become available to auditors.
5. List of schedules to be prepared in part by client's staff.

Third, Accent the Foundational Accounts

- I. Regardless of previous audits, thoroughly satisfy yourself as to the client's past history and background. Minimal requirements include:
 - A. Inspect the entity's documents of origin:
 1. Charter or articles of incorporation with subsequent amendments, or
 2. Partnership agreement and all other pertinent documents.
 - B. Review all recorded minutes, not overlooking those of management committees.
- II. Analyze the capital and surplus accounts back to their inception. Your analysis should reveal reorganizations, recapitalizations, write-ups or write-downs of assets, and the like.
- III. Give special attention to:
 - A. The opening inventory, which may require the opinion on the operating statement to be qualified.
 - B. Real estate, which requires review of deeds, leases, mortgages.
 - C. Fixed assets, which calls for a summarization of existing assets by years of acquisition and a thorough familiarization with practices affecting DAD (depreciation, amortization, and depletion).

Technique in the Production Of an Audit Report

Many a CPA is convinced that a quality report is his best goodwill emissary and often his only contact with a great many people in the business world. For this reason, he makes a continuing effort to produce as fine a job of reporting as possible, presented in a format of highly professional appearance.

Many of the steps involved in the production of a report may seem

almost too obvious to mention, but one cannot pay too much attention to detail. Although every firm must develop procedures most suited to its own needs, a detailed recital of the steps taken in one individual firm may be helpful to others. Any system is necessarily imperfect, but some benefit can be gained from the discussion.

It is helpful to trace the various steps in procedure on a report after an administrative officer has subjected it to a complete review and forwarded it to the report department.

Registering Report. The head of the report department maintains the record of a report on a register that shows the date received, name of client, and due date. In addition, the register contains information from an instruction-and-progress sheet required to be turned in on all work to be reproduced. It contains instructions for completion and delivery of the attached work—the client's name, period covered by report, accountant and assistants responsible for work, date released for typing, date to be delivered, and special remarks, initials of those who work on report, and the date on which the report is actually delivered.

Statistical Check. In the beginning footing of a report, all figures are added down for both the current and previous years. Increase and decrease figures are checked down and checked across only in final total.

All computations of percentages are checked for the current year and footed. Computations for the previous year are not recomputed but referenced to the last year's report unless there were some changes made in between.

Working capital ratio, book value per share of common stock outstanding, and all other statistics in the context are also recomputed.

Beginning Referencing. An over-all glance at the report is made when received by the referencer to see if all footings, computations, etc., have been completed. The name of the client is confirmed, and the fact established that the business is operating as a corporation, partnership, or sole proprietorship. This is the first step in referencing because of the continued usage throughout the report and the varied terminology applied to each.

The closing date, the period of time covered by the audit, and the date of the report letter are verified. The name and address of the person to whom the report is to be delivered are checked.

The index and listing of exhibits are checked next. The wording in the index, of course, should agree exactly with that on each exhibit.

The history section of the report is read carefully with special attention given to the chronology and completeness. It is best to compare it with the history in the previous audit report and verify only transactions of the current period.

Next, all figures are checked. Supporting exhibits are checked first because any errors there would ultimately affect the principal exhibits, as well as the text, thereby causing unnecessary work.

If the report is on a comparative basis, the prior year's figures are checked to the preceding report. If any differences are found due to reclassification, they are reconciled. The beginning inventory is closely checked, not only to the comparative income statement, but to the closing inventory as shown on the prior year's balance sheet. Beginning cost and accumulated depreciation of fixed assets are checked to the preceding year.

The complete text is then read. The referencer must always be alert in checking spelling, punctuation, construction of sentences, and the consistency in names and terminology. All minor irregularities important to the typist are noted by the referencer and placed on the instruction sheet.

The report and progress sheet are now turned over to the head of the typing department. She notes it on her records, checking the due date.

The report is usually typed in two sections—the comments and the exhibits. This allows two girls to work on the report at the same time.

When an exhibit or schedule is too large to be typed on the standard (9 $\frac{1}{2}$ " by 11 $\frac{1}{2}$ ") paper used for audit reports, it may be typed on an elite typewriter, preferably one which types 14 spaces to the inch horizontally and 8 spaces vertically. (The ordinary elite machine allows only twelve spaces and 6 spaces respectively.)

Exhibits or schedules which are too large for either machine have to be reduced photographically. The typist must prepare a sheet large enough for typing the exhibit, but the width and length of the sheet must be in proportion to the size of the regular audit paper. A line is ruled around the sheet leaving a margin on all sides to match the margin on the other sheets of the report. The exhibit is then typed on a regular machine. After the usual footing, reading, referencing, and checking, it is sent to a company which produces

a negative of the page, reducing it to the size of the report paper. A plate is burned from the negative.

Post-Typing Review. The carbon copy of the typed mats is returned to the statistical clerk so that all footings can be checked. All errors are marked for correction.

The copy is then proofread by two girls other than the typist or beginning referencer. The girl watching the copy must not only notice any typographical, punctuation, grammatical, or spelling errors, but must also challenge anything that does not sound right. The corrections or questions are then discussed with the beginning referencer. When the typist returns the corrected material to the referencer, she checks the corrections to make certain all of them have been made neatly and accurately.

While the report is being proofread, the mats are being ruled. Because a typewriter prints jagged lines, they should be drawn in by hand with ruling ink and an ordinary ruling pen.

After the report has been typed, proofread, and corrected, a final referencer—one who has not worked on the report before—checks it for meaning, continuity, sentence structure, spelling, and setup. He also makes sure that the figures in the comments agree with those in the statements themselves. Any errors are corrected; the corrections are checked; and the report is ready for the operator.

Duplicating Machine Operator. The operator is trained to expect perfect copies from his machine. (The firm whose procedures are outlined here uses a Multigraph Duplicator.) Some of the problems are: getting uniform inking on all sheets, correcting imperfections in typing (such as fuzziness caused by splattering of carbon ribbon), and adjusting the ink low enough to avoid leaving fine black specks on the background of the finished copy. If the typewriter embosses the mat, the operator tries various methods of correcting this imperfection.

As soon as he achieves a perfect copy, the operator runs off the necessary number of copies for the client plus two for the office. One copy is also run off on work paper to be used as a guide for the next year's report.

High grade paper, cover stock, and supplies are used. The report is printed on 100 per cent rag bond paper. The paper is cut 9 $\frac{1}{2}$ " by 11 $\frac{3}{4}$ ", grain long, and punched on the long side with a standard three-hole punch. One hundred per cent rag bond paper is chosen because of its quality, durability, and permanency. It is hoped that

the paper will do its part in reflecting the high caliber of the report; that it will remain in good condition over a period of years; and that it will be sufficiently durable to withstand much handling.

Assembly. The report is bound in a dark blue leatherette binder, which resembles real leather but is much more suitable for this purpose. The front cover has a cut-out window through which the client's name shows, adding interest to the binder and avoiding the necessity of special stamping. A transparent sheet of cellulose acetate, a clear and durable sheet which should not be confused with glassene, covers the inside of the window and protects the top page of the report. The report and transparent sheet are held in the binder by three metal paper fasteners. Firm name is stamped in gold on the lower right-hand corner of the cover. After the combined report is stapled together, it is checked to make certain that all sheets are included in the proper order.

A stenographer transmits the report to the client as per the instructions on the instruction-and-progress sheet, and the office copies are filed in the client's binder.

Reporting to Management On Internal Control

The inexperienced may do more harm than good in his reports on internal control tests. By emphasizing the unimportant along with the important, he may negate the effect of the recommendations made. Any report to management should include three basic parts: the deficiencies found, the possibilities of fraud or error, and corrective measures recommended.

In considering methods of reporting to management on internal control, care must be taken to pick the one most apt to meet with management response and the one most suited for the type of shortcoming to be discussed. Reports may be oral in the case of minor divergences from the required system. For the most part, however, reports should be in written form so that management will have a permanent record of the discrepancies, and so that the certified public accountant will be on record as having called the discrepancies to the attention of management.

The reporting should be concise, accurate and, above all, the remedy suggested should be practicable both from the standpoint of operation and of additional cost in relation to the risk involved.

The pointing out of a discrepancy between the system in operation and the system as prescribed carries little weight with management unless at the same time the risks inherent in such discrepancy are disclosed and a suitable remedy is recommended. Reporting should always have a positive approach; i.e., what is wrong, what are the possible results, how can the wrong be righted. Following is a hypothetical example of how *not* to submit a letter on internal control to management:

During the course of our examination, the following matters which came to our attention are, we believe, worthy of your consideration.

1. Petty cash fund (\$25 in amount) left unattended during lunch period.
2. Receipts from gum machine are not removed in the presence of a second person.
3. The cashier maintains the accounts receivable ledger and the sales journal.
4. Receiving reports are not prepared when material is received and payment of invoices is made without any check as to the actual receipt of merchandise covered by the invoice.
5. The stamp fund was short \$2 at the time of our cash count.
6. In our review of payroll and personnel records it was noted that the cashier had not taken a vacation in seven years.

It can readily be seen that this letter is the work of an "eager beaver." This is an excellent example of trying to cover too much ground. Items one, two and five could well have been omitted from this letter. By their presence they tend to belittle the serious defects in the system as outlined in items three, four and six. While the letter points out certain discrepancies, its approach is definitely a negative one. No explanation is given of the possible risks involved in items three and six, and the risk involved in item four is shown only by inference. It would be no surprise if management failed to act on a letter of this type. An explanation of the risk involved in each item and a recommendation as to its correction would strengthen the letter.

Poor Reports: A Major Source Of Claims Against Accountants

Good professional reports are potent reputation builders.

Poor reports, on the other hand, are prolific troublemakers. An

interesting bill of particulars on this score is contained in the recent sales literature of one of the leading underwriters of accountants' liability insurance. The company mentions twenty-six common reasons for liability claims against accountants. When the overlapping items are eliminated, they shake down to the seventeen classified items shown below:

- A. Failure, in the course of audits, to:
 - 1. Make a close check of bank deposits
 - 2. Check all client's bank balances
 - 3. Make proper check of branch-office statements
 - 4. Perform work in a diligent manner
- B. Failure of income-tax reports to show:
 - 5. Correct income tax
 - 6. Correct address of taxpayer
 - 7. Official's salary
- C. Failure of accountants' report to show:
 - 8. Shortages of employees
 - 9. Thefts of employees
 - 10. Dishonesty of client's officers
 - 11. Shortages in municipal tax collections
 - 12. False warehouse inventories
 - 13. All the pertinent facts of the situation
- D. Defects in report contents, causing:
 - 14. Damage to reputation of client's employees
 - 15. Improper extension of credit
 - 16. Hurting of public official's reputation
 - 17. Losses from misplaced reliance on reports

Four items in the table spring from auditing negligence. Three arise from tax-return errors of omission or commission. And ten of the seventeen originate either from outright report deficiencies or from apparent loose presentation of report findings.

Action Signals in Monthly Reports

"Whenever you fellows see something that ought to have my attention as manager, I want you to place a red asterisk next to that item in the regular financial statements you prepare for me."

Those were the instructions given by one manager to his accountant and in a short time the manager's operations were humming.

Standardizing Reports With a Report Form Kit

Over a period of several years, a firm undertook to develop a manual called the "Standard Report Form Kit." Its purpose is to standardize report and statement presentation.

The advantages of standardizing are well known:

1. Time is saved in report-writing.
2. Typists save time by becoming familiar with standard forms.
3. Reports develop a style which is like a firm trade-mark to bankers and others.

Years ago, the firm followed the client's "last report" when writing the current one so that changes were infrequent and improvements in the presentation of one report failed to be carried over to a similar report for another client unless the reviewer or the auditor happened to remember the change. Even when the reviewer knew of improvements which could be made, he was reluctant to tear apart a completed report just to improve the form.

When a special situation required a special report, memories were searched in an attempt to remember on what job the same situation had come up before. A lot of time was wasted in fruitless hunting in order to avoid having to invent a new form or to devise a special presentation.

Occasionally a partner spent considerable time developing new ideas on an important client's report. For the next year or so report writers would be referred to the "XYZ Company" report. This proved unsatisfactory because the XYZ Company had different problems of presentation. After awhile, the file copies of the reports became dog-eared and finally lost.

Several years ago the firm decided to make a general revision of audit reports and, at the same time, in order to preserve the improvements and make way for future improvements, they conceived the "Standard Report Form Kit." This is the way it works:

1. They did not want to spend the time or incur the expense of setting up a complete report manual of "XYZ Companies" as the national firms do, so they decided to use copies of existing reports and limit the use of these "kits" to the office premises.
2. They set up a loose-leaf binder for each partner, senior staff member and one for the typing department. This amounted to seven binders.

3. They selected as the first model a long-form audit report for a client whose fiscal year ended on September 30. The purpose of this selection was twofold—first, because it was a large and complex report; and second, because this would serve as a model for December 31 closings coming up.
4. All partners and senior staff members were called upon to suggest changes and improvements in audit reports. When the draft of the report of this client was prepared the suggestions were incorporated in it.
5. When the report was typed, an extra seven copies were made and inserted in the loose-leaf binder marked “Standard Report Form Kit.” These were distributed to those mentioned above with a memo calling attention to improvements and changes made.
6. With this as a nucleus, the kit was launched and subsequent reports began to conform. The reviewer was instructed to be on the lookout for other representative or special reports and to mark them for inclusion in the kit by preparing an extra seven copies. He was required to write a memo with each one calling attention to the special problems.
7. It is the firm’s policy to review and replace these forms as additional changes are made.
8. The typing department copy is marked with notations covering spacing, indentation, centering, underlining, etc., which have speeded up this process and improved the quality at the same time. This makes it easier to train new typists, too.
9. There is much less discussion of report-writing problems among the staff since they now have a definitive source of information which reflects the firm policy and procedure.

After three years of operation, the kit contains four sections with various types of reports as follows:

1. Long-form audit reports:
 - a. Corporation
 - b. Corporation with two wholly owned subsidiaries
 - c. Limited partnership
 - d. Nonprofit corporation
2. Interim reports
Samples of monthly, quarterly and semiannual reports
3. Special reports
Reports on reorganizations, specific industries, etc.

4. Certificate forms

Examples of short-form reports with various exceptions, qualified opinions, etc.

Since adoption of the "Standard Report Form Kit," the job of report preparation and review in this firm has been considerably lightened, and clients, bankers and even fellow accountants constantly remark on the high standards and consistent high quality of the reports.

The Application and Advantages Of "Whole-Dollar Accounting"

Whole-dollar accounting has been defined as "a technique applied to general accounting procedures through which the last two digits of dollar and cents amounts are eliminated and amounts are recorded in whole dollars." It has also been known as centless, pennyless bookkeeping, or cents elimination.

The major advantages of whole-dollar accounting are as follows:

1. The average figure consists of five figures. It is easy to see that eliminating the last two penny digits will cut all work dealing with these figures by forty per cent.
2. Errors occur most frequently in pennies when posting, tabulating, typing or checking. By eliminating pennies, errors are easier to locate and the figures are easier to handle.
3. An important saving is made in report space. A multicolumn schedule becomes less crowded and, in some cases, smaller-sized paper can be used.
4. Easier reading of reports is obtained by eliminating pennies.

An application of whole-dollar accounting is being made by some firms in connection with monthly and interim financial statements. A number of smaller clients, for whom these accountants do work on a monthly or quarterly basis, receive condensed operating data on forms which are purchased from a national system form company. Through the application of whole-dollar accounting, the time saved in the preparation, typing and checking of these reports makes it possible to service these accounts profitably. The client in turn is highly pleased with an operating statement that he can easily read, interpret and compare with prior periods.

Figure I

**Statement of Operational Accountability to Financial Position
1957-1958**

POSITION 1957

Assets

| | | |
|---------------------|--------------------|--|
| Current | \$10,000.00 | |
| Fixed (Net) | 20,000.00 | |
| Other | 5,000.00 | |
| Total Assets | \$35,000.00 | |

Liabilities

| | | |
|--------------------------|------------------|--|
| Current | 6,000.00 | |
| Long Term | 14,000.00 | |
| Deferred Credits | 1,000.00 | |
| Total Liabilities | 21,000.00 | |

| | |
|---------------------|-------------|
| Capital End of 1957 | \$14,000.00 |
|---------------------|-------------|

Operations 1958

| | |
|------------------------------|------------------|
| Sales Net | 60,000.00 |
| Cost of Goods Sold | 38,000.00 |
| Gross Profit on Sales | 22,000.00 |
| Operating Expenses | 13,000.00 |

| | |
|-----------------|-----------------|
| Net Profit 1958 | <u>9,000.00</u> |
|-----------------|-----------------|

POSITION 1958

| | |
|---------------------|-----------|
| Capital End of 1958 | 23,000.00 |
|---------------------|-----------|

Liabilities

| | | |
|--------------------------|------------------|--|
| Current | 11,000.00 | |
| Long Term | 18,000.00 | |
| Deferred Credits | — | |
| Total Liabilities | 29,000.00 | |

| | |
|----------------------------|-------------------------|
| Assets to Be Accounted For | <u><u>52,000.00</u></u> |
|----------------------------|-------------------------|

Assets

| | | |
|-----------------------------------|------------------|--|
| Current | 25,000.00 | |
| Fixed | 18,000.00 | |
| Other | 9,000.00 | |
| Total Assets Accounted For | 52,000.00 | |

The Answer to The Client's Question

"But where did my money go, and where is the profit I made?"

Many accountants have been confronted with this question by clients whose earned funds have apparently vanished. They can be provided with a source of funds and application statement, but many clients find it difficult to wade through. They can find answers quickly and easily in the very simple statement shown opposite. Its creator, a practicing CPA, refers to it as "operational accountability of financial position."

This statement is an excellent example of how accountants throughout the country present financial data to their clients in unusual and effective ways.

Comparative Balance Sheets And Analysis of Changes

Simplified financial statements are used increasingly to get across to the layman many of the important points in financial statements. They need to know and understand the advantageous and disadvantageous changes in their balance sheets.

A small practitioner, whose clientele is composed almost exclusively of small businesses owned or controlled by individuals, faced this problem frequently. He reports struggling mightily in an effort to find a statement which *really* answers the question about where the money went to the inquirer's entire satisfaction.

When he became familiar with the sources and application of funds statement several years ago, he thought he had at last found a statement which would show clients in graphic form the disposition of the net income shown in the financial statements. However, he found the clients unable, or unwilling, to decipher the funds statement. It seemed that instead of accomplishing his purpose he had increased the confusion in the clients' minds. He was certain that the approach lay somewhere in the realm of differences between successive balance-sheet figures. He tried various modifications and arrangements of funds statements, always striving toward simplicity of form and terminology, but all met the same fate; none erased the doubtful frowns from the clients' faces!

He has one client in particular whose small manufacturing busi-

Figure II
Comparative Balance Sheets and Analysis of Changes
December 31, 1957 and December 31, 1958

| | <u>1957</u> | <u>1958</u> | <i>Increase (or Decrease)</i> |
|--|------------------|------------------|-----------------------------------|
| Cash | \$ 9,000 | \$ 6,000 | (\$ 3,000) |
| Accounts receivable | 40,000 | 63,000 | 23,000 |
| Inventories | 50,000 | 51,000 | 1,000 |
| Land and buildings | 46,000 | 48,000 | 2,000 |
| Machinery | 45,000 | 50,000 | 5,000 |
| Office equipment | 3,000 | 5,000 | 2,000 |
| Trucks | 6,000 | 6,000 | — |
| Withheld by bank on installment contracts | 13,000 | 15,000 | 2,000 |
| Prepaid expenses | 500 | 1,000 | 500 |
| | <u>\$212,500</u> | <u>\$245,000</u> | <u>\$32,500</u> |
| <i>Less—depreciation reserves</i> | 30,000 | 33,000 | 3,000 |
| <u>Total Assets</u> | <u>\$182,500</u> | <u>\$212,000</u> | <u>\$29,500</u> |
| Notes payable | \$ — | \$ 2,500 | \$ 2,500 |
| Accounts payable | 35,000 | 30,000 | (5,000) |
| Accrued expenses | 2,000 | 3,000 | 1,000 |
| S. B. A. loan | 48,000 | 44,000 | (4,000) |
| Net worth | 97,500 | 132,500 | 35,000 |
| <u>Total Liabilities</u> | <u>\$182,500</u> | <u>\$212,000</u> | <u>\$29,500</u> |
| <u><i>Advantageous Changes</i></u> | | | |
| Increase of accounts receivable | | \$ 23,000 | |
| " " inventories | | 1,000 | |
| " " land and buildings | | 2,000 | |
| " " machinery | | 5,000 | |
| " " office equipment | | 2,000 | |
| " " bank withholdings | | 2,000 | |
| " " prepaid expenses | | 500 | |
| Decrease of accounts payable | | 5,000 | |
| " " S. B. A. loan | | 4,000 | |
| <u>Total Advantageous Changes</u> | | <u>\$ 44,500</u> | |
| <u><i>Add—Personal drawings</i></u> | | | |
| Income taxes paid | \$ 8,000 | | |
| | 14,000 | 22,000 | \$66,500 |
| <u><i>Disadvantageous Changes</i></u> | | | |
| Decrease of cash | | \$ 3,000 | |
| Increase of depreciation reserves | | 3,000 | |
| " " notes payable | | 2,500 | |
| " " accrued expenses | | 1,000 | 9,500 |
| <u>Difference—Net profit as shown on Profit and Loss Statement</u> | | | <u>\$57,000</u> |

ness is expanding rapidly and who, consequently, needs two dollars of profit to reinvest in plant and equipment for each one that he actually makes. The cash balance is always low, accounts payable occasionally become past due, and it is always a tremendous task to find the money to pay the income taxes. Naturally he was the one who was always most dubious about the accuracy of the profit and loss statement and who looked with most disfavor upon the attempts made to *show* what became of the profit the statements said he was making.

His accountant believed that if he could ever devise a statement that would satisfy this client, he would have a form which would be infallible in answering the question, "if I made that much money, what became of it?" Finally he did devise such a form (see Figure II on preceding page). It may not be perfect from the viewpoint of a technically trained professional accountant, but since it underwent the acid test of scrutiny by a most doubtful client, it is offered in an effort to help other accountants who may be faced with such a problem.

HANDLING TAX RETURNS AND REPORTS

Scheduling Tax Return Preparation

The problems of handling numerous tax returns and scheduling the workload face the certified public accountant each year. One office attempted to forestall the last-minute rush, with considerable success and with some accompanying benefits which had not been foreseen.

Probably every practitioner is familiar with a lull in the tax season followed by the frantic calls as the deadline approaches. This phenomenon is followed by appointments with clients who have forgotten to bring essential information with them. All of this results in lost motion, wasted time, work under pressure, and occasional errors which are difficult to explain away.

One recent year, after their annual frenzy was over, the partners wondered why some people had not called for an annual visit. They were surprised to discover that even people who are willing to pay a reasonable fee for service seemed to have a feeling that they were imposing on a CPA when seeking his advice and assistance.

As an experiment, the firm sent out postcards one year to everyone for whom they had prepared a return the prior year, suggest-

ing a date and time when they would be pleased to assist with tax returns. They were completely dumbfounded when people appeared at the appointed hour exhibiting their postcards and explaining to the secretary that they had appointments.

The experiment was so successful that the following year the firm sent individually typed letters with even better results. Clients were much more impressed by the personal letter and showed them with some pride to their friends which resulted in additional referrals. They seemed to take great delight in being able to say, "My accountant automatically sets up an appointment each year and reminds me of it."

A sample letter is appended. It is designed to cover several things. First, this firm feels the client should be aware that his patronage is remembered and appreciated. Any notion that he is imposing should be dispelled; he should be impressed that the firm values his account. (Of course, the letters are sent *only* to those clients served by the firm the previous year.)

A second point which is important is the suggestion that if his affairs are materially different from the prior year it might be well to call for instructions as to what data will be needed. This has proved a timesaver because invariably he will get out his last year's return and refresh his mind as to what he should bring in. If something is different, he will call and the groundwork can be laid to avoid last-minute scurrying.

It is important to suggest to the client that he may call and set an alternate time if he wishes. A secretary maintains a list of open time and is prepared to shift the schedule as needed. Surprisingly, there are comparatively few changes since the partners give some thought to the known habits of each client and attempt to set times which will be convenient to him. Also, they attempt to allow sufficient time to consider his case when he arrives.

SAMPLE LETTER

October 7, 1958

Mr. John Doe
2156 Montreal St.
Toledo, Ohio

Dear Mr. Doe:

In reviewing our work for the forthcoming federal income tax filing season, we are endeavoring to plan our work sched-

ule so that we can serve our clients in the most efficient manner possible. In order to give your tax returns proper attention without undue time pressure, we have taken the liberty of blocking out some time to confer with you.

We appreciated the opportunity to serve you last year and sincerely hope that we may do so again this year. To serve you if you are planning to call on us, we have set aside conference time for you on (date). We would suggest about (time) if this is convenient.

If either the date or the time is inconvenient, please call our secretary who will be pleased to suggest alternate times.

If you have had problems this year which are materially different from those of last year it might be well to call us so that we can outline the data that will be required to complete your return.

We are looking forward to the pleasure of serving you again.

Very truly yours,
Harris, Perry and Co.
By

In actual practice the partners block out Saturdays and times during the week when they will be available. The clients' files are out when they arrive and usually a staff man is available to confer with the client and assemble the essential data. When a partner finally sits down with the client most of the detail work is done, and the return can be discussed in a short period of time.

The firm installed a copying machine as an experiment. When a client asked when his return would be ready, he was told that it could be ready in a few minutes if he would accept photocopies. If he preferred it typed, it might take several days. Every single client asked for photocopies, expressing appreciation for our efficiency in the use of the copy machine and in the reminder letters. The relief from typing and proofreading was tremendous.

Often the question is debated as to whether or not a CPA can afford to take on a great amount of individual tax return preparation. Probably there is no conclusive answer to the question. The partners in this firm feel that they cannot refuse to do it with impunity. They are convinced that it can be handled efficiently and profitably, in a manner which brings goodwill and highly desirable referrals.

And finally, the staff puts in less night work.

Planning Work Ahead May Eliminate Overtime

The pride that so many practitioners had in working themselves to death no longer seems to be a desirable attitude. Planning that can be done before the busy tax season can aid considerably in cutting down the overtime one would normally have to put in without such planning.

In one office the Bruning machine is used for the tax returns and the schedule forms. The only typing that appears on the return is the name, address and social security number—everything else is written with pencil and the Bruning machine does an excellent job of reproduction.

The CPA makes an effort to keep in touch with tax clients during the year. He keeps a running inventory of their securities (their brokers send him duplicates of the purchase and sales confirmations). They mail him the escrow papers when a real estate transaction has been closed, and usually inform him of other transactions which affect their current year's taxable income. Even with clients who do not maintain contact on a monthly basis, he is usually brought up to date on tax problems and data when the question comes up every three months as to whether or not to amend their declaration.

Before January 1 rolls around, he has the following information with regard to the majority of tax clients: (1) a manila file with client's name, address, type of return and year involved; (2) office job sheet; (3) all of the tax forms which will be involved as well as the schedules which will be attached to the returns (a great many of the latter being complete in every respect). Furthermore, he has usually prepared and mailed several dozen returns to clients prior to January 1.

It has been the experience of this practitioner that most of the errors creeping out of an office during the tax season are due to exhaustion on the part of the person preparing the return rather than to ignorance of the law or carelessness. Practitioners owe it to their clients to plan ahead so that the overtime can be eliminated or at least be kept to a minimum.

Individual Questionnaire For Tax Returns

“The best memory is a pencil and paper.”

How many times have CPAs had to do a tax return over again because the client forgot to give complete information?

The questionnaire shown opposite is a good reminder for the client and a handy check list for the accountant. It is sent in advance to the client, and reminds him of data he needs for his tax return. In going over the return, the accountant need take only a few minutes to check over the questionnaire; he is quickly reminded of items which may have been overlooked. When every number is checked, he is sure everything is accounted for. Although much of the information is basic, the questionnaire is a timesaver during a period when forgetfulness can waste time—and time is a valuable commodity.

Timesaving Techniques in Preparation of Tax Returns

There are many accountants who use copying and duplicating machines in the preparation of tax returns. There are still many others who do not use any kind of duplicating equipment. Yet, by careful planning, a great deal of overtime can be saved by accounting and typing staffs.

One CPA's procedures, which have resulted in considerable saving of time during the rush period, involve the use of carbonized income tax returns and schedules. The returns and schedules shown in Figure II (page 86), both official and unofficial, are regularly used.

The use of carbonized tax forms is no innovation for they have been available for some time. However, over a period of five years this firm has developed a technique of typing in advance as much information as possible on the unofficial schedules and the official tax returns. A supply of the unofficial forms and schedules is kept on hand at all times, and pretyping on these schedules may be done at any time during the year. The official tax forms usually are available some time in November and the pretyping on these forms may be begun as soon as they are received.

Figure I

INDIVIDUAL INCOME TAX QUESTIONNAIRE

1. Does client qualify as "Head of Household"
2. Does client qualify for retirement income credit
3. Has either spouse died during the past 2 years
4. Has wife separate income, if so:
 - From wages
 - Are W-2's submitted
 - Occupation
 - Other sources—specify
5. Has client filed an estimated declaration
 - Do we have record of payments
 - Are there any credit carry-overs
 - Has original estimate been amended
 - Has full amount of declaration been paid
6. Has client income from wages
 - Are W-2's submitted
7. Has client any excludable "Sick Pay"
8. Business income
9. Farm income
10. Income from dividends
 - Domestic
 - Foreign
 - Insurance Companies
11. Are stocks listed in name of Husband and Wife
12. Interest income
13. Capital gains and losses
14. Gains or losses from sale of other than capital assets
15. Pensions
16. Annuities
17. Income from rental property
18. Income from royalties
19. Partnership income
20. Income from estates and/or trusts
21. Director's fees
22. Commissions received — without W-2 reporting
23. Has client sold his home during the year
24. Have any insurance policies matured or been cancelled
25. Building and loan maturities
26. Have U. S. bonds been redeemed or cashed
27. Were any personal assets sold (auto, etc.)
28. Contributions
29. Interest paid
30. Has a single premium annuity been bought
31. Tax paid
 - Federal Income
 - State Income
 - Real Estate
 - Social Security
 - Auto
 - State Liquor
 - Gasoline
 - Excise
 - State Sales
32. Medical expenses and dental expenses
33. Casualty losses
34. Losses on guaranty of loans
35. Accounting and tax fees paid
36. Investment advisory services costs
37. Travel expenses
 - Local
 - Away from home
38. Automobile expenses
39. Business entertainment
40. Association or business dues
41. Bad debts
42. Convention expenses
43. Alimony or maintenance payments
44. Should separate state returns be filed
45. Is a return necessary for any dependent
46. Discuss next year's declaration

Figure II

 Unofficial Forms

| <i>Five-part schedules (stock items)</i> | <i>Four-part schedules (made to order)</i> |
|--|--|
| Depreciation schedule | Travel schedule |
| Blank schedule | Deduction schedule |
| Rental schedule | |
| Farm schedule | |

Official Forms

| <i>Three-part forms</i> | <i>Five-part forms</i> |
|-------------------------|-------------------------|
| Form 1040 (all 4 pages) | Form 1065 (all 4 pages) |
| Form 1040 ES | |
| Form 1040 Sch. C | |
| Form 1040 Sch. D | |
| Form 1120 (all 4 pages) | |

The pretyping procedure follows this pattern. As soon as practicable after each filing season, each partner reviews the returns prepared during the filing season. From past association with and knowledge of each client, they are able to determine which information may be typed in advance. This information is checked with a red pencil. The office secretary may, at any time during the year, know which forms should be placed in the client's files and what information may be pretyped.

This means that by the beginning of the filing season, much of the work has been done. The method has the following advantages:

1. Although the total work is not decreased, the period during which the work is actually done is greatly extended.
2. It can serve as a training program for the typist. Even though she may not have been employed during the previous tax season, she will become thoroughly familiar with the forms and schedules prior to the tax season.

3. Time of the typist is more fully utilized.
4. When the typist is doing part of her own typing in advance, she is reducing a portion of the accountants' "writing." The firm uses the last copy of each return or schedule which has been pretyped as an office copy. The office copies need to be completed in pencil when the final information is available during the tax season. The typist knows that only the pencil information, which has been added since she pretyped the forms, has to be added to the returns and schedules.

It may be well to consider some of the information which may be typed in advance. On page 1, Form 1040, as an example, the client's name, address, names of dependents, employer, and previous year's information may be typed in advance. If there is a possibility that any of this information may change, it should be omitted. On Form 1040, Schedule C, as another example, in many cases all information except the amount of the current year's earnings may be pretyped. This includes the maximum amount subject to self-employment tax and the amount of the self-employment tax in many instances.

With reference to depreciation schedules, many of the firm's clients have no detailed record of fixed assets owned other than the schedule which accompanies their tax return. For this reason, it has been necessary to prepare detailed depreciation schedules. In many cases, the complete schedules may be pretyped. The firm has experimented with typing in the current year's depreciation. This means that if there are no changes, the schedule is complete prior to the tax season. If there are additions and/or disposals, adjustment can be made following the subtotals which have been typed on the schedule.

On the average, as much as 50 per cent of the information may be typed in advance. This means that this much work will not have to be written by the accountants, typed or checked during the tax season. It may be the difference between hiring additional personnel for a short period or accomplishing the work with regular, well-trained personnel. It goes a long way toward minimizing overtime.

Although variations in procedure probably will be necessary to conform to local conditions, there should be some practical application of this system—or at least some aspects of it—to offices both large and small.

Figure III

P. R. Stewart & Co.
26 Sycamore St.
Wallingford, Conn.

.....
.....
.....
.....

These instructions apply to the enclosed tax return. Please comply with them.

Draw Check to

- () Internal Revenue Service
- () Tax Commissioner
- () Administrator Unemployment Compensation
- ()

To Be Signed on Page ...

- () by taxpayer
- () by any officer or partner
- () by two officers
- ()

Mail to Address Checked

- () Director of Internal Revenue
- () Administrator Unemployment Comp., Hartford
- () State Tax Commissioner, Hartford
- () Secretary of State, Hartford
- ()

Notary's Signature

- () required
- () not required
- () notary's seal required
- ()

Amount of Check

- () Full amount of tax
- () Installment of \$.....
- ()

File Return By

P. R. Stewart, CPA

By

Instruction Sheet for Clients' Tax Returns

Many clients waste valuable office time by calling and asking obvious questions concerning the amount of tax or installment due. They ask to whom the check should be drawn, and to where the return and checks should be mailed. Sometimes they also want to know how many persons must sign the return, and where they should sign.

The form shown (Fig. III), devised by a small practitioner, provides a quick way to handle client queries on most tax returns. Some firms attach a different instruction sheet and form to each type of return, such as federal 1040, 1040ES, 1120, state individual return, etc. A form can be specially designed for every other type of return, for refunds due, and for refunds applied against the next year's estimate.

These preprinted instruction forms may be used by accountants to serve their clients better, and to save their own valuable time during the filing period. The forms save time for typists assembling returns. They merely have to insert the figures in the proper blank spaces.

As an additional service to their clients, many firms include, with the tax forms, envelopes addressed to the taxing authorities. Some firms include an envelope for clients' use in keeping their copies. Other firms provide manila folders in which the tax returns are stapled and ready for filing. It is always a good policy to make it easier for clients to file returns and to pay their taxes. The accountant's job is then a much simpler and more pleasant one.

FEES AND BILLING PRACTICES

Let's Talk Fees

Probably the best and fastest way to learn the fundamentals of fees is to read Chapter 12 of the *CPA Handbook* by T. Dwight Williams. There are 21 pages of distilled information, followed by a 26-item bibliography. Mr. Williams' treatment includes a discussion of nine basic factors in setting fees, namely: (1) staff time devoted to the work; (2) technical importance of the work and the extent of responsibility assumed; (3) value of services to the client; (4) difficulty of the engagement; (5) skill and experience of the principal or firm; (6) special considerations, in the case of a new client; (7) size and character of the community; (8) relation of the engagement to the utilization of the staff; (9) unusual amounts of overhead caused by the engagement. One of the best, if not the best, of book references on fees is *Accountant's Office Manual* by Charles S. Rockey.

So much for background sources. Three accountants of wide experience now present what they think the younger or less experienced practitioners should know about fees. Here are their earnest convictions on various aspects of the problem.

BETTER SERVICE, BETTER FEES

The first correspondent discusses the essential nature of the CPA's work:

"It is not possible to standardize the professional services of the certified public accountant. Neither is it possible wholly to standardize or equalize fees charged by certified public accountants for their services.

"None of us believes that our fees should be uniformly established on a basis comparable to union scales for trades, such as electricians, carpenters, and masons.

"Many of the services of the certified public accountant involve the exercise of judgment in contrast with work of a routine nature. In consequence, the worth of these services can vary according to the judgment and experience of the individual practitioner. The soundness of one's judgment depends on the integrity, independence, and competence of the individual. Also the length and breadth of one's experience have considerable to do in the evaluation of one's services.

"Location and the importance of the service to the client are important factors in the determination of fees. It is probable that costs generally will be higher in a large city than in a small community. Also it is reasonable to expect that some types of services result in more direct benefit to the client than others. For example, services in connection with income tax matters or services that directly increase the profits of the client may justify larger fees than services for the usual auditing work.

"In summary, we can agree that charges for the services of the CPA cannot be standardized by an hourly charge in the same manner that charges are made for services of skilled and unskilled workmen. The time employed is an important consideration, but consideration should be given to other factors such as the nature of the work, the degree of experience required to do the work ably, and the importance of the results to the client, which may, to some extent, be influenced by the domicile or location of the client or of the practitioner.

"It seems that all of these factors are in some manner woven or merged into one determinate, namely, *service*. The CPA who serves best will profit most. If that be true, each of us should concentrate on the improvement and expansion of his services, and fees will then take care of themselves. Whether we are in practice for ourselves, in partnership with others, or in the employ of others, our

fees or our share of the profits or compensation will be measured by the extent to which our services meet the needs of the clients. If our services are superior, our rewards will be comparably greater. If our services are average and routine, we deserve no more than average pay.

“Let us then concentrate on the improvement and expansion of our own services and on raising the standards of practice throughout the country.

“He profits most who serves best.”

KEEPING CLIENTS HAPPY WITH BILLS

The second contributor addresses himself to the perennial question: Can we make clients happy with our fees? He punctuates his views with some pungent illustrations and suggestions.

“It is rare that anyone is happy to receive a bill. In the days just after the first of the month most people would like to file their mail unopened in the waste basket. When services are involved, whether it is the plumber, electrician, dentist or certified public accountant, there is a universal feeling of certainty that the rates charged are outrageous. Usually the only pleasure to be found from the bill is in the topic of conversation it affords. The value of the services received—such as fixing the broken water pipe before all furniture was ruined, adjusting the washing machine that was off-cycle, pulling the tooth that was ‘killing me,’ and even convincing the Internal Revenue Agent who was set to disallow those ‘ordinary and necessary’ expenses—is likely to be entirely overlooked.

“Usually the best we can do for our clients is to ameliorate the situation. That is, we can merely make our clients less unhappy. Only occasionally may we have a rare instance when they actually seem happy with our bills. Practically never are they so pleased that they suggest and pay a higher fee than we had planned to charge.

“How can we improve our ‘billing’ habits to extract adequate fees with little pain? Here are a few suggestions:

“First, we should bill often rather than accumulate our charges until the bill is formidable and frightening. The client forgets what was done for him two or three months ago. Services performed ten months ago are so erased from his mind that he may be sure they never were received. Therefore, a monthly billing, whenever possible, will be the least painful and usually the most productive of adequate fees.

“For example, a recent engagement seemed never to arrive at a good billing point. The job was to supervise and improve the accounting methods for the client. Months passed. Finally, after ten months a bill for \$850 was sent. The client ‘hit the ceiling.’ The bill remained unpaid for three months. The accountant was advised to appear less often. In fact, he wasn’t called for four months.

“In this case, the accountant was at fault. In all probability, if ten monthly bills had been presented instead of one total bill for \$850, \$100 per month would have been paid readily for each of the ten months, and the work would have been appreciated.

“Some accountants have learned to bill monthly *always*. Yes, even on annual audits part of the total fee can be billed each month when interim work is being done.

“Moral: Bill early and often.”

“A second fundamental rule is to talk freely with the client about the bill, particularly when it is larger than had been planned or estimated. Such a conversation must, of course, be interspersed with facts as to why additional time was required, what particular difficulties were encountered, the nature of the unusual services rendered, etc. Some clients may even be asked to suggest the proper fee under the circumstances, with gratifying results. For instance, one accountant asked his client a few years ago if \$2,500 would be an agreeable amount for the engagement. The client replied that he had \$3,000 in mind and would be glad to pay that amount. Since that time this particular client *always* sets the fee!”

PLAIN-TALK EDUCATION OF CLIENTS

Our third contributor believes that in many instances the air can best be cleared and the problem solved by taking the time to talk plainly (but tactfully) to fee-allergic clients. He thinks that, when the occasion is suitable, the accountant’s position might be presented somewhat in this vein:

“As a successful businessman, you have developed the practice of weighing your costs against results obtained. As your adviser, your accountant encourages and assists you in this.

“But when the question of the cost of your accountant’s services is before you, a certain coyness is prone to come into play. Perhaps you shrink from suggesting that which you feel may offend a man whom you value and respect. So this little dissertation is offered to disclose to you that your accountant has some problems too. And with your fair-minded realization of his problems, you can see

better how to use his abilities and facilities in approaching your own problems.

"You want, and your accountant desires that you receive, the greatest relative value in results obtained for every dollar you spend for audit and tax service. Still, you would rather pay \$2 and get \$10 in value than to pay \$1 and get only \$3 in value. But to be able to give you that \$10 in value, your accountant must meet and solve his own problems.

The demand for competent accounting services throughout the country is now far outrunning the supply. The supply has been lagging for the simple reason that for several years capable young men have been attracted to other fields by the better salaries offered. The salaries for young men in the field of public accounting have been held down in relation to other fields by the lack of understanding of the basic relation between accountants' fees and the salaries paid.

"The fact has been well established by studies of costs in many accounting offices, both in this country and in England, that where any use of independent judgment and power of discrimination in accounting matters is required in the service rendered, there is a definite relation between the equivalent annual salary of the accountant and the minimum per-hour fee that must be charged. As an illustration, if his salary is \$4,500 per year, his work of this character must yield \$6.25 per hour in fees.

"If you have a sharp pencil you will compute that \$6.25 per hour on a full-time basis amounts in a year's time to somewhat more than \$4,500. Many factors contribute to this spread, and we will suggest here only a few.

"The first is the cost of stand-by. You are not asked to pay for all of the time of the men needed to handle your accounting and tax service. Nor can any accounting organization, with the best possible management, make full use all year of all the time of all of the men it has available to serve its clients. So one part of your accountant's overhead is necessarily 'unassigned time.'

"The next factor is the accountant's office overhead, including rent, supplies, equipment, technical library and all of the other facilities that help you to get the greatest possible value out of the hours put in directly on your work. If you employed the accountants directly on a salary basis, these costs would be borne by you over and above the salary.

"You are a businessman. You know the many elements in un-

avoidable overhead. But even beyond this there are two other 'invisibles' that make the costs of the accountant still higher.

"One of these arises in myriads of complex specific situations. Under our tax law the tax returns of many individuals and all partnership, corporation and fiduciary returns are definitely complicated. On-the-spot research is usually required before any otherwise capable accountant can handle one. That costs money. And the fee must be correspondingly higher.

"A second common instance is found in those cases whose complications require specialized knowledge. These can be successfully handled only by dint of extra training or intensive study. Such knowledge may be called into play on only relatively few occasions. Estate and inheritance tax returns, and special-purpose investigations, are in this class.

"And finally, just a word about the accountant's attitude toward competition. As in all other business matters, competition must play a big part in your selection of an accountant. But good judgment on your part will lead you to discriminate on the basis of relative *real* results rather than the lowest immediate dollar cost. As a good businessman, you can do no less than just that."

APPRAISING THE SERVICE UNITS

Maintaining a meticulous daily record of the time spent and the nature of the services performed for each client is a tedious proposition. Yet, since the invisibles of time and skill constitute the accountant's stock in trade, it can be stated categorically that neglect or carelessness at this point can be more costly to practitioners than leakage at any other point in the economic cycle. Stated positively, the time spent in painstaking recording of each day's service will consistently yield more monetary return per minute than any other time spent in the office. The unhappy fact is that without a detailed day-to-day record, the elusive and perishable product is, as if by evaporation, literally lost for billing purposes. Here, then, if any place, is where good suggestions might go a long way toward stopping preventable leakage, and where the subject should be presented in such a manner that the small practitioner can visualize it and apply it to his own practice.

Use "Units" Instead of "Hours." Most accounting offices keep track of their time in hours and fractions thereof (usually half-hours or quarter-hours). But the fractions enormously complicate the

time controls. Not only that, when half-hours are the lowest time-spans recognized, there is the perpetual problem of whether or not to put down 5-minute, 10-minute or 20-minute consultations. The adoption of units, with one unit representing a quarter-hour or, regardless of time, the smallest unit of service recognized by the practitioner, will definitely help on both counts, i.e., simplify the office timekeeping, and capture on paper elusive trickles of potential revenue.

Thus if an \$8-per-hour man works $7\frac{1}{2}$ hours on one client only for a day, he records 30 units (@ \$2 = \$60) rather than $7\frac{1}{2}$ hours (@ \$8 = \$60). By the same token, if a principal gives the answer to an important technical question in a 5-minute telephone conversation, he jots down on his time sheet the name of the client, the subject of the call, the one unit, and the charge (perhaps \$5). At the end of a busy $7\frac{1}{2}$ -hour day of consulting, the principal's time sheet thus might show 32 or 36 units instead of 30, and the charges for the several units of service might vary, depending on the decision at the time, from "no charge" to as high as \$10.

Think in Terms of Variable Rates. It is axiomatic that the smaller the practice the wider the range in levels of skill required of any one man in a day's work. It is possible for a sole practitioner, in one 28-unit day, to put out 16 units worth \$3 per unit (writing an important report), 4 units worth \$1.50 per unit (observing a physical inventory), 4 units worth \$1 per unit (machine-checking typed schedules of a report), and 4 units of nonchargeable administrative time. The only fair policy is to charge the client for *what* is done, not *who* does it. Incidentally, this policy of strict fairness rightly places a premium on efficient advance scheduling and sound organizational structure so that the higher the caliber of man the less junior-level work he will perform. From bottom to top in a small practice each member of the entire organization should be encouraged to evaluate realistically the worth of his services. The monotonous charging of the same amount per unit day after day, irrespective of the tasks performed, is destructive to the spirit and bad for the practice. Remember a rate is a *ratio* between *two* things: (1) the *value* of that class of professional service, and (2) the *time* involved in performing it.

Specimen Time Sheet for the Small Office. To illustrate the use of *units* in place of *hours* as well as the practice of using *variable*

Figure 1
Principal

| Office | Middletown | Person | Principal | TIME REPORT, WEEK ENDED 10/8/58 | | | | | | | | |
|---------------------|--|--------|-----------|---------------------------------|-------|------|--------|------|------|------|-------|----|
| NON-CLIENT WORK | | | | Mon. | Tues. | Wed. | Thurs. | Fri. | Sat. | Sun. | Total | |
| Personal | | | | 12 | | 2 | | | | | 14 | |
| AICPA | Practitioners Forum Contribution | | | | 4 | | | | | | 4 | |
| Alma Mater Club | Treasurer's Report | | | | | 3 | | | | | 3 | |
| Travel | To Branch Office | | | 16 | | | | | | | 19 | |
| Administration | Reviewing Timesheets, Billings | | | 4 | 10 | 3 | 2 | 2 | | | 21 | |
| | Totals | | | 32 | 14 | 11 | 2 | 2 | | | 61 | |
| CLIENT | | | | Mon. | Tues. | Wed. | Thurs. | Fri. | Sat. | Sun. | Total | |
| | DESCRIPTIVE DETAIL FOR BILLING PURPOSES | | | U | \$ | U | \$ | U | \$ | U | \$ | U |
| | Conference w/ official re Financial Statements | | | 8 | 28 | 2 | 7 | | | | | |
| | Conference re "Plant" valuation | | | | | 6 | 21 | | | | | |
| | Conference re duplication of records | | | | | | | 6 | 21 | | | |
| Big Company | Regular Financial Report | | | | | | | 6 | 21 | 5 | 17 | |
| | Letter to attorney | | | | 4 | 12 | | | | | | |
| Estate Trust | Insurance analysis | | | | | | 4 | 20 | | | 8 | |
| Eastern Co. | Admin., phone conversation re finances | | | 1 | 5 | 1 | 5 | | | | 2 | |
| Tax Client #1 | Phone conversation re gift tax | | | 1 | 3 | | | | | | 1 | |
| Tax Client #2 | Phone conversation | | | 1 | 3 | | 1 | 3 | | | 2 | |
| Water Co. | | | | | 2 | 6 | 2 | 6 | | | 4 | |
| Land Co. | Phone conversation | | | | | | | | 1 | NC | 1 | |
| Loan Co. | Conference with staff man | | | 1 | 2 | 1 | 3 | 4 | 12 | 4 | 12 | |
| Cotton Gin | Conference with staff man re account | | | 1 | 3 | 1 | 3 | 2 | 6 | | 4 | |
| Profit-Sharing Plan | Conference re amt. of Prem./ Disc. Bonds; Chg. replace to Dep. on Reserve | | | | | 2 | 6 | | 1 | 3 | 3 | |
| Transportation Co. | Rate Case, conference with officials | | | | | 2 | 6 | | 10 | 30 | 12 | |
| Machinery Co. | Re audit of receivables | | | | | 1 | 3 | | | | 1 | |
| Tax Client | Interest on contract problem | | | | | | | | 2 | 6 | 2 | |
| Church | Conference re audits | | | | | | 4 | 8 | | | 4 | |
| | Totals | | | 9 | 33 | 13 | 41 | 19 | 68 | 17 | 50 | 23 |
| | | | | | | | | | | | 68 | 81 |

John Principal
Person Reporting
John Principal
Approval

rates in accordance with the value of the various services, a specimen time sheet (Figure I) of a principal of a small firm is reproduced. Note these features: (1) the ease of footing and cross-footing the whole units—there are no fractional hours to bother with; (2) the variations in rates; (3) the allotment of space between nonclients and clients; and (4) the extra space allowed for descriptive information as to the two clients for whom it was expected the most work would be done during that week.

This time sheet represents a fairly satisfactory compromise between the desire to assemble adequate information for the intelligent billing of clients, on the one hand, and, on the other, the desire to avoid getting smothered in the bookkeeping.

This form, moreover, lends itself to posting *weekly totals only* of units and dollars from the time sheets to the clients' individual accounts. In preparing the descriptions of the work done when billing, the time sheets are referred to directly, thereby saving a great deal of posting and general rehandling of the same information.

No two practitioners can be expected to have the same taste in a matter of this sort. To tell any practitioner how to design his time sheets is like shipping corn to Iowa. But the young practitioner who is rethinking the matter will do well to remember that a greater wealth of detailed information can be developed only at the expense of more time spent on timekeeping. On the one extreme is the employment of daily carbonized time cards, one for each client for each staff man, the originals being sorted and reassembled by clients and the duplicates sorted by staff men. This involves hundreds of pieces of paper even in a very small organization. On the other extreme is one monthly time sheet for each man showing only the time and without values or work descriptions. In designing or redesigning time sheets, the aim should be to achieve the most effective compromise between these two extremes.

The Steps from Time Sheets to Billings Preparation. Weekly time sheets of the type illustrated facilitate the quick and compact final assembling of units and values according to clients and staff.

First, the sheets should be footed and cross-footed by each employee both by units and values before being presented for the principal's review and approval.

The second step is to post the totals to the Units Control and the Values Control. These steps are simple indeed and can easily be placed on one sheet (Figure II).

Figure II
Units Control

| <i>Week Ended</i> | <i>Principal</i> | <i>Senior A</i> | <i>Senior B</i> | <i>Junior A</i> | <i>Total</i> |
|-------------------|------------------|-----------------|-----------------|-----------------|--------------|
| 11/4 | 154 | 160 | 166 | 200 | 680 |
| 11/11 | 171 | 160 | 155 | 170 | 656 |
| 11/18 | 147 | 160 | 149 | 182 | 638 |
| 11/25 | 84 | 128 | 90 | 127 | 429 |
| | <u>556</u> | <u>608</u> | <u>560</u> | <u>679</u> | <u>2,403</u> |

Values Control
(Same arrangement)

Figure III

| <i>Client</i> | <i>W/E</i> | <i>Principal</i> | | <i>Semi-Senior</i> | | <i>Total</i> | |
|---------------|------------|------------------|-----------|--------------------|-----------|--------------|------------|
| | | <i>U</i> | <i>\$</i> | <i>U</i> | <i>\$</i> | <i>U</i> | <i>\$</i> |
| No. 1 | 11/4 | 2 | 10 | | | 2 | 10 |
| | 11/11 | 4 | 17 | | | 4 | 17 |
| | 11/18 | 4 | 20 | 8 | 12 | 12 | 32 |
| | 11/25 | 4 | 20 | 18 | 27 | 22 | 47 |
| | | <u>14</u> | <u>67</u> | <u>26</u> | <u>39</u> | <u>40</u> | <u>106</u> |
| No. 2 | 11/4 | | | | | | |
| | 11/11 | | | | | | |

(Etc.)

The third step is to post units and values to clients' ledger accounts, or to an assembly sheet which contains six lines for each client as shown in Figure III.

From the client totals, the final step in the mechanical marshalling of data is to post to the Accounts Receivable/Work-in-Progress sheet, the W-I-P section appearing on the right side (Figure IV).

The left-hand side of this spread sheet can neatly accommodate the receivables accounting, with a column each for recording the carryover balance, current month's charges (billings), current month's collections, and the end-of-month balances to be invoiced.

The system described is very elementary. The practitioner may wish to elaborate on it and improve it. What has been presented is merely a minimum framework, one highlighting the homely virtues of compactness and proved workability.

Figure IV

| <i>Client</i> | <i>W-I-P</i> | <i>This Month's Work</i> | | <i>W-I-P</i> | <i>Billing</i> | <i>New</i> | |
|---------------|----------------|--------------------------|--------------|----------------|----------------|---------------|----------------|
| | <i>Carried</i> | <i>Units</i> | <i>Value</i> | <i>Accumu-</i> | <i>Adjust-</i> | | <i>Billing</i> |
| | <i>Over</i> | | | <i>lated</i> | <i>ment</i> | <i>Carry-</i> | |
| | | | | | | <i>over</i> | |
| No. 7 | 115.21 | 2 | \$ 2.50 | 117.81 | | | 117.81 |
| No. 8 | 9.25 | 50 | 78.00 | 87.25 | 2.75 | (90.00) | |
| No. 9 | — | 42 | 49.75 | 49.75 | .75 | (50.00) | |
| No. 10 | 221.25 | 135 | 193.25 | 414.50 | 10.50 | (425.00) | |
| No. 11 | 4.75 | 115 | 139.75 | 144.50 | .50 | (145.00) | |

TEXTS OF CLIENT BILLINGS

By the time all the service units and values are assembled, it is not unnatural for the practitioner to have grown slightly impatient with the tedium of the task. In such mood, it is all too easy to slight the job of preparing the bills. He is eager to get them in the mail and "get back to work." Yet here is the one point about which he should be unhurried and of judicial mien. He should set aside an uninterrupted half-day for doing nothing else, consciously take plenty of time, and prepare the text of each bill as carefully as he would prepare an audit opinion. With more and more practice, smoothness (and hence speed) will develop.

There are, of course, different types of billings. The one essential common to all of them is that they be truly descriptive of the services rendered.

Under many circumstances, the descriptive text can and should be quite terse. On repeat monthly work, for instance, the text might be "Accounting and consulting services rendered during the month of September, \$100." On an annual audit, too, the text can be quite simple, even though the engagement was sizeable. This is so because the audit report speaks for itself as to what was done. Hence the text might properly read "Annual audit fee relating to fiscal year ended October 31 per report transmitted December 8, including the review of the corporation's federal and state tax returns for the year, \$3,000." Similarly, the billings for routine tax return preparation can be pretty well standardized, such as "Preparation of federal and state income tax returns and declarations for 1956, including accounting analyses and tax research incidental thereto and also incidental advisory service during the year, \$85."

Under other circumstances, particularly on new or special engagements, considerable care should be exercised to make the text

really descriptive. The description may be couched in general terms and yet be adequate. Example: "Revision of the billing and collection procedures in the Title Department, including the surveying of and the redesigning of forms, the testing and selection of new cash-registration equipment, the preparation of a Manual of Operating Instructions for the new procedures, and the complete installation of the forms, procedures and equipment to the point of satisfactory operation, \$1,200."

In some cases, especially in consulting, careful itemization may be in order. If billheads are small, a letterhead might well be used to permit adequate description without crowding the space. The accountant might itemize the steps in the engagement, the phases of the work, or the dates when conferences were held or other services performed. As a general rule, the itemization should not be priced. Rather, the fee should be set out in a single figure. Thus the billing might read "Accounting and auditing services rendered in the comprehensive Personnel Study completed April 15, as more fully described below, \$2,000." The itemization below will usually be under "*Detail of Services*" or "*Memorandum of Services*."

Here are some practical hints for the accountant preparing billing texts. He should:

1. Do easy billings first. Then it is easier to deliberate on difficult ones.
2. Never charge more than he would be willing to pay. If in serious doubt, he should err on the side of reasonableness. (Golden Rule.)
3. Never charge more than he can collect. This implies faulty arrangements with the client or failure to keep him posted.
4. Round out odd figures instead of using odd ones (except for out-of-pocket expenses).
5. Beware of establishing and publishing minimum rates. The minimums tend to become the maximums.
6. Avoid "lapping." If the accountant with a new client does work worth \$165 the first month, \$110 the second and \$100 the third, he should bill accordingly. If he bills only \$125 the first month, hoping to make up the \$40 later, he is likely to lose out more than once. The client, conditioned to the wrong yardstick, may complain when he is billed the correct \$110 the next month, saying that his bill was "nearly as high as the first month, but you didn't spend anywhere near the same time.")

The recommended idea of fairly valuing the services day by day as they are rendered should go a long way toward minimizing book-to-actual billing adjustments either upward or downward. It should also be helpful in imparting conviction to judicial courage.

LONG-RUN CLIENT ADVANTAGES

While efficient mechanics are important and require experience and know-how, the technique of fee-setting is secondary to sound philosophy and sound economics.

Absolute fairness in fees is paramount. In the last analysis the CPA is paid for accomplishment, not for mere time spent. All other considerations are subordinate to the supreme goal of the client's long-run advantage. Conversely, no sin compares with "making busy work" for a fee.

Although analogies are perilous, they serve to illustrate key points.

Suppose a person goes to his doctor for an annual checkup. The doctor's advice is ignored. As a consequence an operation is the only way out. Should the doctor reduce his operating fee? To do so would manifestly discourage hygienic living and regard for the rules of health.

Suppose a service station man calls his customer's attention repeatedly to bad wheel alignment or a flaw in an axle or worn-out tires. Some night at 1 A.M. he gets a phone call for tow service. The charge? Five dollars per mile. "What an outrage," says the man. Here, too, a stitch in time would have saved more than nine.

What does the professional man do when his advice is sought? In effect, he uses radar. Perhaps the solution to the problem involves an image pattern that is very familiar. The answer then is easy. In other cases the radar has to go out to a new combination of memory islands. That means thought, research, consulting with colleagues. The value of experience in such cases is simply incalculable. The good client appreciates this.

Accounting is concerned with the health of wealth. The accountant's all-pervasive duty is to keep clients out of trouble, to help them use their material and personal resources to the maximum benefit of all concerned. His advice and professional help to clients, and his fees, should rest on this basic premise of "preventive maintenance."

Fees are equation-balancers.

The only way for clients truly to save fees is to pay a good price

for good services, and devoutly to follow professional advice—earlier rather than later.

COST-FEE RELATIONSHIPS

The relationship between fees and costs is changing. The minimum facilities required to practice accounting properly are far greater, both relatively and absolutely, than ten or twenty years ago. The readiness-to-serve, the stand-by plant, are increasingly important factors. Too, the cost of the necessary equipment—education and training—has zoomed apace.

The old idea was to rent a room, buy the *Accountants' Handbook*, hang out a shingle, do good work, and hire a helper when needed. Today the "helper" is no longer available for the asking. And without him the development of more practice is self-defeating. So the starting point, nowadays, is hiring the help before he can be fully utilized. The practitioner then pays him whatever it takes to attract him to the profession, counts on losing money on his efforts for at least six months, but ultimately, by this process of putting the old-fashioned cart before the old-fashioned horse, builds an accounting practice.

Now this costs. And in the long run fees are tied to costs. At the minimum, fees have to be twice the salary costs to stay in business and continue to serve a widening clientele.

To arrive at salary costs, add all payroll taxes, insurance, and fringe benefits. Divide the annual total by the number of hours actually on the job, less a reasonable allowance for nonclient time. The resulting cost per hour, and the corresponding fees required, are frightening.

The nub of the matter is that every hour expended for the client must be crammed with value, and the staff man must keenly realize this. The efficiency of the national economy depends upon good accounting. Good accounting requires costly talent. The costs can only be met from fees. There seems to be only one way out: to earn those fees, and earn those salaries.

From time to time the belief is expressed that more fee surveys should be conducted. The idea behind this is that there must be some trick to the matter and that this trick might come to light if only enough detailed statistics could be compiled as to what other accountants charge.

Such hopes for a solution are pretty shallow, but their quality

of shallowness is relatively harmless. The real objection to fee surveys is that they are likely to prove dangerous and misleading.

About all fee surveys prove is that there is a wide range of fees being charged, that many practitioners are charging too little, and that there is little uniformity in the classification of services or staff people.

Fee surveys, moreover, tend toward the idea of the compulsory fee, the blanket fee, the minimum fee, the standardized fee—which have never worked. “He profits most who serves best.” Conversely, low fees tend to be an indication of low quality work.

Another fallacy of fee surveying is that every firm may not see fit to co-operate. In their collective aspect, fees are not very attractive. When the fees reported are too low, everyone laments the fact; when too high, no one believes it.

In sum, hope for a better general situation as to fees lies in educational guidance and practice, not rule-of-thumb formulas or statistics.

Briefly, the fee-wise CPA: (1) is acquainted with the nine fee factors treated by Dwight Williams in the *CPA Handbook*; (2) has adopted the slogan “Better Service, Better Fees”; (3) is a firm believer in billing early and often; and (4) is not afraid to educate clients about the invisible costs underlying professional charges. He is resolved (5) to switch to “units” from “hours”; (6) to appraise as he goes; (7) to be very deliberate in preparing the texts of client invoices; (8) to eschew standardized fees; (9) to aim above all toward the long-run advantage of his clients; and, possibly, (10) to give up the idea that there is magic in surveys.

Why Not Be 100 Per Cent Candid In Fee Arrangements?

Certainly one of the most unpleasant and most damaging of professional experiences is a misunderstanding about fees. The fee arrangement should be clarified at the outset as an integral part of defining the engagement. The positive advantages of candor can be expressed in these words:

A firm’s staff members number about forty-five. They make no attempt to bill according to flexible rates. When an engagement is inquired into, this firm is *very frank with the prospective client*. They tell him that charges are based generally on one per cent per day of a man’s annual salary. They give him a review as to how they

attempt to use the seniors on senior work, the juniors on junior work, and so forth.

They endeavor to close the engagement strictly on a per diem basis, if it is an initial engagement, but they are not averse to giving a prospective client a maximum fee with the explanation that they are deliberately making it larger than they believe the time to be consumed will actually come to. If it involves supervision on the part of a principal, they let the prospective client know that the total time to be devoted by the principal will usually not exceed 10 per cent of the entire time to be devoted to the engagement. This runs \$20.00 per hour. They agree with him on that in advance. They also tell him that he will be charged for office review time at the rate of \$8.50 per hour, and \$4.00 per hour for comparing and proving and typing time.

When the time comes for the actual billing, they prepare a memorandum of billing. On that memorandum of billing are two columns showing the agreed rates and the standard rates. If the rate seems low in the light of the results, the partner in charge has a discussion with the client, and frequently the fee is raised. Occasionally, the client is charged less than the standard rates. If the firm makes suggestions not expected at the outset, which prove to be of exceptional value, the fee is raised. In the main, clients are reasonable.

More on Fees and Billing

Is the prevailing level of fees high enough to (1) cover sufficiently high salaries to enable the accounting profession to compete with other professions for competent personnel, and (2) return to the partners and individual practitioners a high enough annual net income in relation to the responsibilities they have to assume? Is it possible for any professional accounting organization to render top quality service continually without revenues sufficient in amount to cover (1) the costs of competent personnel together with their continuing training and education, (2) all of the other expenses of carrying on a practice, and (3) a satisfactory level of net income?

Another aspect of this subject which needs a good deal more discussion is the extent to which practicing accountants are really making an effort to set fees on a logical and solid foundation. Perhaps the prevailing practice, in deciding upon hourly rates to be charged, is one of finding out what the other fellow is charging so as not to be 'too far out of line.' Wouldn't it make more sense for the indi-

vidual practitioner to start at the last line of his own profit and loss statement and work up from there? Such an approach would mean beginning with a realistic appraisal of one's own abilities, experience and technical competence, and an attempt to decide what ought to be a fair annual income under the circumstances.

The next step might be to make the same kind of appraisal of the expenses which will have to be incurred during the ensuing year for salaries and other costs. The sum of these factors will be the total revenue required to produce the desired net income. That same revenue ought to be susceptible of conversion into a target for the year in terms of hours of work at various billing rates. Obviously, this is an oversimplification of the problem because many variables are involved in predicting a year ahead. On the other hand, this approach is used in many instances in large-scale business enterprises not without a considerable degree of success. Possibly the smaller firms and individual practitioners do not set realistic financial goals for achievement during the ensuing period.

If it is true that the prevailing levels of fees are not adequate, then it seems that a long-range educational problem with clients must be faced. Some time ago, in a newsletter of a well-known investment service, there was a discussion about so-called growth stocks. The statement was made that one of the principal characteristics of a growth company was its ability to pass on cost increases to its customers in the form of higher prices. Has the accounting profession been successful in passing along its own cost increases to its customers?

The "service unit" concept is a very interesting one. The most challenging feature is that the client is more likely to be charged for what is done and therefore pay a fairer fee. Such a system would stimulate the practitioner to create a greater sense of value in the mind of his client. Slavish devotion to hourly rates fails to give the proper amount of emphasis, in the mind of the client, to the real value of the work performed.

One CPA is very much in favor of the practice of inventorying work in process "at retail" as is done in the example shown (Figure V). It is easy, he says, to make a reduction in the amount one starts with as the prospective fee to be charged. Many practitioners inventory only the hours worked, extend them at cost, and then mark them up to the amount of the fee to be charged. The amount finally arrived at by starting at retail will always be higher, according to this man, than that arrived at starting at cost.

Figure V

Code for Billing

(Unless otherwise indicated, invoices are to be dated the first day of the new month)

1. Accounting services rendered to date
2. Accounting services rendered during the month (*previous month*)
3. Accounting services rendered during the months of _____, _____, _____
4. Accounting services rendered to date:
 - a. Previously billed
 - b. Month of (*previous month*)
 - c. Total
5. Accounting services rendered, including examination of accounts for fiscal year ended _____ and preparation of federal and state income tax returns
6. Same for calendar year 19____ (*preceding year*)
7. Accounting services rendered, including closing of accounts for fiscal year ended _____ and preparation of federal and state income tax returns
8. Same for calendar year 19____ (*preceding year*)
9. Accounting services rendered, including preparation of federal and state income tax returns
10. Preparation of federal and state income tax returns
11. Progress billing toward fee for examination of accounts for fiscal year ended _____
12. Same for calendar year 19____ (*preceding year*)
13. Accounting services rendered, including examination of accounts for _____ quarter 19____ (*applicable year*)
14. Accounting services rendered during the period _____ to _____
15. Accounting services rendered to date in installing revised accounting system
16. Accounting services rendered to date:

| | <i>Unbilled Services</i> | <i>Billed Services</i> |
|--|------------------------------|----------------------------|
| a. Balances at (<i>first of previous month</i>) | \$ _____ | \$ _____ |
| b. Services rendered and fees received, respectively, during (<i>previous month</i>) | _____ | (_____) |
| Subtotals | \$ _____ | \$ _____ |
| c. Progress billing for (<i>previous month</i>) | (_____) | _____ |
| d. Balances at (<i>end of previous month</i>) | \$ _____ | \$ _____* |

*This amount is payable presently

He further states that he does not happen to believe in lengthy texts when it comes to clients' bills. First of all, if the right amount of work has been done in creating a real sense of value in the mind of the client, he shouldn't need a lengthy bill to refresh his memory.

Secondly, one can spend a lot of time writing out the texts of bills or even dictating them into a dictating machine. In his firm a book-keeper types bills from a billing sheet as shown, but the bills are not mailed to the clients until they have all been reviewed at a meeting of a majority of the partners. Sometimes, a discussion of a particular piece of work at that time will result in an adjustment, either upward or downward, to a fair fee for the work performed.

Another CPA succinctly expresses his opinion in the matter of fees:

“When an individual goes to work for an employer he satisfies his own mind as to how much he thinks he should receive, taking into consideration the going wage. The practitioner does similar thinking, and in setting his fees he must decide on the scale of living he wishes to attain. There are only so many hours in a year and the number of working hours gets smaller. We keep track of our time in terms of quarter hours and establish a standard daily rate on the basis of one per cent of the annual wage of the employees and one per cent of the annual wage I expect to receive as a practitioner. Naturally, my wage as a practitioner must be net after expenses are paid. By keeping a record of the time, we usually determine what is the standard fee on all work done before the billing is made. Endeavoring to attain standard rates for work done has a tendency to cause one to use more efficient methods and see that all clients are treated fairly.

“To summarize, I would recommend to other practitioners that they keep an accurate record of their time, establish standard rates using the one per cent or other rule to obtain a daily or hourly standard rate, compare the billing amount to standard for a percentage of actual to standard, and use the same figures to develop the allocation of fees to staff members in order to measure their productivity in terms of salary as compared to fees received.”

Using a "Conference Report" To Simplify Billing

Many a practitioner has sat down at the end of the year to prepare a bill, and has found it difficult to remember what he did for a particular client. Or he has taken over a case from another partner and found that many of his actions and recommendations are not on record in the files. A conference report is advantageous in these and many other cases.

A conference report, as the name implies, is a written memo of any kind of conference affecting a client. It could be prepared as the result of a phone conversation or a discussion with another partner or staff man. It is always prepared after a conference with the client or others representing him if any actions are taken or recommendations made. These reports are invaluable when a long project is going on, such as a tax case or a reorganization where a series of conferences is held over a relatively extended period. These reports in the file provide a running record of what is taking place so that any partner can take over the case right in the middle if necessary.

When originally adopted in one firm, the conference report was prepared as a printed form. Since the printed form was restricted as to space, they have since abandoned it and now require only that the conference report be prepared on work-sheet-size paper and contain the following information:

1. Client
2. Date of conference
3. Time of conference
4. Place
5. Those present
6. Subject
7. Discussion
8. Recommendation
9. Data promised, if any
10. Time spent
11. Signature

The conference report is filed with the papers on the particular case or in the correspondence file.

When the time comes to make out the bill, it is a simple matter to review the file to see what has been done during the year, especially with regard to the many small but valuable tips which are given to the client by telephone or in his or the CPA's office, but which are often overlooked in a subsequent discussion of fees. Such a record also provides a ready answer when the client asks, "But what have you done for me lately?"

An Example of a Descriptive Client Bill

Here is an example of the type of bill which contains a detailed description of the work his accountant has performed. Noted are

conferences, telephone conferences, correspondence, research, and preparation of various tax returns.

A more detailed bill would give exact dates of conferences, telephone conversations, and letters sent for the client.

Figure VI

May 20, 1957

No. 2059

DILL TRUCKING CO.
East Claymont, Delaware

IN ACCOUNT WITH
JOHN HOWE & Co.
Certified Public Accountants

| | |
|-----------------------|-----------|
| For Services Rendered | \$ 405.00 |
| To Expenses | |

| | |
|-------------------------|-----------|
| Balance Due As of | \$ 405.00 |
|-------------------------|-----------|

Conference with Mr. Mackay at City Bank.

Conference with Mr. Johnston in Columbia on Carry Corp.

Research on tax problems in connection with Carry Corp.

Telephone conferences with Harold Brady and Mr. Mackay and Mr.

Howe at various times during the first quarter of the year.

Preparation of: Financial statements for the year of 1956

Form 1120, U.S. Corporation Income Tax Return, including Schedule D, Gains and Losses from Exchanges or Sales of Property, and special depreciation schedule.

Form F-1, Franchise Tax Return.

Form 938 and 939, Corporation Financial Statements.

Form 945, Inter County Corporation Return.

Form 931, Balance Sheet for Corporations.

Form 1040, U.S. Individual Income Tax Return, for Bernard Dill.

Form 1040 ES, Declaration of Estimate of Tax, for Bernard Dill.

Form 916, County Return of Taxable Intangible Property for 1957, for Bernard Dill.

ICC Report for the year 1956.

Description of Services In Billing Clients

Perhaps, in preparing bills, accountants would like to consider giving first a broad description of all the work performed with wording similar to the following: "For accounting services rendered." It has been the experience of some that such wording lessens likelihood of a possible challenge at a later date as to whether or not the invoice was all for accounting services rendered or whether possibly it was commingled with the billing of other kinds of professional services.

Usually an invoice is paid more promptly if it contains adequate description of the work performed. That eliminates questions in the mind of the client whose memory may be slightly rusty as to the services performed over a three- or four-month period. There is also the point that an invoice that is not clear on its face with respect to the work performed is apt to be delayed in payment and also challenged.

It is generally agreed that wherever feasible it is better to bill the work at the end of each month regardless of how much work is still in process. This monthly procedure, however, sometimes raises a question in the client's mind as to whether he is being billed twice for the same item, since identical descriptions of work performed may appear on several invoices. Wording to the following effect in small print at the bottom of the invoice, however, has solved this problem for one firm:

"Because of the nature of accounting services, it is not feasible to describe in detail all the work performed. In order to expedite our billing, a summary of certain major items only is shown. Won't you please review all invoices upon receipt and call us promptly if you have any questions? In general, invoices are forwarded at the end of each month whether or not the work is completed; this may result in identical wording appearing on more than one invoice; for example, if federal, state and local tax returns were in the course of preparation at December 31, then identical wording would appear on the January invoice. We reserve the right, at any time, to charge interest at the legal rate on past due accounts."

A Tip or Two on Billing Procedure For Tax Work

Measured by number of returns prepared per accountant, the seasonal tax load probably falls heaviest on offices in the smaller towns throughout the country.

Bills for this class of service should be rendered at the same time the returns and declarations are submitted to clients.

One way to accomplish this easily is simply to drop in each tax client's file a copy of his bill as it is prepared. Then upon completion of the next year's return, the fee can be marked right on the return, and the bill typed at the same time that the return is typed. Thus the secretary, in typing the appropriate (form) transmittal letter, can refer therein to the fee payment due (per bill enclosed) as well as to the taxes due. This not only facilitates early finalization of the whole job, it also assures more uniform and equitable billings for each client from one year to the next because the amounts are determined at the very moment when the current year's work may be most fairly compared with the previous year's.

It is all too easy to let tax billings go until after the seasonal cleanup. Any accountant who does is in for a "three-day headache." And at least a few unintentional errors and even complete omissions are bound to occur, to say nothing of the delay in collections which is the result of such a course.

One further note. On the regular time sheets, it is best to have *one* controlling account for *all* small (individual) tax returns, with a separate supporting sheet listing the work performed and "units" of service rendered for each client. Values are not shown on these supporting sheets as a matter of simplification, but instead the total value of tax work for the week is indicated on the group controlling account on the main time-sheet only. (Such total may be quickly ascertained by adding the fees already indicated on the completed returns.)

Additional Fee When Tax Returns Are Examined

Every year more and more returns prepared for individual taxpayers are being examined by the Internal Revenue Service. Many of these individuals have never been examined before, and are apprehensive about coming into contact with the IRS. As a conse-

quence, many of them contact their accountants to request their presence and assistance during the examination, or merely to give advice concerning points that may be questioned.

In this type of situation, the return is a fairly simple one and the examination is usually completed in an hour or two. However, in many instances the client feels that since the accountant prepared the return, he should be willing to "defend" it without further charge. The problem of how to go about charging for the service rendered is requiring serious attention from many practitioners.

One solution is to make a sufficient charge for the preparation of all returns, so that an additional charge for assistance during the examination would not be necessary. However, this places all tax clients in the position of paying for examinations of the few, and therefore is not a completely satisfactory way to charge.

Another possibility would be to charge extra for the preparation of returns that are likely to be examined due to large refunds, or some other reason. This involves trying to predict the actions of the Internal Revenue Service, however, and therefore is not effective.

The other approach that one firm has considered is to devise some means of advising the client at the time of preparing the return that the fee does not take care of subsequent examination. A short, simple statement along this line might be used:

"Your fee covers preparation of your income tax return. It does not cover assistance rendered during any examination of your return by the Internal Revenue Service. We will be happy to assist you should this occasion arise, and will make an additional charge based on the additional services rendered."

This could be placed on the invoice by means of a rubber stamp, or it could be printed on a small sheet which is attached to the client's copy of the return. It might be possible to include it on the client's instruction sheet, although it might be overlooked there.

Three Suggestions on the Fee-Collection Problem

When Bills Become Delinquent. Once a bill has become past due, one practitioner states he does not hesitate to discuss it with the client. If the amount owed is substantial, he also asks the client for a judgment note, personally endorsed by an officer if the client is a corporation. He turns over accounts to attorneys or collection agencies if he feels a client is not giving him fair treatment.

Obviously, the best time to "collect" an account is before the accountant begins his work. By this is meant a frank discussion about fees with the client, even if the accountant has to admit that he does not know how much the fee will be. A frank discussion can go a long way toward prompt payment when the invoice finally is presented.

This practitioner deals frequently with the heads of small businesses. In his initial talk with such a client, he suggests that the client send him a check at the same time he makes out his payroll. "We set a round amount which we feel will not be too much of a strain on the client, depending upon the circumstances he happens to be in, and we do not hesitate to bring up the matter if he should skip a payment. We have found from experience that this arrangement is highly acceptable. The client is paying us when he wants us most and when we are doing the most involved part of the work. If the original periodic payments turn out to be too small or too large, we change them. We send an invoice at the end of each month showing a credit for the amounts paid us, and noting the balance due."

Another technique favored by this accountant is enclosing a postage-paid envelope with his bills. He has learned that many of the small businessmen who are his clients find it quite a chore to write a check, hunt up an envelope, address it, and find a stamp. By furnishing a completed envelope, he accelerates payment.

A Seven-Point Policy. Following these rules can be the key to avoiding trouble before it comes, which is in turn the secret of successful collection of fees:

- (1) Explain fees as clearly and concisely as possible at the time you are engaged, and in letter form.
- (2) Bill clients promptly.
- (3) Send out statements regularly.
- (4) Follow up statements with a personal reminder ten days later.
- (5) Call up client ten days after reminder is sent to ascertain why payment has been delayed.
- (6) If a client cannot pay because of low finances, arrange for small periodical payments.
- (7) If there should be a misunderstanding, refer him to your letter *re* your fee.

Importance of Keeping Billings Current. A third practitioner reports that he does not allow work to accumulate for billing at the end of a six-month or even a three-month period. Three invoices submit-

ted at intervals seem to be paid with less question than one for the total of the three individual bills, or even one for 75 per cent of the three.

The practitioner further states that a CPA called in by a prospective client should determine whether the previous accountant has been paid in full for his past services, or whether arrangements to pay have been made. If a client leaves one accountant without paying him, he may be expected to do likewise to a new accountant.

Fees and the Future Of Accounting

Recently one of the leading accountants in a state society gave a reasoned analysis of the place of fees in the development of the profession. Here is the essence of his speech:

“Our state committee on practice management recently sent out a questionnaire concerning fees to all public accounting firms practicing in the state. Replies were received from sixty-five per cent of the CPA firms to whom the questionnaire was sent. The tabulation of the replies furnishes a reliable study of the fees charged in the state.

“I am not quite sure what I expected this study to reveal, but frankly I was appalled to learn how little my colleagues feel their work is worth. I could hardly believe my eyes when I read of principals—lots of them—charging so little an hour for their time. Rates charged for juniors also amazed me. This hardly seems realistic at the present time, when college graduates with no experience are paid upwards of \$2.50 an hour as a starting salary. Then, too, I find that many practitioners charge no more for tax work than for audits. Without attempting to assess the relative worth of tax work to the client, the actual cost of such work to the practitioner dictates a higher fee when one calculates the cost of maintaining a tax library; time spent in studying day-to-day changes in tax laws, rulings and decisions; time spent to attend tax institutes, etc.

“About five years ago one of our committees made a study of fees and their relationship to the cost of living. Their purpose was to ascertain just how much net income was needed to yield an accountant the same standard of living as a given income supplied in 1939. The results of this study indicated that an accountant's net income must have risen two and one-half times since 1939 to yield a comparable standard of living after giving effect to differ-

ences in the cost-of-living index and to income tax rates. By now, the ratio probably would exceed three times. Bear in mind that this study compares net incomes. Since the growth of our labor costs has far outstripped the cost-of-living increase, our gross fees should probably be four or five times as great as those charged in 1939 to keep the professional accountant in the same relative position in our economy. Few segments of the American economy have been satisfied not to improve their relative positions, yet we have failed even to maintain ours. Our fee study shows all too clearly that many practitioners still live in the past, closing their eyes to the inflation which is all around us.

“Probably one of the most important factors in personnel recruitment is the remuneration which is offered—not in the distant future, but immediately. Since pay scales are inevitably tied to fees, our failure to charge adequate fees and to pay salaries comparable to those paid by other professions will drive many young people elsewhere. This is probably the quickest way for an entire profession to commit suicide.

“How can we reverse a trend which already has gone too far? As you have probably already inferred, I feel that the cure starts with increased fees.

“How best to sell ourselves on the worth of our work is a question each of us must answer in his own way. I find that attending meetings of various accounting groups has been a great stimulus to me. At such meetings one invariably finds the leaders of our profession, men who practice accounting at the highest level. From them I have learned of many new ways in which to serve my clients. Talking with people has served another purpose as well—it has kept me dissatisfied with the caliber of services I render and the fees I charge. Only dissatisfaction with your present status will cause you to swallow the capsule; no one else can force you.

“Once you have sold yourself you are ready to sell your client. How this can best be done is a subject about which little has been written. Each of us develops during our professional career a number of techniques designed to dispose our clients favorably toward the payment of a fair fee. I would like to see these techniques discussed freely, for I am sure that each of us would benefit.

“One of the most successful practitioners I know considers that each member of staff has a two-fold duty during any engagement. First, he must perform his work with the utmost technical proficiency. Second, he must prepare the client to pay a fair fee. Unless each of

these functions has been properly performed the engagement has not been completed. This approach seems eminently reasonable, for a practitioner who collects a fair fee only after putting himself and his client through an unpleasant emotional experience has been professionally unskillful.

"No one of us enjoys discussing fees with his clients. Yet it is a necessary element of any successful practice. The nature of any professional occupation is such that the client is seldom able to appraise the value of the service rendered or the cost of rendering it. Professional people, then, must take the time to explain these matters to their clients. They must conduct their practices in such a way as to create as a by-product the mental attitudes in clients which will cause them to appraise the services fairly and pay a fair price willingly.

"The techniques by which these mental attitudes are created may best be described by the term salesmanship. Though normally considered a nonprofessional term, salesmanship is the ingredient that accounts for substantial fee differences where all other factors are equal. Salesmanship is composed of such intangibles as self-confidence, strong nerves, ability to impress and convince a prospect, alertness to opportunities to bring out values and achievements, personal impressiveness, demonstrable competence, intuitive ability to recognize the proper approach, etc. An accountant who is possessed of excessive humility or who is basically insecure may not negotiate the best fee arrangements.

"The same native shrewdness which accounts for success in business stands an accountant in good stead when discussing fees with clients. This trait, like those which make up a good salesman, cannot be acquired. However, by appraising our shortcomings and emulating the procedures used by a successful negotiator, it is possible to bring about substantial improvement. A recent article in *The New York CPA* suggests that some accountants might find it advisable to turn fee negotiations over to a partner who is more adept. I agree that this can often accomplish a better result and, if handled tactfully, should cause no embarrassment. It is merely another means by which a firm can make the best use of its various talents.

"In conclusion, let me stress that nothing contributes so much to receiving a fair fee as being worth it. As our economy becomes increasingly complex, we must grow to meet the enlarged demands on our services. Our perspective and scope of service must be broad-

ened so that we may penetrate more deeply into the problems of those who depend on us for guidance. Let us recognize the symptoms and take the cure, so that the profession which has been temporarily entrusted to our care may grow to a virile adulthood."

Basis for Billing Clients— Service vs. Time

Much has been said about billing for the value of the services rendered in preference to billing on the basis of time alone. Yet most accountants keep their records of productivity by time spent and think in terms of per diem rates.

Convinced that "time alone should not measure the fee," and that "we should bill for the value of the services rendered," etc., a firm strove for a formula which would fuse measurement by time and measurement by value, and yield a fee which would be reasonable and easy to explain to the client.

Figure VII is the result of the firm's efforts. Each person has a "per hour" rate. Upon completion of the engagement a tentative proposed billing is prepared on those rates. Then this form, together with the time ledger sheet, passes among the three partners, winding up in the hands of the partner who is in charge of that client. Each partner first writes down all the reasons he can think of to justify a billing at more than per diem rates and writes these reasons in the second section of the form. He then takes the opposite and writes down all the reasons he can think of to justify a billing at less than per diem rates.

Armed with these analyses the partner in charge of the engagement prepares the bill in pencil on the bottom of the form detailing the work performed and the total amount.

They do not bill expenses separately, but have the following printed on their billheads: "Unless Otherwise Stated, Billing Includes Travel and Other Expenses. Detail Breakdown Will Be Furnished on Request."

Even where an engagement has been undertaken at a fixed fee, this form is used. If it is an engagement that is continuous at the same fixed fee per month or per year, they can judge whether the amount they are charging is materially above or below a reasonable amount, and when they approach the client for renegotiation, they have the facts to support their position.

Figure VII

No.

ANALYSIS OF COMPLETED ENGAGEMENT

Based on per diem and expense

| Initials | Hours | Rate | Ext. |
|----------|-------|-------|-------|
| | | | |
| | | | |
| | | | |
| | | | |

Observations relative to charging more than per diem, based on value of unusual services

.....
.....
.....

Observations relative to charging less than per diem due to persons at high rates doing low rate work

.....
.....
.....

Details of Bill

Client

Job Number

SERVICES BEYOND SCOPE OF ENGAGEMENT

.....
.....
.....

Date

Signed

Should Charitable Organizations Be Billed at Reduced Rates?

Frequently the CPA is called upon to audit the books or render other professional services to a charitable organization. Should he submit a reduced bill, nominal bill, or some kind of less-than-normal bill?

One can watch such organizations and study their accounts for many years. He would find no builders who build their institutions,

few artisans who work for them, few lawyers who render them legal services, few architects who design their plants at less than the going rates.

One CPA suggests that if an accountant wants to make a contribution to a charitable endeavor in his community the way for him to do it is to do the work, evaluate his services, bill them, and then to give back some of it as a donation. On these boards and budget committees are people whom accountants serve in business from day to day (people with just as keen an analytical sense) and they measure what accountants do for these charitable institutions in terms of what they presume to be their costs. On occasion some of them then turn around and apply leverage in the fixing of rates and fees for private engagements.

This particular CPA is firmly convinced that the time has come when the accountant should no longer do free work or do work at nominal fees in these cases but, instead, he should bill them on the basis of the value of services rendered and then make his contribution in a manner that will enable the other fellow to give him credit for the contribution he is making to the cause.

Reduced Fees for Charitable Groups— A Contrary Stand

A substantial group of accountants nowadays disapprove of reduced bills for charitable organizations. But many a CPA holds to the view that these groups merit special treatment. Typically, the CPA of this persuasion states that most charitable, religious, and educational institutions are of a worthy nature. The income of these institutions, small or large in size, private or public in nature, is very limited. Members and friends of members are constantly being tapped for funds and contributions. In turn, the expenses of the institutions go on with few reductions.

It is this CPA's feeling, as evidenced in action, that *those individuals closely connected and interested in the wellbeing of the institution* should, not only through right but by duty, contribute of their talents, capabilities, or funds so long as it does not interfere with their normal business practice. Thus, there are lawyers who have contributed of their services, doctors who have examined campers free of charge, just as accountants have served those institutions in which they are interested.

Perhaps this is as it should be. Rather than being degrading, in

the opinion of many it uplifts the status and dignity of the profession. These gestures indicate that here is a profession the members of which are not mercenary, the members of which participate in community affairs, are selfless and give of themselves and of their talents to worthy and deserving causes. Perhaps not all professionals can contribute sizable funds, but many have time available equivalent to funds.

If more individuals, professions, and business concerns were to assume this attitude, our fee-reducing accountant concludes, we would find such institutions on a far sounder basis.

Again, What Fee Policy When Serving Charitable Organizations?

Another CPA describes his own definite policy in billing charitable groups and, equally interesting and important, reveals the personal philosophy and professional background underlying it.

Regarding reduced rates to charitable organization, he votes yes. He believes all accountants have a duty to participate in community service just as do members of other professions. Accountants who give of themselves will gain in stature and in their perspective toward their fellow men. He feels their opinion of accountants also will be improved.

At the beginning of the CPA's fifteen years of practice, he accepted charitable engagements as a means of making favorable contacts with prospective clients—as do many young practitioners. Recently he has set lower rates in order to encourage all organizations to have periodic audits by CPAs, rather than by members of so-called "audit committees."

His policy in charging charitable organizations is to bill them at about 50 per cent of the usual rates, with the provision that all such work be done during the summer, if possible. If it is necessary to do such work during the busy season, he gives a smaller discount but still does not charge his regular rates. He extends the discount privilege whether or not he is personally connected with the organization.

"Some of my clients criticize me for giving discounts to charitable organizations, and tell me that they don't give discounts to anybody," the CPA goes on. "But I do not consider that type of person in formulating my policies. Many individuals contribute their efforts to charitable organizations, and I want to be counted with them.

“Each of us has to make his own decision. I would be the last person to force a CPA to give a discount to anyone. However, I will continue to do work for charitable organizations and will welcome all those who choose to do likewise. I’m sure many CPAs have been following such a policy out of a sense of responsibility, and with no thought of publicity or reward.”

PARTNERSHIP AND STAFF PROBLEMS

Three Index Areas to Watch In Practitioner Development

In any skill the most natural thing in the world is to observe how others do it. Men forever learn by watching each other.

There are as many ways of looking at accounting adeptness as there are accountants.

One effective way for the practitioner to judge his own development and that of others is to view assignments in three parts: the beginning, the main body, and the finish; or, perhaps better: *the planning, the procedures, and the wrap-up*. What is the natural evolution of each practitioner's development in these index areas?

All start in the middle or No. 2 area. Without exception, the fledgling accountant's work is laid out for him. The final touches are also usually applied by a superior. For several years at least, the beginner's practice of accountancy is largely confined to the execution of basic, specific, detailed accounting and auditing procedures.

Full development requires much of this intensive mid-zone drill. The learning curve is the standard one of very rapid development at first, then a plateau, then a gradual ascent to the near-saturation point. Certainly, after ten years a man has reached his peak on the individual task-skills of the middle area.

What is the path of progress from there?

Obviously, to the engagement planning phase on the one hand and to the wrap-up work on the other.

On the part of the rising young accountant, there is a natural eagerness to plunge rapidly into these more exciting areas. Those over him are in most cases more willing than he might think to delegate responsible work to him—*gradually, as he demonstrates his capacity to handle it*. But this brings both parties to the threshold of a potentially delicate professional and personal situation.

If the delegation of Area 1 and Area 3 responsibilities are too long withheld from an able young man, he is bound to feel thwarted and to become discouraged. On the other hand, if he is prematurely granted too much authority, or he deliberately swims out beyond his depth, costly mistakes can be made which can undermine his confidence at the same time that they create embarrassment between the real paymaster, the client, and the accounting firm.

Evaluation of Partners: Factors and Methods

The problem of evaluating partners arises periodically in accounting partnerships with respect to the revaluation of the interests of partners in the whole, as a result of a partner or partners dying or retiring and staff members being admitted to the partnership, or as a result of new partners coming into the firm because of mergers.

What basis or "score sheet" is used to evaluate the salary and profit percentage for the new partners?

Ages and abilities differ considerably: some partners may demonstrate ability to secure new engagements, while others may become specialists in taxation or systems work or some field of industry which has resulted in enhancing the reputation of the firm and influencing the recommendation of many clients to the firm.

The comments on "Profit Sharing and Compensation Arrangements" in the *CPA Handbook*, Volume I, Chapter 3, are very general, such as the following (page 18):

"The division of income is accomplished by various methods. Each plan presumably represents the best efforts of the parties to develop that formula which in the particular case will most fairly and judiciously compensate them for ordinary and extraordinary contributions to the firm's income and growth.

Figure 1

| | A | B | C | D |
|--|----------------|--------|-----------|-----------------|
| 1. Age | 32 | 34 | 35 | 37 |
| 2. Years a staff member | 8 | 10 | 10 | 10 |
| 3. Hours charged to clients in preceding year at approximately the same per diem rates. | 1,600 | 1,700 | 1,750 | 1,750 |
| 4. Hours engaged in assisting and training of personnel, completing a report manual, etc. | 200 | 0 | 0 | 150 |
| 5. Demonstrated ability as a specialist in costs and systems work | Yes | 0 | 0 | 0 |
| 6. Demonstrated ability as a member of the Tax Department of the firm | 0 | 0 | 0 | Yes |
| 7. New engagements, in dollars, brought in solely as the result of personal friendships within the past three years. | 1,000 | 2,000 | 2,000 | 10,000 |
| 8. New clients, in dollars, brought in from the development of firm accounts within the past three years. | 1,000 | 2,000 | 2,000 | 5,000 |
| 9. Activities in community affairs. | Church Vestry | 0 | 0 | American Legion |
| 10. Activities in accounting societies. | On a Committee | 0 | 0 | 0 |
| 11. Health and vitality. | Excellent | Good | Excellent | Excellent |
| 12. Expected dollar billing for first year of clients to be supervised. | 28,000 | 30,000 | 32,000 | 45,000 |
| 13. Salary received in past fiscal year of the firm | 7,000 | 7,500 | 7,500 | 8,500 |

“Personal abilities cannot readily be evaluated. Moreover, accomplishments in business often depend on personality as much as on ability. Some achievement in public accounting is not due to any extraordinary efforts of accountants but may well result from the growth of small clients into large ones, or from good family and other associations. These factors complicate the problem of determining what is a fair method of division. Finally, the effectiveness of partners and their income-producing abilities do not remain in the same relationship indefinitely. This presents the most disturbing problem of all. In other words an arrangement that is deemed satisfactory at an early stage of a firm’s existence may be inadequate at a later stage, unless some flexibility or a provision for modification is introduced into the plan to deal with this situation.”

It is understood that those becoming partners in national accounting firms usually do so on a purchase arrangement, and the cost of their shares may be a drain on their income for a number of years. However, such partners expect that, upon their own retirement, they will sell these shares or an increased number of shares to incoming partners.

It would be of interest to have answers to these two questions:

First, to what extent are incoming partners obligated to purchase a partnership participation in the profits of smaller firms? Second, is the practice prevalent of requiring a sizable capital contribution in due course from new partners regardless of whether interest may or may not be paid on capital under the terms of the partnership agreement?

Some firms have indicated that, when a new partner is admitted who has been a staff member, it is customary for one or more of the senior partners to give up a small percentage of interest and the new partner to receive an interest, including a salary in those partnerships where salaries are paid, equal to his former salary plus a modest increase for the first year or so. Nothing appears to have been written on the subject, for example, of what weight, in evaluating a partner, was given to many factors such as:

1. Number of years a staff member and number of years a partner.
2. Hours charged to clients at the firm's per hour or per diem rates.
3. Total billings by the partner for office and staff other than his own time and whether such billings are usual rates or considerably in excess of usual rates.
4. Source of services rendered by a partner, whether it was firm work originally turned over to him, or clients he secured from his own friends, or clients developed through firm work, etc.
5. Technical ability generally.
6. Ability to develop unusual interest of client.
7. Ability as a specialist in costs and systems, taxes, brokerage, hotels and clubs, etc.
8. Co-operation in the administrative problems of the firm.
9. Activity in community affairs.
10. Activity in accounting societies.
11. Health and vitality.
12. Growth in clientele.
13. Losses in clientele due to errors of omission or commission.

If a partnership of ten partners admits as partners the four staff members whose qualifications are described in Figure I, and Partner D is evaluated at 100 per cent, how would the interests of the other three partners, compared to D, be evaluated percentagewise to share a 15 per cent interest in the profits of the partnership that the other partners are relinquishing? A one per cent interest is worth approximately \$800 a year, the average for the past two years.

Salaries for the four new partners will be \$7,500 each.

More on Partnership Evaluation

In the preceding item the new partner in general was dealt with. There remain further considerations which stem from the performance of the new man in particular: his personality, his individual characteristics, and his potential usefulness in dealing with clients. Although these qualities are difficult to assess, he must be graded in some fashion on this phase of his future work.

Of equal importance in selecting new partners—and requiring some method of scoring—are the following important factors:

1. *Loyalty.* Is the person under consideration likely to be able to stand the stress and strain of working in a team or is he one who will eventually think that he would be better off taking his particular accounts and going into business for himself? In considering this factor, would he be likely to have so little loyalty to the firm, which has promoted him, that he would be tempted to accept offers that might be made to him by other firms which would be interested primarily in accounts controlled by him?
2. *Technical Ability.* Can the candidate be graded on the subjects of accounting and auditing technique, ability to program engagements and supervise them through completion in a reasonable budgeted time allowance? How conscientious is he in analyzing and checking work papers and in other steps in the review process?
3. *Business Ability.* How does he deal with clients in setting the fee arrangement for engagements under his supervision? How does he impress clients in his normal day-to-day handling of

their affairs? Do they have such confidence in his integrity and his professional and intellectual capacity that they seek his advice in management problems such as tax and estate planning and many other facets of their business and personal affairs?

4. *Leadership Ability.* Does he have the ability to handle men assigned to his engagements; to show interest in training them; the willingness to study and understand their problems? At the same time can he, *without losing the objective viewpoint*, manage and supervise engagements in a thorough professional fashion within the time budgeted?

Is he, from all angles, one who is likely to become a partner that the firm will be proud to have represent it with clients with whom he must deal?

The Benefits of Planned Transfers of Practice

In 1955 the advisory committee of local practitioners of the American Institute of CPAs made several recommendations and suggestions regarding the orderly transfer of the practices of deceased or disabled practitioners. As a result, a number of state societies and local chapters have set up orderly plans which are being used with real benefits to the three important parties affected:

First, the deceased practitioner's estate. There is many a practitioner who, until recently, entertained little hope for salvaging anything substantial from his practice when the time arrived that he could no longer carry it on. The dismal thought was that the clients would have to transplant themselves to others' hands as best they could, while his estate's main efforts would be to try to collect the accounts receivable. To such a practitioner, the new possibility of being able to realize as much as one year's additional gross fees comes as a complete (and completely pleasant) surprise. Without question, the greatest and most direct benefits of a preplanned transfer of a practice go to the family of the deceased or disabled practitioner.

Second, the client. The transferring of his account to another office is likely to be an annoying, unpleasant, and inconvenient task

for the average client. The onus is largely removed, however, when he can rest assured that such transfer can and will be smoothly made to another practitioner of his own choice through the good offices of a special committee of the nearest chapter of the state society. The fact that this machinery is being provided for his service and benefit, as well as for the estate involved, cannot fail to impress him anew with the high public aims and sincere service standards of the accounting profession.

Third, the practitioner who purchases the account. The office taking over the new account benefits because the transfer is effected in a timely, considerate, dignified, and mutually confident manner. His pecuniary benefits from the arrangement are, it is true, deferred to the future. Nevertheless, he has the satisfaction of knowing that he is helping his erstwhile colleague and at the same time cementing the goodwill between his profession and his community. Topping all this, he can note with satisfaction that he is forging one more link in a permanent chain that some day may inure to the substantial direct benefit of his own family.

Probably the best-known plan which accomplishes these objectives was developed by the Bridgeport, Conn., chapter of the Connecticut Society of CPAs. It is known as the "Bridgeport Plan." It utilizes a "disaster committee" of local accountants who dispose of a practice when disaster strikes. The committee compiles a list of CPAs interested in buying additional accounts. When a death occurs, the committee helps clients to choose another CPA from the list before the client's affairs deteriorate. Each CPA taking over a client agrees to pay the widow or estate $33\frac{1}{3}$ per cent of the fees he receives for his services to the client over a period of three years. (Other arrangements can be and have been made.)

The individual practitioner may find that his state society or local chapter has adopted such a plan. He should contact the appropriate committee and begin to put his own practice in transferable condition by assembling the necessary data concerning his clientele, as outlined clearly on page 22, Chapter 2, of the *CPA Handbook*. These data include:

1. Date of acquisition of client.
2. Type of service performed.
3. Dates and places of performing services.
4. Fiscal year.
5. Time and fees last three years.

6. Time and fees this year.
7. Time and fees estimated for next year.
8. Dates of billings and payments.
9. Financial status of client (in general terms).

Suggested Plans for Retirement of a Practitioner

The objectives of the retiring practitioner are threefold:

1. Adequate income for himself and his dependents.
2. Continuing high-caliber service for his clients.
3. Suitable outlets for his energy and interests.

Most practitioners seek these objectives through sale of their entire interest. The market is excellent—in certain areas, prices range up to 150 per cent of gross annual fees.

Let us assume that what must be considered a favorable deal is made. A \$50,000 practice is sold for \$50,000, payable 30 per cent down and the balance in three annual installments of 25 per cent, 25 per cent and 20 per cent. To the extent that the price includes payment for unrealized receivables, it is taxable as ordinary income (IRC Sec. 751(a)). A 25 per cent capital gains tax is deducted from each payment, as this plan qualifies for the installment treatment (IRC Sec. 453(b)(2)(A)).

The balance is to be invested to yield 6 per cent, for seeking a higher permanent return would probably move the capital outside the area of safety. The seller can look forward to the following income:

| | |
|---|---------------------------|
| First year | \$ 675.00 |
| Second year | 1,237.50 |
| Third year | 1,800.00 |
| Fourth year and thereafter | <u>2,250.00</u> |
| Twenty-year total (including principal of \$37,500) | <u><u>\$79,462.50</u></u> |

Such a return may prove attractive to one with substantial independent earnings, but the practitioner not so blessed will find himself faced with the choice of risking his capital to produce a higher

yield, making the strenuous effort needed to launch a completely new enterprise, eating into his principal sum, or skimping along on an income insufficient to permit him to enjoy his retirement. And what provisions can he make for his family? The security of a trust usually means a modest rate of return, while an attempt to earn more without trust protection exposes the principal to dangers of mismanagement and aimless dissipation by his beneficiaries.

How can the seller be certain that his clients, now absorbed by a larger practice, will find the same personal attention to which they are accustomed and entitled? He cannot—unless he is familiar with the operations of the purchaser. He can justifiably assume that his successor has both ability and good faith, but not a schedule so flexible as to preclude the possibility that some of his former clients may be shunted into the background.

When the practitioner has actually retired, how will he spend his time? Perhaps he will be occupied with managing his substantial accumulated investments. Perhaps he is eagerly waiting to begin some new activity or study, something which has always fascinated him, but which his busy professional life has forced him to disregard. Perhaps his prime wish is to spend the rest of his days in tranquil relaxation. Perhaps physical infirmity will force him to make the psychological adjustment necessary to accept a sedentary existence. If none of these factors is present to a significant degree, he will unhappily long for those days of frantic telephone calls, report deadlines and crucial conferences.

Development of Younger Partner. Is there another avenue to successful retirement less fraught with pitfalls than the sale of one's entire accounting practice?

Let us consider once again a practice which grosses \$50,000, assuming a net income of \$20,000 for the sole principal. The firm operates with a three-man staff, including a capable young CPA of partnership caliber earning \$7,500 per annum. This man is the key to the problem, for he is to eventually acquire full control.

The essence of the plan is the gradual withdrawal of the principal from active duty. Assuming that it becomes necessary to engage an additional staff man at \$5,000 and that the new partner is to continue receiving his salary of \$7,500, the annual partnership net profit is reduced to \$15,000. Profits are to be divided as shown in Figure II on the next page.

This agreement contemplates that at the end of twenty years, or upon the death of the retiring partner, whichever is later, the new

partner is to become sole owner of the practice. Other suggested features of the arrangement are as follows:

1. Upon the death of the retiring partner, his estate shall succeed to all his retirement rights under the agreement.
2. Action is to be gradual, over a period of years; the retiring partner's prime responsibility is to build client confidence in his successor.
3. The withdrawing partner should remain a member of the firm until termination of his interest. He should continue to serve in a consultative capacity, spending such time as is mutually desirable.
4. Fees paid by new clients obtained by the retiring partner are to be subject to the profit-sharing provisions set forth above. He is not to share in fees paid by clients which the new partner or staff members may acquire.

Figure II

| | <u>New Partner</u> | | | | <u>Retiring Partner</u> | |
|--------------|--------------------|---------------|---------------|------------------|-------------------------|------------------|
| | <u>Profits</u> | | <u>Salary</u> | <u>Total</u> | <u>Profits</u> | |
| | <u>Per cent</u> | <u>Amount</u> | | | <u>Per cent</u> | <u>Amount</u> |
| 1st yr. | 25 | \$ 3,750 | \$7,500 | \$ 11,250 | 75 | \$ 11,250 |
| 2nd yr. | 33 1/3 | 5,000 | 7,500 | 12,500 | 66 2/3 | 10,000 |
| 3rd yr. | 40 | 6,000 | 7,500 | 13,500 | 60 | 9,000 |
| 4th yr. | 50 | 7,500 | 7,500 | 15,000 | 50 | 7,500 |
| 5th yr.- | | | | | | |
| 10th yr. | 60 | 9,000 | 7,500 | 16,500 | 40 | 6,000 |
| 11th yr.- | | | | | | |
| 20th yr. | 75 | <u>11,250</u> | <u>7,500</u> | <u>18,750</u> | 25 | <u>3,750</u> |
| 20 yr. total | | | | <u>\$338,751</u> | | <u>\$111,250</u> |

Despite the fact that the retiring partner is to share in the profits up to twenty years after he terminates full-time duty, the average certified staff man would jump at the chance to participate in such a plan. He is to acquire a substantial immediate interest with no capital investment. Although his salary is to remain constant, his total earnings are to rise from \$7,500 to a minimum average of almost \$17,000 over the twenty-year period. This can be augmented by the addition of new clients or the expansion of services to existing ones. The retiring partner should share in any increased billings resulting from his own efforts.

It must be stressed that the proposed arrangement is merely a

suggestion, subject to such revisions as may be necessary to effect maximum fairness to both participants. This will depend largely upon the time which the older partner plans to devote to the practice after he ends his full-time schedule.

Tax Consequences. 1. All payments made by the partnership to the retiring partner to the extent of the tax basis of his interest in partnership property (excluding unrealized receivables) constitute a nontaxable return of capital. The difference between this tax basis and the fair market value of such property is taxable as capital gain. Everything in excess of the fair market value is taxable as ordinary income (IRC Sec. 736, Reg. 1.736-1(b)(5)).

2. The partners can agree upon any method of allocating the annual payments so long as the total amount allocated to the partner's interest in partnership property does not exceed the fair market value at the date of his retirement (Reg. 1.736-1(b)(5)(iii)).

3. Capital gain treatment could be accomplished by an outright sale of interest by the old partner to the new (IRC Sec. 741). If a sale is not desired, it could be obtained to the extent that the partnership agreement specifies that distributions by the partnership to the retiring partner in exchange for his interest are to include payment for goodwill (IRC Sec. 736(b)).

4. In any event, amounts received attributable to unrealized receivables are taxable as ordinary income (IRC Sec. 751(a)).

5. While beneficial to the retiring partner, capital gain treatment would increase the tax burden of the new partner, which would generally be contrary to the intentions of the parties. If the retiring partner were in a high tax bracket, a plan could conceivably be worked out under which he would accept a smaller percentage of the profits in exchange for capital gain treatment, the net effect of which would be a higher aftertax income for both parties.

6. Ordinary income would cause the withdrawing partner to forfeit any social security benefits to which he would otherwise become entitled from age sixty-five to seventy-two. After age seventy-two, there would be no loss of benefits.

Over-all Effects of Plan. How effective will this plan be in attaining the announced objectives of the retiring practitioner?

Incomewise, it returns about \$111,000 over a twenty-year period as opposed to about \$80,000 yielded by the sale of the entire practice. The latter figure includes both principal and income; both figures are before deducting income tax for the year in which re-

ceived. While this \$31,000 difference may be reduced by the possible loss of social security benefits for seven years, a fair comparison must give weight to the following factors:

a. Under an outright sale, the net proceeds will be subject to reduction by (1) the extent to which unrealized receivables result in taxation as ordinary income; (2) loss of clientele in the first year. Most purchasers will insist on a guarantee covering this period.

b. An inactive partner can still increase his income through the acquisition of new clients, but an ex-practitioner cannot.

c. Many practices grossing \$50,000 net substantially more than the \$20,000 used in our illustration.

Merger with Established Firm. Is there still another method available, perhaps superior to the two already discussed? Under certain conditions, the answer is yes.

We must first recognize that the retiring practitioner could not expect the same profit-sharing percentage from an established firm that he could from a younger partner. Nevertheless, it is possible that the resulting savings in overhead would so increase the net profit available for distribution that, notwithstanding his reduced percentage, he would receive a higher return from a merger. There also may be specialized talent available in the new entity to help solve particular client problems. However, he would probably find that joining forces in this fashion would give him a much smaller measure of managerial freedom. If inactivity is what the retiring practitioner wants, this would prove to be an advantage.

The beauty of this arrangement is its flexibility. The profit-sharing provisions can be tailored to fit the time which the retiring partner is to devote to the firm. This will be determined both by his willingness and capacity and by the needs of the practice.

The Flexible Work Week: Natural Answer to the Seasonal Problem

The very nature of an accounting practice, with its peak period and slack season, would seem to preclude the establishment of a 40-hour week as a regular procedure. In the experience of most firms, there are certain periods when 50 or 55 hours are necessary to complete the work, and other periods when 30 or 35 hours are the maximum to be expected. Naturally, accountants strive to level out the work as much as possible by encouraging clients to adopt

a natural business year and by doing a considerable amount of preliminary work, but those peaks and valleys remain.

Several years ago one firm discarded the idea of thinking of a work week in terms of any specified number of hours since the partners realized that the week would consist of just as many hours as were necessary to complete the work. They geared their thinking, rather, to annual hours and adopted a policy that has produced excellent results for the firm as well as for its employees.

Pattern of Work. Because of the pattern of work, they know that from January 1 to March 31 the staff will average a minimum of 50 hours per week and that from September 15 to December 31 the scheduled work will require an average of about 40 hours per week. Therefore on April 1 the firm goes to a five-day week of 37½ hours, which continues until about September 15. Allowing two weeks' vacation during this period and assuming another two weeks for holidays and excused absences during the year, each employee has a yearly potential of approximately 1,950 productive hours—which means an average slightly in excess of 40 hours per week for the 48 weeks.

Although the foregoing schedule is the policy of the firm, in order to meet deadlines the five-day week may develop into five and one-half or six and, on rare occasions, even a seven-day week. On the other hand, unavoidable idle time may reduce productive hours to the equivalent of a three-day week. Because these situations are ever present in an accounting office, the work week can only consist of as many hours as are necessary to perform the services required in the time available. On the whole, however, the end of the year shows that the staff has come reasonably close to the total annual hours expected by the partners.

Several years ago, when the firm instituted the shortened work week, it was necessary to have a girl in the office on Saturday morning to answer the telephone and tactfully advise clients that the office was closed. The Saturday morning calls dwindled so rapidly that it is no longer necessary to have anyone in the office; it is well known that the firm is closed officially on Saturdays during the summer.

Reaction of the Staff. Since a large percentage of the personnel is not subject to the law's overtime provisions the partners of the firm feel that, through this policy of the shortened work week and the resulting averaging of hours on an annual basis to approxi-

mately 40 hours per week, they have somewhat compensated these employees for the long, arduous hours of the busy season. The reaction of the staff has been gratifying, and the partners believe that this solution is the next best thing to establishing the 40-hour week as a regular procedure.

Planning the Engagement Helps in Staff Training

A majority of the engagements performed by smaller accounting firms are most appropriately handled by one man capable of performing the whole job from start to finish.

Query: What training technique most quickly develops the new staff member to a point where he can effectively handle a one-man engagement?

One answer is the requirement that step-by-step blueprints of procedure be drafted on all engagements, even the smallest. The first few times such programming is done by the principal. In the next stage it is performed by the recruit, under supervision. Finally, it should be done by the trainee himself, subject only to quick review.

The programs so drafted will usually be correlated with a time budget which in turn will be cross-referenced to the balance-sheet and operating accounts.

On the part of the trainee, this planning-the-work technique builds self-confidence and accelerates development. At the same time it gives the principal an amazingly accurate index of the trainee's strengths, weaknesses, and insight. In particular, the quality of his planning begins to answer the paramount long-run questions: what are the man's creative thinking ability and general resourcefulness?

An Easy Way for the Small Firm To Inaugurate Staff Meetings

A survey of small-staff CPA offices would probably reveal that most of them never hold a staff meeting, and that the others hold them only rarely. Undoubtedly the psychological reason behind this omission is the feeling that communication between employer and employees is more or less automatic anyhow, so why bother with

such pomp and ceremony? Such practitioners may wish to try a Monday morning staff meeting for the combined purpose of (1) lining up the entire week's work, (2) disseminating information of general interest, and (3) clearing up pressing problems encountered on pending engagements.

This idea can be put into effect at any time. It is practical, and will improve morale.

Somehow, either systematically or haphazardly, the week's work must be assigned. If the work is not preplanned and assigned, staff men may run out of work while the principal is tied up and be forced to waste several hours waiting to see him. When this happens, additional time is usually lost through numerous back-and-forth interruptions at odd intervals throughout the week, usually at times when uninterrupted production should be paramount. The prime purpose of the Monday morning preplanning session is to eliminate this waste time, and to assure a smooth flow for the week ahead.

Discussion of new and nearly completed work, and unexpected speed or slowness on pending jobs, can all be integrated into a new work plan on Monday morning—the time when all hands are fresh and ready for action. It is a good idea to keep a record of the assignments given each person in vertical columns of a simple form, so that, from week to week, progress on previous assignments can be noted, and expected progress on current assignments can be estimated.

The reason for getting the staff together bright and early Monday morning is essentially to assign the week's work load. The other benefits are spontaneous. Minor changes in internal policy can be explained. Meetings in the community during the coming week can be mentioned, and in some instances accompanied with requests that certain staff members attend them. Each person present can probably contribute some interesting local business news or some recent professional development affecting the practice. It is a wise practice to invite each one present to volunteer anything on his mind. Someone may wish to report briefly on a book or article he has just read, to raise a question about some part of the previous week's engagement, and so on. Everybody should have full opportunity to show his lights, to contribute to the good of the order.

These meetings will usually last only fifteen minutes, never over an hour. They do not substitute for periodic instruction meetings on taxes, auditing, and other subjects. But they do accomplish for the

small accounting organization the co-ordination of assignments, communication of plans and policies, and help on immediate problems, which large firms must accomplish through bulletins and by having one partner devote all or most of his time to "herding the staff" and co-ordinating and dispatching assignments.

One of the maxims that all small organizations might well remember is: you get bigger by acting bigger. An unpretentious staff meeting on Monday morning, even if a staff consists of only one person, is a step in the right direction.

One Solution to the Problem Of "Dead End Seniors"

Many small practitioners are faced with the problem of "dead-end seniors," staff men who are not partnership material, but whose services the firm would like to retain. These men can reach only a certain stage in the accounting firm and are then "dead ended."

In many instances these seniors are placed with clients who are looking for capable people with the background these men offer. This ties the accounting firm closer to the client since one of its alumni is in a key position.

In other cases, firms have made very good use of the seniors by making them specialists in systems, estate planning, budgeting, cost analysis, or management problems. While they are preparing to specialize, they may be used as audit supervisors. All their unassigned time during this period is devoted to the study of the particular specialty that they have chosen or have been assigned to.

When the men become specialists, naturally the firm can charge more for their services because they are worth more to the client. Because of these higher fees, the men can be paid more than they could earn as staff seniors.

Discharging a Staff Member: Some Helpful Pointers

Among the more unpleasant duties sooner or later encountered in the management of any accounting practice is the discharging of a staff member. Shallow indeed would be any discussion of the subject which merely gave instructions to both parties on how to

sever the relationship with minimum emotional wear and tear. That the delicate operation is capable of being performed in a way calculated to serve the best long-run interests of all concerned is the gist of some cogent remarks by Max Block in the September 1954 issue of *The New York Certified Public Accountant*:

"The discharge of a staff member is a matter of great seriousness to the person involved. Humane considerations as well as the interests of the employer demand that such an action, even if for cause, be carried out in a manner that will not crush the individual's self-respect, nor make him feel that he is totally unqualified.

"It is always an unenviable job to lay off an employee, particularly one who may have been on the staff for several years, at a time when jobs may be scarce, and if the individual involved has family responsibilities. The unpleasantness of this task can be reduced considerably if it is handled in a sympathetic manner, the reasons for the action reasonably explained, and some advice given to the individual as to what he might do about helping himself. In most cases, such an employee will leave without rancor and his regard for the firm may even be raised.

"Employees who leave with a feeling of bitterness may spread malicious tales about their former employer among fellow-accountants and, possibly, among clients. This is a situation that should be avoided. Staff morale can be adversely affected by stories of 'cold' discharges.

"Even in a large organization a staff member should not be released by merely giving him a discharge slip. He should be given the courtesy, as a professional man and employee, of a personal notice and explanation. If a man can be given advance notice, that is usually appreciated. Where a firm, as a matter of policy, does not like to keep men who know they have to leave, it would be fair to give them some extra severance pay in lieu of notice. The amount of severance pay is a matter for the conscience of the accountant and is controlled by a number of factors.

"There undoubtedly are many cases where a release from a position (the word 'release,' for psychological reasons, is preferable to the term 'discharge') for cause was the turning point in a man's career. It either spurred him on to greater effort or made him realize that his aptitudes were in another field. Some of these men later became very successful. A helping hand to the released staff man may keep him from making a serious mistake in charting his future course."

ACCOUNTING AND AUDITING TECHNIQUES

How Not to Conduct the Financial Affairs of a Small Corporation

Just as the corporations listed on the big board of the New York Stock Exchange require professional accounting services of a magnitude which only national firms can furnish, there are thousands of smaller corporations who depend upon counterpart smaller accounting organizations. The financial affairs of these smaller corporations deserve to be spotlighted because they constitute an important segment of the national economy and also because they form a most important part of the typical small accounting firm's practice.

As observed by accountants, what are the weaknesses of financial structure and the abuses of good corporate policy that are most characteristic of small corporations? And what is their underlying cause? Surprisingly, a majority of the difficulties originate from, and constantly revolve around, the simple failure of shareowners to respect the small corporation as a legal and financial entity separate and distinct from themselves.

One can list the abuses most frequently found in shareowner-corporation financial relationships. The accountant reading this list

will wish to keep in mind the small corporation his own office is now serving.

In a healthy corporation, the flows of funds between the corporate entity and the owners of its shares are normally only three in number.

First, there must be an original contribution of capital, in cash or other assets, by the shareowners.

Second, there must be regular compensation disbursements by the corporation to its officers in payment for managerial services.

Third, assuming good earnings, there should be systematic payments of dividends in accordance with a definite dividend policy.

Wise is the corporate management which limits the interflow of funds to this trio of essentials. For insidious complications in the financial framework are almost always created when, going beyond these, a controlled corporation makes it a practice to lend to its shareowners or borrow from its shareowners—often in the guise of innumerable forms of advances, drawings, receivables, or payables.

Initial Capitalization. The incorporators of a new company are commonly afflicted with a “Kingfish complex” in deciding the par value of stock to be issued for the assets being conveyed to the new entity. Quite often the mistake is made of stepping up the valuation excessively. In such cases the end result is undue future accounting complexity and unduly high future amortization charges against revenue. Reducing volumes to one sentence, incorporators should be guided by the controlling fact that the real value of those shares will be determined by the earning power of the business, not by the fiat of the directors at the time they judge the fair value of the assets, and thereby the number of shares to be issued therefor. Accountingwise, the ideal situation is one where the initial transaction is a bank deposit, offset by an equivalent issuance of capital stock. The further the departures from this ideal, the greater are the chances of future headaches.

Officers' Salaries. Small corporations frequently develop engine-knock by setting up unrealistic initial officer salaries, by raising or lowering such salaries with each variation in the economic weather, and by accruing salaries instead of issuing regular paychecks in full to the officer employees just as is done to nonofficer employees. As with other employees, officers should expect to get the highest possible amount commensurate with the salaries they have commanded or could command with another organization of similar size.

The bad effects of sporadic ups and downs in officer salary levels is well known to all accountants. And the use of journal entries in lieu of the checkbook is almost always a signal that something is wrong somewhere—working capital is depleted, the salary is exorbitant, or whatnot.

If a small corporation is expanding and truly prospering, let the officers receive their executive pay in cash, then turn around and buy additional issuances of capital stock with the money.

Dividends. Comparatively rare are the small corporations that can point to a prudent, consistent, systematically executed dividend policy. Yet probably no one thing will more favorably impress bankers or prospective new shareowners with the fact that here is a business blessed with mature management.

The pattern to be followed is plainly visible in the records of successful large corporations. As a rule, they pay out from 40 per cent to 80 per cent of earnings in dividends. The dividends are paid regularly on the same dates year after year, usually in cash and always in compliance with prior dividend declarations.

Shareowner Loans to the Corporation. Independent accountants have learned to take a frankly skeptical attitude toward unsecured loans made by shareowners to the small corporations they control. Why? Because experience has shown that in many instances such debt is not paid off in the same strict manner as that owed to outside creditors. A case in point is unsecured loans payable "on demand." If the "demand" is never exercised and is still on the auditor's report as a current liability five years in a row, might not the banker say to the auditor, "See here, is this a current liability or is it permanent capital in masquerade?"

An excellent set of criteria for distinguishing between corporate debt and corporate equity may be found in Merten's *The Law of Federal Income Taxation*, paragraph 26.10, which deals with the debtor-creditor relationship in terms of: The intention of the parties; nomenclature of the instruments; definiteness of the obligation's maturity date; the security as to assets; voting powers; the definiteness of the interest as to rate and dates of payment; redemption or retirement provisions; presence or absence of contingent conditions; redeemability; and financial risk involved.

Corporation Loans to the Shareowners. Everything stated above

applies here, only in reverse. By and large, people don't pay their debts to controlled corporations in the same conscientious way they pay arms-length creditors. They are prone to follow the lines of least resistance, to "let 'em ride." So the auditor's question is, "Are those advances or drawings or accounts receivable actually realizable assets to the corporation, or are they really unauthorized liquidating distributions or unauthorized earnings distributions?" If they are genuine receivables, the acid proof is their collection. If not collected, words of explanation are mere vibrations of the atmosphere. And in such circumstances, how can the corporation's financial position be interpreted? To the embarrassment of everybody concerned, including the independent auditor, nobody really knows. But all must agree that the corporation is the victim of lax corporate practice—of substandard financial care and prudence.

Formula for Speedy Familiarity With a New Client's Accounts

Accounting systems are like people: no two are alike, they are always interesting, and many are complex.

This being true, probably every auditor has at least faint pangs of apprehension about getting a quick enough initial mental toehold on the accounting structures of new clients.

Strange, isn't it, how the client assumes that a CPA will be intimately familiar with the whole web of accounts after only a few hours on the job?

Doubtless every practitioner has up his sleeve some ingenious shortcut approaches to the basic task of orientation. But there is one old standby, three-in-one rule which is rooted in pure logic and guaranteed to get the job done and lead to relatively early peace of mind for the practitioner. First, he should trace the latest financial report to the general ledger; second, trace all the general ledger charges and credits of the latest month to the journal sources; third, test the journalization by examining the detail behind *one* typical day's transactions.

If these three tracings can be carried through completely, without any interruption, he will no longer have to bluff when the accounts come under discussion—even though it may be weeks before his grasp of the integrated picture is all that he is already given credit for.

Program for Small Business And Farm Accounting

A variety of problems arise in a public accounting practice in a small but economically diversified community. More attention and further study should be given to the techniques employed in serving smaller enterprises.

Client Personnel Vary Greatly in Training and Experience. The independent public accountant in such an area serves a mixed clientele: manufacturers ranging in size from home workshop industries to branches of nationally recognized corporations; merchants of many types; and farming enterprises varying from small family groups to intricate associations.

The individuals with whom the accountant deals vary as widely in training and experience. There are those with advanced training in business operations, those who have supplemented limited training with practical business experience, and those who must rely upon independent technical assistance. Since many of the men who complete their college work—with or without emphasis upon business management—tend to overlook local opportunity and seek employment with outside firms, a significant share of the CPA's local clients fit into the second and third categories mentioned above: those with limited technical training and those who must proceed on a trial-and-error basis lacking qualified independent advisers.

Emergency Engagements Must Give Way to Continuing Service. Too often, the first meeting of the small businessman and the CPA occurs when the businessman faces the urgent necessity of compressing a mass of accumulated operating data into an acceptable financial statement or tax return. Here, the training and experience of the CPA enable him to classify these data and prepare the reports. Yet the hazards of last-minute statement preparation are well known.

Recognizing that the value of careful business advice to the smaller businessman is obviously greater in proportion to his net worth than it would be to the larger owner, the following plan is presented for a continuing small business engagement:

1. Clients submit data periodically. Whether the data are to be submitted in summary form by the client or recorded in the accountant's office will be determined after the initial confer-

- ence. It may be observed that current entry of data which might otherwise accumulate into an unwieldy deadline mass may help to solve the workload problem of the practitioner.
2. Scheduled client conferences are held. The scheduled conference with the client can be used to develop details of the personal and business transactions affecting his future financial status. Lack of adequate plans, caused by lack of adequate records, may well be a major inhibiting factor in the growth of a business enterprise. By carefully guiding the small businessman through the difficult initial survival period, the CPA is providing service for which he is specifically qualified and is developing his practice by growing with his clients.
 3. The CPA regularly prepares reports and returns. The preparation of annual statements and returns will be an incidental routine in the larger program of complete accounting service to the client. The data will have been carefully and thoughtfully accumulated, classified, and interpreted; the client's policies will have been established so that his capital is conserved and his profit is maximized.
 4. More complete services educate the client to regard the CPA as an adviser, and at the same time make possible higher standards of practice. The practitioner in the small community must render this complete service if he is to maintain the highest standards of the profession of accountancy. In so doing, he will assure himself of a year-round income from regular clients who have learned to rely upon him for professional advice; and he will provide a high level of continuous and constructive service that cannot be offered by less qualified persons.

Taking Off Trial Balances The New-Fashioned Way

This idea is packed with merit, yet is so absurdly simple each practitioner will no doubt mumble, "Why didn't I see and adopt this long ago?"

It is a new-fashioned way of proving the equality of general ledger debits and credits which yields the significant net profit or loss

figure in the *same* mechanical operation. It is based upon the universally known accounting axiom that net profit for a period equals the increase in net assets (i.e., assets minus liabilities). All there is to it is to strike the total key after all balance-sheet items have been added or subtracted. If the ledger is in balance, the addition of revenue balances and subtraction of expense balances come to the same tape figure.

With this method there is no reason why the manager can't be told two minutes after the ledger is posted what the sales and the profits were for the preceding month.

The technique also has practical application to the big business with voluminous journals and a giant general ledger. Here, the bookkeeper takes an adding machine tape after posting each journal, picking up a subtotal balance of the asset and liability accounts therein, the final total, of course, zeroing out. When this is done on all journals, the net profit or loss is the sum of these tape subtotals, a profit if an increase in net assets, a loss if a decrease. Not only this, there is the added advantage of proving the accuracy of the postings as the work progresses, which greatly minimizes the hunting for posting errors if any have been made.

The Acrobatics of Trial Balancing: A Sequel

One practitioner reports that he has refined his trial balancing into five steps: (1) total the sales accounts for the month, (2) total the cost-of-sales accounts for the month, (3) total the expense accounts for the month, (4) total the asset accounts, (5) subtotal the liability and net worth accounts, to which add the previous month's year-to-date profit or loss, then the current month's profit or loss, which total should equal the total assets. If the general ledger is not in balance, this technique, coupled with comparison with last month's similar trial-balance runs, quickly localizes the error or errors in the asset, liability, sales, cost-of-sales, or expense categories.

Another practitioner shares some interesting and fruitful experimenting along these lines. He has found the sectionalizing of work paper balances to be especially effective because then "I have a clear picture of the financial condition and operations before me at all times" which assists in focusing attention on the main facts and thinking through the major problems as the audit progresses.

A third man confirms these advantages, adding that the basic categories "are never mixed; even if the assets, for example, run over only one or two lines onto the next work sheet, nothing further is put on that sheet and, when the liabilities are listed, a fresh sheet is used; thus we can tell quickly what effect our adjustments are having on the profit."

Interaccount Relationships In Small Business Control

To the uninitiated, there is one skill of a good auditor that seems uncanny, namely, the ability to flip through a ledger or a schedule of comparative figures and in a couple of minutes spot weaknesses in accounting applications, internal control, and business management. The secret lies not in occult magic but in an ability to *distinguish patterns in the figures* rather than to look at them as isolated phenomena.

A practitioner concerned with this matter emphasizes that the "interaccount relationship" technique can be particularly helpful in examinations and reviews of the accounts of small businesses.

The real value of this approach lies in the assistance it gives to the auditor in determining, within a very short time, whether the accounts are correct in the essential information contained therein, or whether the basic principles being employed are incorrect. The auditor must determine as quickly as possible whether there is an incorrect application. Relationships such as the amount of labor or materials going into each unit of product, capacity of the plant, approximate level of activity, cost of sales to sales, and overhead costs to volume of activity, when traced through the monthly data, will quickly disclose incorrect accounting procedures.

Suppose, for example, the labor cost normally runs about \$10 per unit produced. A quick check could be made to determine whether the labor cost as recorded by months approximates the labor cost necessary to produce the units sold. Thus the relationship of labor to units produced will begin to shed light not only on the correctness of the labor account, but of the sales and inventory accounts as well. Once the basic relationship is determined, and the spreadsheet of the whole year's monthly figures is prepared, the adequacy of the accounting data can be determined very quickly, sometimes with the aid of nothing more than mental arithmetic.

To illustrate more specifically how this technique may function as an aid in locating the misapplication of accounting principles, let us suppose the auditor finds the ledger balances shown in Figure I.

Figure I

| | <i>Ledger Balances, etc.</i> | | |
|-------------------------|------------------------------|----------------|----------------|
| | <u>Jan. 31</u> | <u>Feb. 28</u> | <u>Mar. 31</u> |
| Cash | \$ 400 | \$ 380 | \$ 1,150 |
| Accounts Receivable | 1,200 | 2,900 | 1,800 |
| <i>Inventory</i> | 3,000 | 4,000 | 3,400 |
| Fixed Assets | 8,000 | 8,000 | 8,000 |
| Liabilities | (1,800) | (1,700) | (1,800) |
| Capital | (80,000) | (80,000) | (80,000) |
| Surplus | (23,900) | (25,880) | (31,050) |
| <i>Sales</i> | (14,000) | (17,000) | (10,000) |
| Material Costs | 5,000 | 5,500 | 4,500 |
| Labor | 3,000 | 3,500 | 3,000 |
| <i>Overhead Costs</i> | 2,000 | 2,200 | 4,000 |
| <i>Production Costs</i> | 10,000 | 11,200 | 11,500 |
| Administrative Expense | 2,500 | 2,500 | 2,400 |
| Selling Expense | 1,000 | 1,200 | 1,000 |

(Italicized items are those referred to below.)

One important fact that is readily apparent from these balances is that overhead costs total approximately two-thirds of the labor costs for January and February, but increase considerably over that ratio in March. If a survey of the business' operations indicates that labor and overhead costs parallel each other, then their accounting methods should be examined.

Further analysis of the March balances reveals that not all is correct within the inventory account. *Production costs for March are approximately equal* to those of February, but *sales have declined*. This usually means an *increase in the ending inventory*. However, in this case the reverse is found, for the inventory account has decreased. The auditor must now search for the cause, and could, for instance, find that entries are being made setting up receivables

and crediting income when sales orders are received, although shipments do not take place for some time afterward.

This approach does not eliminate any of the generally accepted auditing procedures for ascertaining the amount of cash, receivables, inventory, or other assets on hand as of the balance-sheet date. Generally accepted auditing procedures must be applied regardless of the approach the auditor takes.

This approach does, however, serve three basic purposes which will more than compensate for the time spent by the auditor:

1. For the small business it is a form of internal control, and gives the auditor a working knowledge of the adequacy of the accounting principles employed. Since one of the auditor's functions should be to give recommendations as to how more reliable monthly data can be derived from the accounting records, he is immediately placed on guard for such items as yearly tax bills or large purchases of supplies or fuel that are expensed as paid, with no accruals or deferrals.
2. It aids in setting up the audit program, and is useful in determining the extent of sampling.
3. Last, and by no means least, it gives the auditor a basis for helping the client set up a workable accounting system that will give him reliable and useful monthly data.

This CPA has found that the additional time spent in this type of analysis will in most cases be more than balanced both by the increased value of the practical information developed and by the savings in time and audit cost resulting from the elimination of much detail work.

Sum-of-the-Years-Digits Monthly Depreciation Table

A favorite device of many effective tax practitioners is the placing of handy tables of condensed information under the glass tops of desks. Such tables can be referred to easily in preparing returns or in either telephonic or across-the-desk discussion with clients.

A good example of a very useful table is the one shown in Figure II. It shows in decimal form the years-digits depreciation on depreciable assets with lives of three to ten years. To interpret

| Life Years | | | | | | | | | | | | |
|------------|------|------|------|------|------|------|------|------|------|------|------|------|
| 3 | 5000 | 3333 | 1667 | 3333 | 3889 | 4444 | 1667 | 2222 | 2778 | | 0556 | 1111 |
| | 4583 | 2917 | 1250 | 3472 | 4028 | 4583 | 1806 | 2360 | 2917 | 0139 | 0695 | 1250 |
| | 4167 | 2500 | 0833 | 3611 | 4167 | 4723 | 1944 | 2500 | 3055 | 0278 | 0833 | 1389 |
| | 3750 | 2083 | 0417 | 3750 | 4305 | 4861 | 2083 | 2640 | 3194 | 0417 | 0972 | 1528 |
| 4 | 4000 | 2667 | 1333 | 3000 | 3333 | 3667 | 2000 | 2333 | 2667 | 1000 | 1334 | 1666 |
| | 3667 | 2333 | 1000 | 3083 | 3417 | 3750 | 2083 | 2417 | 2750 | 1084 | 1416 | 1750 |
| | 3333 | 2000 | 0667 | 3167 | 3500 | 3833 | 2167 | 2500 | 2833 | 1166 | 1500 | 1834 |
| | 3000 | 1667 | 0333 | 3250 | 3583 | 3917 | 2250 | 2583 | 2917 | 1250 | 1584 | 1916 |
| 5 | 3333 | 2222 | 1111 | 2667 | 2889 | 3111 | 2000 | 2222 | 2445 | 1333 | 1556 | 1777 |
| | 3055 | 1944 | 0833 | 2723 | 2945 | 3167 | 2055 | 2278 | 2500 | 1389 | 1611 | 1833 |
| | 2777 | 1667 | 0556 | 2778 | 3000 | 3222 | 2112 | 2333 | 2555 | 1444 | 1667 | 1889 |
| | 2500 | 1389 | 0278 | 2833 | 3055 | 3277 | 2167 | 2389 | 2612 | 1500 | 1722 | 1944 |
| 6 | 2857 | 1905 | 0952 | 2381 | 2539 | 2699 | 1905 | 2064 | 2222 | 1429 | 1588 | 1746 |
| | 2619 | 1667 | 0714 | 2421 | 2578 | 2738 | 1944 | 2104 | 2262 | 1469 | 1628 | 1786 |
| | 2381 | 1429 | 0476 | 2460 | 2619 | 2778 | 1984 | 2143 | 2302 | 1509 | 1667 | 1825 |
| | 2143 | 1190 | 0238 | 2500 | 2660 | 2817 | 2024 | 2182 | 2342 | 1548 | 1706 | 1865 |
| 7 | 2500 | 1667 | 0833 | 2143 | 2262 | 2381 | 1786 | 1905 | 2024 | 1429 | 1548 | 1667 |
| | 2292 | 1458 | 0625 | 2172 | 2292 | 2411 | 1816 | 1935 | 2054 | 1459 | 1578 | 1696 |
| | 2083 | 1250 | 0417 | 2203 | 2321 | 2440 | 1845 | 1964 | 2084 | 1489 | 1607 | 1726 |
| | 1875 | 1042 | 0208 | 2232 | 2351 | 2471 | 1875 | 1994 | 2113 | 1519 | 1637 | 1756 |
| 8 | 2222 | 1481 | 0741 | 1944 | 2037 | 2129 | 1667 | 1759 | 1852 | 1389 | 1482 | 1574 |
| | 2037 | 1296 | 0555 | 1967 | 2060 | 2153 | 1690 | 1782 | 1875 | 1412 | 1505 | 1597 |
| | 1852 | 1111 | 0370 | 1990 | 2083 | 2176 | 1713 | 1805 | 1898 | 1435 | 1528 | 1621 |
| | 1667 | 0926 | 0185 | 2013 | 2106 | 2199 | 1736 | 1829 | 1921 | 1459 | 1551 | 1644 |
| 9 | 2000 | 1333 | 0667 | 1778 | 1852 | 1926 | 1556 | 1630 | 1704 | 1333 | 1408 | 1481 |
| | 1833 | 1167 | 0500 | 1797 | 1870 | 1945 | 1574 | 1649 | 1722 | 1352 | 1426 | 1500 |
| | 1667 | 1000 | 0333 | 1815 | 1889 | 1963 | 1593 | 1667 | 1741 | 1370 | 1445 | 1519 |
| | 1500 | 0833 | 0167 | 1833 | 1908 | 1981 | 1612 | 1685 | 1760 | 1389 | 1463 | 1537 |
| 10 | 1818 | 1212 | 0606 | 1636 | 1697 | 1757 | 1455 | 1515 | 1576 | 1273 | 1334 | 1394 |
| | 1667 | 1061 | 0454 | 1651 | 1712 | 1773 | 1469 | 1530 | 1591 | 1289 | 1349 | 1409 |
| | 1515 | 0909 | 0303 | 1666 | 1727 | 1788 | 1485 | 1545 | 1606 | 1304 | 1364 | 1424 |
| | 1364 | 0757 | 0151 | 1681 | 1742 | 1803 | 1500 | 1561 | 1622 | 1319 | 1379 | 1439 |

1
2
3
4
5
6

Years of Depreciation

the table, remember that the twelve months of each year are arranged in the table:

| | | |
|---|---|----|
| 1 | 5 | 9 |
| 2 | 6 | 10 |
| 3 | 7 | 11 |
| 4 | 8 | 12 |

Let's try out the table on a hypothetical asset with an eight-year life purchased on September 30, 1956 for \$1,000 and no salvage value. The depreciation for the three remaining months in the first year are found to be .0555 of \$1,000 or \$55.50 (look in square number 10 as October is the first month subject to depreciation). For the full annual depreciation of subsequent years also look in square 10 of those years which, respectively, show .2153, .1875, .1597, .1320, .1041, .0764, .0487, and .0208. The proof-recapitulation (Figure III) is easy:

Figure III

| | <i>Per Table</i> | <i>Exact Computation</i> |
|--|-----------------------|------------------------------|
| 1956 (3 months) | \$ 55.50 | \$ 55.56 |
| 1957 — first full year | 215.30 | 215.28 |
| 1958 | 187.50 | 187.50 |
| 1959 | 159.70 | 159.72 |
| 1960 | 132.00 | 131.94 |
| 1961 | 104.10 | 104.16 |
| 1962 | 76.40 | 76.38 |
| 1963 — last full year | 48.70 | 48.60 |
| 1964 (9 months) | 20.80 | 20.86 |
| Full-life depreciation | <u>\$1,000.00</u> | <u>\$1,000.00</u> |
| Average constant annual reduction in each full year of depreciation | <u><u>\$27.78</u></u> | <u><u>\$27.78</u></u> |

The use of the constant, in combination with the table, cuts time and work to the irreducible minimum in figuring the depreciation for the first fractional year as well as for every year thereafter.

Strongly suggested as an accompanying accounting policy is to start depreciation from the first day of the month following the asset acquisition. Many, if not most, efficient organizations pursue this basic depreciation *policy* regardless of the depreciation *method* or methods used.

Where Variety Is Not The Spice of Life

On any new technical subject, it is necessary to build from simple distinctions, easily comprehended (day and night, hot and cold, etc.), and then, by subtly graduated steps, learn more and more about less and less until it no longer seems so "technical."

An unusual example of the swift and graceful bridging of this gap was one of the "technical" papers presented at a meeting of the Controllers Institute of America in Los Angeles.

The speaker first reminded the audience about the well-known deadening effects of monotony on the human senses and, conversely, the salutary effects of variety in everything we see, feel, taste, smell, or hear. Therefore, it is exceedingly important in manufacturing consumer products that suitable variety be preserved on all features impinging directly on the organic senses because "visible" (i.e., sensory) variety is the very spice of life, quite worth its extra cost. But what about "invisible" variety? Answer: any excess of invisible variety spells additional cost and that's all. The prospective owner of a new car is not interested in the steel alloys used in the steering column nor in the structure of the brake mechanism . . . but he is interested in driving ease, comfort, and color.

With everybody now alert and wondering what was coming next, the speaker then drove home his main thesis: that variety is one of the great hindrances to higher productivity and lower manufacturing costs, and accordingly the aim should be to manufacture the maximum variety of finished products out of the minimum variety of components, with the aid of the minimum variety of materials.

What causes a superfluity of materials, tools and components? Answer: bad descriptions, fortuitous nomenclatures, and meaningless numbering of items which should be replaced by precise systems of identification and classification.

If this is not done, what happens? In a recent investigation the following very similar parts, which could have been made interchangeable, were found under eight entirely different names:

| | |
|--------|--------|
| Pin | Stub |
| Pivot | Bolt |
| Spigot | Swivel |
| Axle | Stud |

In another case, 32 different names were found for 32 perfectly

plain sheet metal discs. Again, nearly 100 names have been found to be in current use in engineering drafting rooms for the identification of a single diameter pin.

Just how common and extensive is this wasteful overlapping? In general such concealed duplications seldom amount to less than 10 per cent of the number of varieties held, and in each case are only revealed after precise identification according to each item's permanent characteristics as determined from the viewpoint of the user. Many cases are on record of a 20 per cent to 30 per cent superfluity of unnecessary items resulting from such causes as these.

What, then, can be done to facilitate effective identification and classification? Reply: a numerical code must be designed which will symbolize all the classified descriptions of the items in such a way that each digit, by virtue of its position and magnitude, signifies the characteristic which is selected.

With what results? In many instances, slight modification of closely similar items, easily traced by the code, has saved the making of special tools and consequently the performing of extra machining operations. Again, in one of the more startling of numerous cases cited, after classification and coding by this method, the time required to take inventory in a large electrical firm was reduced from three or four weeks to two or three days!

The title of this paper was "Simplification and Classification as a Tool of Management," and its author was R. S. Geohegan, who is a director of E. G. Brisch Partners, Ltd., an organization of consulting standardization engineers in London.

The Language of Symbols

Most accountants develop a language of symbols all their own which they use in their work. As they enlarge their practices and engage others, it is necessary to teach them these symbols so that there is uniformity in working papers.

One practitioner discovered that a simple index of symbols, as shown opposite, can be a valuable aid to any practice. He presents this index to each staff member and requests that he use it. In addition, he asks them to use red pencils for these marks.

Figure IV

- ∩ = Inspected—usually used in making a bank reconciliation where the check is compared to the cash disbursements book and cash deposits are checked to the cash receipts book.
- ∩ = Compared figures such as general ledger postings. Also, when preparing a statement or tax return, use this symbol to indicate that that figure has been used.
- ∨ = Compared vouchers with book of original entry.
- C = Confirmation received and compared with items next to which the (c) is placed.
- ② ② ② ① ② ① = Whenever combining several items which will be used in a tax return or in the preparation of a statement, put a number inside the circle next to each item that is combined.
- ^ = Footed—put this symbol at the bottom of a column between the \$ and ¢ marks of the total of the column footed. (1,234 56)
- > ^ = Crossfooted—put the first symbol at the beginning of the totals that were crossfooted, and the second symbol at the other end of the column indicating that between the two symbols the items were crossfooted.

| <i>Total</i> | <i>Item 1</i> | <i>Item 2</i> |
|--------------|---------------|---------------|
| > \$1,234.56 | \$789.20 | \$445.36 < |

The accountant has also adopted the following abbreviations for use by all members of his staff:

| | |
|----------|-----------------------------|
| T/B | – Trial Balance |
| B/S | – Balance Sheet |
| P/L | – Profit and Loss |
| N/C | – No Charge |
| C/R | – Cash Receipts |
| C/D | – Cash Disbursements |
| J/E | – Journal Entry |
| S/R | – Sales Register |
| P/J | – Purchase Register Journal |
| G/L | – General Ledger |
| LTCC | – Long-Term Capital Gain |
| STCC | – Short-Term Capital Gain |
| LTCL | – Long-Term Capital Loss |
| STCL | – Short-Term Capital Loss |
| T/R | – Tax Return |
| F/S | – Financial Statements |
| P/R | – Payroll |
| A/R | – Audit Report |
| T/L | – Transmittal Letter |
| C/B | – Close Books |
| A/P | – Accounts Payable |
| Acct. R. | – Accounts Receivable |
| F/A | – Fixed Assets |
| P/C | – Petty Cash |
| C/C | – Cash Count |
| S/S | – Social Security |
| FWT | – Federal Withholding Taxes |
| UCC | – Unemployment Taxes |
| N/P | – Notes Payable |
| L/P | – Loans Payable |
| CIB | – Cash In Bank |
| F&F | – Furniture & Fixtures |
| M&E | – Machinery & Equipment |

MISCELLANEOUS

One's Outlook May Be the Cause of "A Bad Day at the Office"

Practicing accountancy can be satisfying or frustrating, depending on one's attitude toward each day's work.

Suppose, to take an extreme case, that a practitioner goes to the office Thursday morning with the fixed goal of at last finishing the X Company report. Instead, his day is occupied with thirty 15-minute conferences, twenty in person and ten by telephone. Was it a good or a bad day?

The reaction of one practitioner would be that this hypothetical day was completely botched because his pre-conceived plan was rudely sidetracked; the X report was still not completed; and that epidemic of picayunish conferences resulted in practically no billable time, as nothing under half-hour units is worth bothering with on the time sheets.

The reaction of another practitioner would be that this same day was an exceptionally good one because a lot of distilled knowledge and experience was communicated. Brief notes were made in the course of each conference so that on Friday either file memoranda or letters were dictated for the benefit of both the clients and the

practitioner (who always reviews correspondence files at billing time). As for the X Company report, the alert senior accountant phoned Mr. X in advance to give him the net profit and other highlights of the year's results, thus removing the imagined pressure from that quarter.

What is the philosophy?

Simply this: At the bottom it is probably pre-conceived notions that largely determine whether the day is good or bad. The happiest practitioner, surely, is the one who expects—and even enjoys—detours, surprises, and interruptions. He has learned to “roll with the punches,” to co-operate with the inevitable. His priorities are kept as flexible as possible. With this approach, all he has to do is follow the guiding principle of always attending now to whatever has priority under the circumstances. Then, every day is a good day at the office.

How to Separate Public Auditing And Public Controllershship

What is the smaller practitioner's basic division of functions on an open-end combination engagement? Typically, such engagements occur when a new business client comes in and in effect says he has to satisfy his banker as to his financial position and earnings so that the pending loan application will be approved and, naturally, he would *also* like any information that will increase profits “*provided, however,*” as the legal documents say, the tab is right. He knows what he's after in net results but not in terms of accounting technique. Success or failure hinges largely on the CPA's judgment and honor. The open-endedness creates a heavy responsibility but it also creates a fine opportunity for the CPA to show his mettle as (1) an independent auditor, and (2) a part-time controller. The skillful and courageous small practitioner would welcome the latitude inherent in this situation.

The question is: How should the opportunity be approached, processed, and presented?

A number of engagements of this type have been handled with fair success by a long-form report which combined both the certified financial statements and volunteered managerial analyses covering

various phases of the business. However, much more success may be attained if the accountant remembers throughout that one distinct function is impartial portrayal of financial position and financial results and the other distinct function is pointed intelligence on just how to improve that financial position and those financial results.

It is somewhat like baseball.

If an engagement is strictly an outside audit, the CPA's duty is analogous to that of impartial umpire and scorekeeper, which certainly requires an intimate knowledge of the game.

If an engagement is strictly one of controllership, on the other hand, his role is like that of the coach who must know the game also, but whose consuming interest, in contrast to the umpire, is victory for his team.

On the rather common "mixed" engagements for smaller businesses, then, the individual CPA is figuratively acting in the dual capacity of both umpire and coach. The two roles are not innately incompatible. Should not the ability to measure income accurately help an accountant in advising on how to produce income effectively?

Consider the survey of internal control procedures. If it is strictly and solely a question of determining financial position and historical operating results, the objective of the survey will naturally be restricted to ascertaining the degree of detail-versus-testing that is proper in the circumstances. On the other hand, if the prime purpose is the internal one of building a more efficient operation through better immediate and future internal control, there will be marked difference in the time spent, the relative emphasis at different focal points in the survey, the character of the notes taken and, in fact, the whole approach and attitude.

Similar differences are easily traceable in the report-writing stage.

The practical upshot is: de-mix those mixed engagements. Pretend they are separate engagements from start to finish. Keep the notes and papers separate. Write separate reports, one a crisp one with standard statements accompanied by independent ("umpire"-type) opinion, the other the part-time or "public" controller's ("coach"-type) report with emphasis on responsibilities, performances and possible improvements.

The big future for the small CPA firm may lie in the public controllership field. Applying the principle of separation will help any CPA on engagements involving both public auditing and public controllership.

Are You One of the Sufferers From Claustrophobic Insecurity?

The list of new CPAs is published in the newspaper. The young men are introduced at the next meeting of the CPA society. In all too many cases, they are not seen or heard from again by their professional colleagues. So far as their fellow practitioners are concerned they are thereafter merely names on the ever-expanding CPA list in the yellow pages of the telephone directory. Explanation? They have "dug in."

The next group is the postwar hustlers. There are numerous excellent CPAs whose careers were severely penalized by World War II. After the war these men were naturally imbued with the spirit of making up for lost economic opportunities. But here it is, 1959, not 1945. Yet some of these fellows, formerly active in civic and professional affairs, are still closeted in "the shop."

Those who fall in the groups mentioned, or are otherwise suffering from this ailment, can be assured that the cure is easy and painless. Just start getting out and around again as a normal social animal should. No CPA likes to see another CPA suffering from civic and professional "claustrophobic insecurity."

In Public Accounting Practice, Selling Means Teaching

There is a certain fear, a certain apprehension, surrounding anything that is not clearly understood. To laymen, including some business men, it is that way with accounting.

Harm is done when people who need to utilize accounting either minimize it or, on the other hand, regard it with excessive intellectual awe. Therefore, a substantial portion of successful accounting practice involves a knack for getting other people to *grasp the true meaning* of what they are doing, what they have done, or what they ought to do. In short, persuading others to utilize accounting reduces itself to the art of teaching.

The practitioner must teach the new junior how to familiarize himself with a client's business affairs.

The practitioner must teach the client's bookkeeper the easiest methods of maintaining control over receivables.

The practitioner must employ proved teaching techniques when addressing public meetings about taxation or any other subject.

In the public controllership field, time limitations will usually restrict the CPA to the "setup" work; i.e., to designing the framework and then teaching client personnel how to get started and how to follow through.

In accountancy, people "buy" only what they understand. To make the "sale," therefore, the CPA has to teach the users.

So, whatever the present station of a CPA, he would be wise to ask himself: "Am I a good teacher?"

And if he wants to test his teaching-selling skill, a ready opportunity will present itself the next time he is asked to set up the books for a new corporation.

Advice for Small Corporation Clients

What should the CPA say to the shareowners of a prospective small corporation when they first meet in his office? He might speak to them in this way:

1. This new corporation you are forming is an entity entirely separate from you gentlemen who own the controlling shares of its capital stock. To reap the full advantage of this modern economic invention you must act differently, usually more formally, than was the case when the business was a sole proprietorship or partnership. Do not treat it like the same old business under a different name.
2. Simple dealing and common sense, not fancy maneuvering, should prevail in the investment of capital, the establishment of executive compensation, and the distribution of earnings or assets. Wherever feasible, these should be cleancut cash transactions, not accrual-journal entries.
3. Debtor-creditor relationships between a corporation and its controlling shareowners, whether in substantial or petty amounts, should normally be avoided in the interest of a clean financial structure and precise determination of corporate financial status. However, if needed loans cannot be obtained from nonshareowners, then the terms, the security, and the performance should, if anything, be more stern than if the transactions were with independent debtors or creditors. This is so because a quasi-fiduciary relationship has been created.

4. Summing up, the corporate entity is an instrument which permits marvelous business flexibility, expansion, efficiency, perpetuation, and protection. Maximize these benefits by pursuing the ABCs just mentioned. Surprisingly few small corporations do. As for the XYZs, consult your lawyer and your accountant at the first sign of trouble or misunderstanding. In the corporate realm, as everywhere, remember that an ounce of prevention is worth a pound of cure.