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By L. zur Nieden

After all arrangements have been made, the scope of the work clearly defined and responsibilities fixed, the program following is suggested with such limitations as are set by the arrangements.

Statement.—After having ascertained the physical location of the bank's resources on hand, including those of the trust department, and after having placed under seal those resources on hand and records which are not to be immediately reviewed, the examiner in charge should request a statement of the bank's business as at the close of the examination day. This statement may be accepted tentatively, but before closing the examination, it should be checked with the bank's general ledger to ascertain that it is a true statement, taken from the books, and the footings of the statement should be verified.

Responsibility as to whether the books are true or not, would seem to depend upon the type of examination one has been instructed to make. If an officer, having access to the bank's investments also has authority to pass entries to the general ledger (which is often the case in smaller banks having no internal auditor or comptroller), he could, for example, mis-appropriate say, $200,000 of the investments and put an entry through debiting depositors' control and crediting investments. His next step, of course, would be to cause to be extracted from the individual depositors' ledgers inactive accounts aggregating $200,000. Thus, in this situation, we have a falsified ledger, a statement true to the falsified ledger, and, of course, the investments and deposits would agree with the statement. In this case, even a confirmation of depositors' accounts might not disclose the real condition. Therefore, a desirable part of a bank examination would be at least a test perusal and check of the general-ledger tickets, as there is a chance that the experienced examiner would detect an entry as unusual as the one mentioned. A further precaution would be to make a complete check of at least one interest distribution to the depositors' ledger, as this might disclose depositors' individual accounts missing from the active trays or inactive file.

The point which I desire to bring out is that I am afraid that the statement of condition presented to us is taken too literally and not enough attention is paid to the accuracy of the general ledger and the statement prepared from it.

Cash.—Having assigned an examiner to each teller, the examiner should present himself at the teller's cage immediately upon reporting at the bank, whether or not the teller has "settled" and is ready to have his cash counted. The most practical way to count the cash is, first, to list all bundled and rolled money, assuming for the moment that the bundles and rolls contain the stated amounts. Next, all loose bills and coin should be counted and the totals of each denomination listed. Assuming that the teller has no cash items, about which more is said hereafter, the examiner's count should then be footed and the total should be compared with the teller's settlement sheet. Any overages or shortages should be clearly indicated and the teller's signature on the count sheet should be obtained. The extent of verification of bundled bills should depend upon the system of internal check at the bank. For example, when the bundles have come from the bank's currency department and have been made up and double-checked by that department and the bands bear the initials of two clerks, a very meager test of the larger denominations would seem sufficient. Larger denominations in bundles coming from outside sources should be carefully checked, and the smaller denominations from $5.00 down should be test-checked.

Rolls of coins should not be broken open. A test should be made, however, by opening the ends of a few rolls to make certain that the rolls do actually contain coins. Except in the cash of the reserve teller, bagged coin, including gold, will rarely be encountered. If some bags are opened, counted and weighed, the remaining bags may be weighed and passed, if the weights closely approximate those actually counted. Bags not counted, however, should be examined to ascertain the genuineness of their stated content.

As the cash items in most banks are handled by a special teller, it has been assumed so far that no cash items will be found in the other tellers' counts. Where a special cash-items teller is maintained and where a bank maintains the orthodox hours of nine to three, no items other than currency should be found in any teller's count. Exceptions to this rule should be carefully noted and brought to the attention of the examiner in charge, who should investigate them.

In the case of a day and night bank, which is open daily from 9.00 a.m. to midnight, the tellers' counts become more involved. For example, at 3.00 p.m. the transit department gathers up all clearing items from the tellers. Any items thereafter constitute the next day's business. As the day tellers are on duty from 9.00 a.m. to 4.00 p.m. and the night tellers from 4.00 p.m. to midnight, it is not possible to check all the day tellers simultaneously, even though an examiner be assigned to each teller, since the bank's business is still going on. Therefore, some of the tellers are not checked until 3.30 or 3.45, when an accumulation of cheques has taken place between the time of the last collection of clearings and the time of the count.

These cheques are received through deposits and by cashing and, of course, do not constitute cash items, although a great many of our examiners seem to think they do and unnecessarily list them in considerable detail. The proper handling of these cheques is to assume control of them and insist that the bank put them through the clearings of that day's business or as a separate deposit under seal. Opposition to this plan is usually encountered, for it disturbs the bank's routine.

In a typical case, a settlement is made by the teller about three o'clock, although he does not go off duty but merely closes his window temporarily for that purpose. Therefore, if the cash is counted at, say 3.30, a reconciliation is necessitated as follows:

Currency on hand	$23,000
Checks on hand	10,000
Total cash on hand	$33,000
Less total of deposit tickets received between settlement (3.00 p.m.) and count (3.30 p.m.)	8,000
Cash on hand at 3.00 p.m. settlement	$25,000

The deposits received after the day tellers' settlements are put through the next day's business. The auditor should insist that these also be put through the current day, as otherwise the way is left open for a teller to "lag" deposits by withholding, until after the count, slips of a sufficient amount to cover a possible shortage.

There are no complications in the case to the night tellers, as they are checked before going on duty and have only currency on hand.

All cash count working papers should state the actual time of the count, bear the attesting signature of the custodian as well as the examiner and should be promptly turned over to the examiner in charge.

In larger banks, having numerous tellers, a master tellers' sheet is usually maintained. The examiner in charge will find this sheet of considerable assistance when preparing the summary of counts. The summary should be prepared so as to show for each teller:

1. Actual currency count.
2. Cash items (if any) examined.
3. Total currency and cash items examined.
4. Amount that should be in teller's hands.
5. Amount over (excess of 3 over 4).
6. Amount short (excess of 4 over 3).
7. Remarks (such as in explanation of cash items held by teller, of overages or shortages subsequently discovered, etc.).

The total of 3, less 5, plus 6, should, of course, equal the total of 4 and should agree with the statement of condition.

Cash items.—The examiner should list in detail every cash item on hand at the date of the examination. There is a possibility that items of a similar nature may be grouped, but care should be taken not to carry this to extremes, as destroying the identity of the items may make it difficult to trace their subsequent clearance. For example, six Liberty bond coupons of the same denomination due on the same date may be listed in total as:

6 L.B. coupons $1.12 each due June 15, 1930—$6.72

On the following day, and every day thereafter until all are cleared, the disposition of the respective cash items should be traced, and any items remaining open at the end of the examination should be submitted to an officer for approval and be mentioned in the report.

Clearings.—The examiner should obtain and keep under his control all clearing items, whether they are to be forwarded to the clearing house or to other banks for deposit and collection. The totals of the respective packages should be listed in schedule form and the packages forwarded to the respective clearing mediums in envelopes sealed by the examiner and accompanied by confirmation form. Any exceptions reported by the clearing house or clearing banks must be thoroughly investigated.

Loans and bills purchased.—Before the examination of the loan department is begun, and before trial balances of the various notes are prepared, the examiner should ascertain, from the statement or general ledger, the controlling accounts carried by the bank and should give consideration to whether they coincide with the captions the accountant intends to use in the statement of condition prepared for the report. For example, I know of at least one bank which carries only two controls, namely:

Loans with collateral
Loans without collateral

Yet in the statement presented by the accountant the following appears:

Past-due paper
Demand loans:
  With collateral
  Without collateral
Time loans—with collateral
Bills purchased
Commercial paper

Therefore, it is obvious that when preparing the trial balance of the notes relative to the loans with collateral, two tapes must be prepared: that is, one of the time loans and one of the demand loans. Since there is no way to reconcile the total of each tape with any fixed figure (the aggregate of the two reconciling with the control) care should be taken that the items included in each classification are correct. This rule will apply similarly to the non-collateral notes, with the addition that commercial paper should be segregated.

Past-due paper, whether under a separate control or not, should be scheduled to embrace the following information:

Name of borrower or discounter
Due date
Amount:
  Single name
  Double name

Other information of interest to the bank might include an indication of notes with collateral, those which were past due at the time of the previous examination and those on which interest is delinquent. Remarks relative to payments or renewals made between the commencement and completion of the examination would be of interest.

The past-due paper will usually be time paper, although some times demand loans, called for payment but not met, have been included under this classification. When the schedule includes demand loans the word "demand" should be written in the "due date" column.

Paper out for collection should be scheduled, designating the classification under which it belongs. This schedule should include:

Date forwarded for collection
Description (name of maker and, if possible, where payable, such as Atlanta, San Francisco, etc.)
Due date
Amount
Name of bank to which sent for collection

If the bank under examination numbers its paper, the numbers relating to the paper out for collection should be indicated in the schedule.

The method of preparing the trial balances of the notes on hand, except those past due, which will have been separately scheduled, will depend largely upon the method used by the bank in filing the notes. For example, some banks file the collateral notes in envelopes with the actual collateral, the amount of the note or balance of the loan being noted on the face of the envelope. In such a case, the trial balance can be prepared from the amounts on the envelope, tentatively accepting them as correct, and the notes may be examined later, with the collateral, and the amount of the note can then be checked by the amount indicated on the envelope.

In any case, however, trial balances consisting of adding-machine tapes are to be prepared of the various classes of notes and their totals, with the past-due paper and paper out for collection reconciled with the respective controls. In considering the mode of attack, auditing sense will necessarily have to be applied to harmonize the method used with that of the bank.

Since all of the notes must be under the examiners' control until they are reconciled and released, any notes extracted by the bank's staff for any purpose whatsoever should be substituted by a memorandum containing all the essential features of the note, namely, date, due date, maker, endorser, amount, place payable, etc.

An examination should be made of all notes to ascertain that they are in proper form. In addition to being properly endorsed, a note in proper form must contain all the requirements stipulated in the negotiable-instruments act, which are as follows:

1. It must be in writing and signed by the maker.
2. It must contain an unconditional promise to pay a sum certain, in money.
3. It must be payable on demand or at a fixed or determinable future time.
4. It must be payable to order or bearer.
5. Where the instrument is addressed to a drawer (such as a draft) he must be named or otherwise indicated with reasonable certainty.

Incidentally, while erasures, changes, deletions, etc., made on notes might not, necessarily, nullify the notes legally, they are not considered good form and should be noted.

Whether the notes should be examined for formality at the same time they are listed for trial balance is debatable. If one attempts too many functions at the same time usually none is well performed.

Before the notes are finally released, particularly those unsecured, and if the arrangements made for the examination are agreeable, the following procedure in their examination tend to make the examination a better one, safeguard the examiner's work and develop information of possible interest to the bank officers:

1. Signatures or endorsements on the paper of larger amounts might be compared with the signatures on record. (The examiner is presumed to have a sense of proportion. For example, $10,000 is an important portion of $1,000,000 but not of, say, $10,000,000.) The examiner is, of course, not a hand-writing expert but glaring vagaries may be noted.
2. Demand loans remaining stationary since a previous examination should be noted for report. These are an indication of frozen loans.
3. Delinquent interest on demand loans should be ascertained and noted.
4. A test-check of the interest records might be made to be certain that entries contained therein synchronize with tickets passed to the general ledger.

Reverting for the moment to notes out for collection, since the auditor is to examine all notes or account for them, it follows that those out for collection should be confirmed by corresponding with the collecting banks.

In cases where arrangements have been made to confirm non-collateral loans by corresponding with the borrowers or discounters, consideration, of course, must be given to this feature before the notes are finally released. As the preparation of the letters (in duplicate) in conjunction with this procedure would take considerable time and as all the notes on hand probably could not be retained by the auditor until his letters were completed, it follows that copies of notes bearing near maturities should be prepared and the originals released so as not to inconvenience the loan department.

Before considering the examination of the collateral, let us assume that the collateral registers of the bank under examination contain a money record of the loan as well as the collateral deposited.

If the notes are kept with the collateral, it becomes apparent that the trial balance could have been prepared from the collateral register and the notes checked to the latter when they were physically examined with the collateral. If, however, the collateral notes are kept in a separate file apart from the collateral, it appears necessary to compare the notes with the collateral register either before or after the trial balance of the notes is prepared, bearing in mind the necessity of keeping under control either the notes themselves or the record after the notes have been compared. It is important to ascertain that notes are in the bank's possession for every loan indicated in the collateral register and that, for every note executed in collateral form, there is a record of the collateral in the collateral register.

Examination of the collateral and the checking with the collateral registers may usually be deferred until the second day of the examination. Brokers' loans, however, because of the frequent substitution of collateral, should be examined on the first day.

The important function of examining the collateral is often done in a perfunctory manner. Consideration should be given to the following features and any exceptions should be carefully noted:

1. Stock certificates executed in the name of the borrower should be either endorsed in blank or accompanied by powers of attorney. It is necessary to have at least one power for each class or kind of stock represented. For example, if the collateral contains 100 shares each of the common and preferred stocks of two different corporations, four powers of attorney should have been obtained. If the quantity of any one kind or class of stock

exceeds 100 shares, it is usually considered good practice to have a power for each 100-share unit or fraction thereof, to make possible liquidation easier. This, however, is not essential.

2. Registered bonds should be accompanied by powers of attorney.

3. Stocks or bonds registered in other than the borrower's name (for example, his wife) should, in addition to the powers of attorney (or blank endorsement), be accompanied by a letter of hypothecation which gives the borrower the right to use the securities for the purpose designated.

4. Coupons, attached to collateral bonds, which are due and have not been clipped, should be noted and inquiry should be made as to why they were not delivered or credited to the borrower.

5. It should be noted whether or not all undue future coupons are properly attached to bonds held as collateral.

6. Documents relative to miscellaneous collateral (such as warehouse receipts, titles to automobiles, etc.) should be in a negotiable form usable by and acceptable to the bank.

A keen eye will occasionally discover interesting irregularities. For example, a stockbroker's clerk recently discovered an unsigned municipal coupon bond that had been in circulation for thirty years and apparently had changed ownership many times in that period. Unusual irregularities, if discovered by the examiner, are the things that obtain for him the confidence of others.

Collateral deposited with others for exchange, redemption, etc., should be listed and confirmed by correspondence with the holders of record.

After the collateral has been examined or accounted for, the confirmation letters, if this class of loans is to be confirmed, may then be prepared in duplicate, the original being forwarded to the borrower and the duplicate being retained as a working paper. Usually the confirmation requests are enclosed and mailed in envelopes addressed and supplied by the bank. This procedure, at times, provokes considerable criticism as one of the weaknesses of an examination. The question is asked: "How do we know it is going to the person named or to the proper address?" To undertake the verification of the names and addresses would be a considerable task and one that the examiner should not be obliged to undertake. I do think, however, that as an added precaution, the confirmation requests should be mailed in envelopes bearing the examiner's return card. Thus any returns by the post office would come to his direct attention.

In the case of the confirmation of secured loans, it appears to matter little whether the name of the borrower is fictitious or not, since, if the collateral is in order, the intrinsic value exists. Regarding the unsecured loans, however, at least a test comparison of the signatures on the confirmations with those on record would seem to be advisable.

Loans secured by real-estate mortgages should be examined, confirmed, etc., in the same manner as collateral loans secured by stocks and bonds, with the exceptions stated hereafter:

First of all, there should accompany each real-estate loan the following documents (subject to any vagaries in the existing laws of the several states):

Mortgage
Bond
Title insurance
Fire insurance (unless only land)

In examining these documents it should be kept in mind that mortgages are transferable only by assignment.

Fire insurance, of course, should be in force.

When examining a bank for the first time, it will, of course, be necessary to examine all the documents relative to real-estate loans. However, since the mortgages and relative bonds are recorded instruments, and, in the event of their loss or disappearance, can be easily traced, there appears to be no good reason for re-examining these documents on repeat examinations; but examiner should ascertain that reductions in the loans have been endorsed upon the bonds by the bank. It is also necessary to ascertain that the fire insurance is active. In other words, a complete examination of the documents accompanying real-estate loans need be made only in case of those acquired since the previous examination.

In the case of unsecured loans, at least a substantial check to the credit ledger should be made to ascertain whether any credit limits are being surpassed or not.

A schedule of loans or "accommodations" to directors, officers and employees should be prepared showing:

1. Name.
2. Title.

3. Amount of liability as:
   (a) Maker.
   (b) Endorser or guarantor.
4. Total amount of liability:
   (a) Secured by collateral.
   (b) Unsecured.
5. Number of shares of bank's stock owned.

Loans or accommodations made to firms and corporations in which a director, officer or an employee is interested should be ascertained and scheduled to give the following information:

1. Name of firm or corporation as:
   (a) Maker.
   (b) Endorser or guarantor.
2. Director, officer or employee interested.
3. As a stockholder, owner, partner, director, officer or employee.
4. Amount of loan:
   (a) With collateral.
   (b) Unsecured.

Any loans appearing to be excessive should be investigated to ascertain whether the loan has been approved in the bank's customary manner or not.

The collateral relative to each secured loan must be valued at the market (bid or last sale price) to establish the adequacy of the margin. The examiner should inquire into the bank's policies—that is, whether loans are made on 70 per cent., 75 per cent. or 80 per cent. of the collateral value. Prices should be obtained only from recognized publications. If prices for inactive or non-marketable securities are accepted from an officer of the bank, these should be carefully noted (naming the source) and mention of them made in the report. When unable to get an officer to commit himself to a value, a schedule of incompletely valued loans should be prepared and included in the report as an exception to loan margins. Undermargined loans should be submitted to a responsible officer of the bank, and the result of the discussion should be noted on the working paper.

All notations of prices, calculations, etc., in the verification of margins should be made on the duplicate confirmation requests, if requests have been made. Otherwise clear and adequate working papers should be prepared. In no case are the pricing and calculations to be made upon the records of the bank.

Any exceptions developed in the examination of the loan department, or, for that matter, any department of the bank, should be fully noted in the working papers and adequate explanations should be made of their disposal.

Due from banks and bankers.—On the first day of the examination the examiner should obtain from the general-ledger bookkeeper a list of the banks in which the examined bank maintains funds and the respective balance at each at the close of business on that day. Requests should be made of these banks for a certificate of balance as at the examination date and for a statement for the period from the date of last rendered statement to two or three days beyond the examination date. In cases where the distance is great, say from coast to coast, the statement should be requested for at least five days beyond the examination date. Eventually, after the statements have been received, reconciliation must be made between the certified balance and the balance carried in the records of the examined bank. All open items should be traced and the date of satisfaction noted.

Deposits made by the examined bank on the day of examination should be forwarded to the depository bank under the auditor's seal. This, however, is not always feasible where deposits are made on the examination day prior to the start of the examination. Since a statement is obtained to a period beyond the examination date, a perusal of the items after the examination will probably disclose charges of an unusual nature, such as cheques returned because of insufficient funds, etc. Items of that kind should be investigated to assure the examiner that no bad cheques were purposely deposited to cover defalcations.

Included either in "due from banks" or under a separate control will be found the items forwarded by the collection department to collection banks. A schedule should be prepared of all the open items indicated in the "collection tickler," setting forth the name of the bank to which forwarded and sufficient descriptions of the items to permit identification. The total of the schedule should be reconciled with the balance in the relative control account. Confirmation of all the open items should be requested from the collection banks.

In the case of federal reserve members, usually at least three accounts with the federal reserve bank will be in existence, namely:

Reserve account
Transit account
Deferred credits (liability)

The transit account is in reality a sub-division of the reserve account and is a convenient means of segregating the recent deposits until they are made available by the federal reserve bank. However, it appears that whenever a confirmation is requested of the federal reserve banks they confirm only the actual amount available. Therefore an analysis of the transit account should be prepared and the items traced to the subsequent daily statements of the reserve account, which are received from the federal reserve bank.

Investment bonds and stocks.—A schedule of the bank's investments should be prepared so as to serve both as a working paper and for use in the report. This schedule should be arranged in the manner previously indicated and the total should agree with the relative controlling account:

Bonds:
- (1) Description.
- (2) Interest rate.
- (3) Maturity.
- (4) Par value.
- (5) Book value.
- (6) Estimated market price.
- (7) Source of (6).
- (8) Estimated market value.
- (9) Location:
  - (a) U. S. treasurer.
  - (b) Federal reserve bank.
  - (c) Other banks or places (designated separately).
  - (d) Vault.
- (10) Remarks.

In listing the bonds, the following classifications should be observed, with a sub-total after each, whether the bank's records are so arranged or not:

United States government
State and municipal
Railroads
Public utilities
Industrial and miscellaneous
Foreign

Stocks, which as a rule are in the minority, should be listed as follows:

- (1) Description (common, class of preferred, warrants, rights, etc.).
- (2) Number of shares.

(3) Par value (if obtainable). If no par, so state.
(4) Book value.
(5) Estimated market price.
(6) Source of (5).
(7) Estimated market value.
(8) Location (sub-divided like bonds).
(9) Remarks.

Segregation of common and preferred stocks should be made if the volume of the list justifies it. Warrants, rights, etc., may be listed under the caption "Miscellaneous."

How much of the information can be included in the schedule from the records without recourse to the actual investment will, of course, depend upon the adequacy of the records. Usually the investment record is well kept and little trouble is encountered in abstracting information.

If the auditor's instructions include a verification of the accrued interest on bonds, appropriate columns for the interest payment dates and the calculation of the accrual should be added to the schedule.

In the case of the pricing of the investments, the same rule as that mentioned in the case of the pricing of the collateral on loans applies.

A summary should be prepared from the schedule, showing for each of the investment classifications the book value, estimated market value, and appreciation or depreciation. Unless specifically instructed to do so, it is unnecessary to extend in the schedule the appreciation or depreciation for each item.

Whether the physical examination of the investments is made prior to or after the preparation of the schedule will depend upon the circumstances. It is desirable to have the schedule prepared in advance, thus enabling the examiner to check the investments by it. However, it is recognized that this matter has to be arranged to meet the convenience of the officers and may be left to the examiner's discretion.

In examining the investments, it should be ascertained that stocks and registered bonds are in the bank's name and that the status of the coupons attached to the coupon bonds is correct.

Investments deposited with others should be verified by requesting written confirmations from the custodians.

Occasionally one will find among investments miscellaneous items consisting of mandamuses, claims, assigned life insurance, etc., documents which should be examined, bearing in mind the objects of good title and formality. Auditing judgment will need to be applied to the confirmation of items of that nature. In a recent case the investments of a bank included a life-insurance policy which the bank had retained from a liquidated loan. The bank continued the payment of the premium. No assignment in the bank's favor was attached to the policy, although a letter to the underwriters revealed that the assignment was properly on record at their office.

When examining a small institution, consideration should be given to noting the serial numbers of the bonds and stocks on hand. At subsequent examinations, substitutions of numbers relating to such investments as have not changed during the interim should be carefully investigated.

Bonds and mortgages.—Certain types of institutions have considerable amounts invested in real-estate mortgages. Trial balances should be prepared from the relative records and be compared with the respective controls. In the examination of these documents, attention may be directed to suggestions in the preceding paragraphs on the examination of real-estate loans.

Due from United States treasurer.—(Applicable to national banks.) Amounts due from the treasurer of the United States are the 5 per cent. redemption fund for outstanding circulation.

Fixed assets consist of the bank's ground and building, furniture and equipment, safe-deposit vaults, etc. Analyses of these accounts should be prepared from the date of the previous examination, or, if a first engagement, from the date of the last closing of the bank's books. Additions to these accounts should be checked by reference to the original invoices or contracts to ascertain that they represent proper capital charges.

If the bank has contracted for construction work on which it has made payments of round amounts and has set up neither the gross value of the new asset nor the corresponding liability, the matter should be fully noted in the working papers and brought to the attention of the supervisor.

The examiner should ascertain whether or not provision is made for depreciation of the bank's fixed assets, and a working paper setting forth the facts should be prepared. Generally, depreciation is credited directly to the asset account instead of to a reserve, and where this has been the practice over a period of years, no attempt should be made to ascertain the gross value of the asset or the relative reserve for depreciation. A study of the accounts for recent periods will reveal the current policy of the bank.

Accruals.—When accruals are set up in the bank's accounts, they are usually based upon estimates. The method used should be investigated and weighed in the light of sound accounting principles. The soundness of an estimate, for example, might be substantiated by tests. In no case, unless specific instructions are obtained from the supervisor, should a detailed verification be attempted, as to do so will probably involve an enormous amount of work not contemplated in the arrangements made.

Other assets.—Almost any kind or class of asset might be carried under the caption "other assets," as a bank, through liquidation of bad loans, etc., might acquire jewelry, other merchandise or almost anything else. Verification of these assets may be made, as warranted by the circumstances, by the examination of documents (good title considered), physical examination of the assets or by written confirmation. The element of depreciation should be considered.

Customers' liability under letters of credit.—A schedule should be prepared of outstanding letters of credit and the total should be compared with the control account. The schedule should show the serial number, the name of beneficiary, original or face amount and unused amount and contain a description of the customers' guaranties. These guaranties should be inspected. Confirmations should be obtained from the issuing companies which should be requested to describe the guaranties, if any, held by them. The confirmation thus obtained will also verify the liability of the examined bank with respect to letters of credit.

Departments.—The present-day ramifications of banking extend into many different fields, for example, the trust department, real-estate department, title-insurance department, foreign-exchange department, safe-deposit department and so on.

Various methods are employed in the accounting of these departments. The following three methods are typical:

1. Separate records and accounts maintained in the department with a control account carried on the general books of the bank.
2. Separate records and accounts maintained in the department with no control in the general books of the bank. (Periodically all or a portion of the income is paid over to the bank.)
3. Resources and liabilities of the department carried in the general books of the bank.

To some extent the method used by the bank will be governed by statutory requirements, which should be ascertained by the examiner. For example, some state laws require that the trust department be kept separate from the other operations of the bank.

In cases where methods "1" or "3" are employed by the bank, the department concerned necessarily becomes subject to the examination, and its resources and liabilities must be examined, confirmed, analyzed and verified in accordance with sound auditing procedure. However, where method number "2" is employed, the examiner should ascertain from the supervisor whether the arrangements for the examination include the particular department or not.

As the trust department is the one most commonly encountered a program for the examination of that department is selected.

Branches.—When branches are operated by a bank the procedure to be followed will largely depend upon the latitude permitted these branches and the accounting methods employed. One thing is certain: namely, they will have cash on hand. Under certain plans, they are operated as separate banking units, as though they were independent institutions, and they retain the custody of all resources and are responsible for all liabilities. They issue a daily statement of their own, the net worth of which should agree with the relative controlling account carried on the main-office books.

A sufficient number of examiners should be assigned to each branch to verify, in accordance with this program, any resources or liabilities maintained there.

In routine examinations adjustments are not usually made, particularly if they are of a minor nature. All exceptions or discrepancies noted are mentioned in the body of the report. But when branches are operated, and particularly if, as is often the case, they are lagging one day behind the main office, adjustments to bring them to a parity for the purpose of consolidation are unavoidable.

LIABILITIES AND CAPITAL

Capital stock.—When a bank acts as the registrar and transfer agent of its own capital stock, the following procedure in verification of its outstanding stock should be observed. On first examinations, in addition to a trial balance of the stockholders' ledgers, a trial balance, in tape form, should be prepared of the outstanding certificates indicated by the stock certificate books and the total thereof should be compared with the total of the trial balance of the stockholders' ledgers. Examination of the certificate books, however, is not always possible in institutions that have been in existence for many years, because of the loss or misplacement of the older books. When it is possible to obtain all the books, the serial numbers of the outstanding certificates should be noted on the tape. This will greatly facilitate verification in subsequent examinations.

On repeat examinations, after the tape has once been prepared in the manner indicated, it is necessary only to refer to the stock transfer journal. Certificates cancelled between examinations, as indicated by this record, should be eliminated from the tape, new issues added and a new total obtained. Reference should then be made to the certificate books to ascertain that the certificate was acquired in proper manner and actually cancelled and pasted back in the book.

In any case, whether all the certificate books are intact or not, a test check should be made of the postings from the stock-transfer journal to the stockholders' ledger and as many as possible of the cancelled certificates should be traced to their respective stubs. Care should be taken to see that all certificates extracted from the current stub book have actually been recorded in the stock-transfer journal.

When the registrar and transfer agent is an appointee of the bank, confirmations of the outstanding capital stock should be obtained. At the same time a list of the holdings by directors, officers and employees should be obtained.

Surplus.—The surplus of a bank may be represented on the statement in three sub-divisions, namely:

Surplus
Undivided profits
Profit and loss (or earnings and expenses)

The surplus account will usually be found to remain fairly well fixed as, when once credit transfers are made to it from the undivided-profits account the bank is reluctant to reduce the surplus, since it is generally the subject of boast and considerably advertised. However, any changes in the surplus account (whether increases or decreases) should be analyzed.

An analysis of the undivided-profits account should be prepared and all entries should be checked, except the periodical closing entries relative to earnings and expenses. In case of these, the extent of the work will be contingent upon the arrangements made.

The profit-and-loss account (or earnings and expenses) will represent the accumulated income and expense items since the last closing of the books. If described as a profit-and-loss account, a condensed analysis should be prepared indicative of the contents of this account.

Often, however, the actual accounts representing the unclosed earnings and expenses are shown on the statement of condition, as for example:

Earnings:
- Discounts received
- Interest and exchange earned
- Departmental earnings
- Etc.

Expenses:
- Collection charges
- Taxes paid
- Interest paid
- Expense paid

It will be observed that the last mentioned item "expense paid" is not very informative and might just as well have been called "general" or "miscellaneous." Therefore, to ascertain the composition of "expense paid" an analysis is necessary.

As a general rule, any profit or loss or earnings or expense items appearing on the statement of condition will be supported by a subsidiary record, so that analysis of the items becomes a simple matter. The subsidiary record is usually in a form of a columnar register, the dates being placed vertically in the left column, the second column being a "total column" and the succeeding columns representing the distribution. Totals are usually computed monthly.

If a statement of the undivided profits is to be included, the examiner, in the absence of precedent, should obtain instructions from the supervisor as to the period to be embraced, i.e.

(a) From date of previous examination to date of present examination.
(b) From January 1st, current year, to date of examination.
(c) From date of last closing to date of examination.

Care should be taken to indicate on this statement any qualifications, such as

1. As per the books.
2. Without verification by audit.
3. Subject to full accruals, etc.

Since examinations are usually made on an odd date and a bank usually closes its books semi-annually on either a calendar or fiscal-year basis, the preparation of the statement of undivided profits often becomes considerably involved, especially if it is to be prepared for a fiscal period not coinciding with the bank's fiscal year.

Circulation outstanding.—(Applicable to national banks.) A working paper should be prepared showing the balance of the outstanding circulation and a confirmation should be asked of the comptroller of the currency. Reconciliation should be made of any variation between the amount confirmed and the amount shown by the statement. Usually any variation will consist of circulation in transit.

Bills payable:—A detailed schedule should be prepared of the bills payable and the relative collateral and confirmations should be obtained from the respective institutions from which the money was borrowed. Since the collateral deposited will usually bear relationship to the bank's investments, confirmation of the collateral should be considered in conjunction with the confirmation of investments deposited outside the bank's premises.

Money borrowed under repurchase agreements is not a customary item. However, one bank, in order not to increase the bills payable on its statement, sold investments to another bank under an option to repurchase within a given date at the same price. The proceeds were charged to cash and investments were credited.

Such agreements as this should be ascertained and the facts should be confirmed by correspondence. Since the statement of condition will not reflect a transaction of this nature, the statement should be adjusted showing the item on the asset side as follows:

	Short column of statement	Final column of statement
Investments sold under repurchase agreements	$2,000,000	....
Less repurchase agreements	2,000,000	....

Deposits.—Under the title "deposits" will appear many classes of items, all representing money on deposit at the bank and subject to withdrawal either on demand or after notice. Those most commonly encountered are:

1. Individual cheque accounts.
2. Savings accounts.
3. War loan deposits or other U. S. government deposits.
4. State and municipal.
5. Postal savings deposits.
6. Due to federal reserve or other banks.
7. Certified cheques.
8. Treasurers' cheques, managers' cheques or cashiers' cheques.
9. Certificates of deposit.
10. Dividend cheques.
11. Christmas, vacation and other clubs.
12. Expense cheques.

Time and demand deposits should be separated.

Items 1, 3, 4 and 5 might be all under the one control so far as the bank's books are concerned. Since a segregation of all government deposits is desirable and they should be confirmed, regardless of whether the individual cheque accounts are or not, it becomes obvious that in preparing the adding-machine tapes (trial balance) of the individual ledgers, the names of the accounts should be noted and a schedule of government deposits prepared. At the same time a schedule should be prepared of all overdrafts showing:

1. Date incurred.
2. Name.
3. Account number.
4. Amount.
5. Disposition up to close of examination.

The same procedure should be followed in the case of the savings accounts and club accounts. The totals of all the tapes should be summarized and the totals of the summaries compared with the respective controls.

The supervisor should be consulted in the confirmation of individual, savings and club accounts (excepting government) either in part or entirety and also in regard to the examination of passbooks presented at the tellers' windows during examination.

In the confirmation of government deposits, information relative to the security deposited by the bank should be sought.

Sometimes the security deposited is confirmed by one government officer while the balance will be confirmed by another. Postal savings deposits are typical as the security is held and confirmed by the U. S. treasurer, while the balance on deposit may be confirmed by the local postmaster.

In the case of the item "due from banks," the bookkeeper should be asked to prepare and turn over for mailing the statements and relative paid and cancelled cheques. A schedule of the balances indicated by the statements should be prepared, the total compared with the relative control account and the statements mailed.

A balance due to the federal reserve bank will generally consist of deferred credits, an analysis of which should be prepared. The items traced to ascertain that the examined bank has subsequently credited them to the reserve account and that they have been included in the daily statement received from the federal reserve bank.

Registers will be maintained by the bank for deposit items Nos. 7, 8, 9, 10 and 12, wherein the particular item is entered at the time of issuance and a column is provided to indicate the date on which the item came back for payment and cancellation. Schedules should be prepared of the open items, the totals of which should agree with the respective controls. In addition, except item 7 (certified cheques) the paid and cancelled cheques on file including treasurer's, manager's or cashier's cheques and dividend and expense cheques, should be checked by the respective register as well as the redeemed and cancelled certificates of deposit. When doing this, the auditor should carefully inspect for proper signatures, dating, endorsements, etc., and any irregularities should be noted. Expense cheques are a sub-division of the treasurer's, manager's or cashier's cheques, the distinction being that the last three are generally issued in transactions with customers (as, for example, in exchange for cash) while the expense cheques are drawn merely for the payment of expenses incidental to the operation of the bank. Manager's cheques usually are encountered when branches are in operation.

How many of the paid and cancelled cheques and certificates should be compared with the register is a matter of opinion and largely dependent upon their volume and the arrangements made.

The examiner should request the bookkeeper to show him daily, until the close of the examination, all the cheques and certificates that were open at the examination date and have come in for clearing subsequent thereto. The schedule of the open items should indicate those inspected and the date of payment and cancellation.

Confirmation of the issued and outstanding certificates of deposit will depend upon the arrangements made.

Since certified cheques are returned to the depositor upon request, very few of those paid and cancelled will be in the bank's files for comparison with the register. Those coming in subsequent to the examination date should be examined and the date of payment should be noted on the schedule of the certified cheques outstanding on the examination day. Confirmation of outstanding items should be made only after consulting the supervisor and the request should, if possible, be addressed to the payee rather than the maker, because, if the maker has promptly forwarded the cheque to the payee, the former will not be in a position to certify to the fact that the cheque had not been presented at the bank for payment and cancellation.

In the case of the various cheques and certificates mentioned, the danger is that, even though marked off the register as paid, they might easily be used over again by a dishonest employee before the cancellation perforation is made and the cheques are destroyed upon their second presentation. Therefore, the more cheques and certificates examined and compared with the register, the smaller the risk will be.

Reserves.—All reserve accounts should be analyzed and the entries verified from the date of previous examination or, if a first examination, from the first of the year or from the date of last closing. Consideration should be given to the purposes of the reserves, their adequacy and the basis upon which they are determined.

Letters of credit issued for cash.—Practically the same verification should be made of letters of credit issued for cash as in the case of the other letters of credit, with the exception that since they are issued for cash, no guaranties from the purchaser exist. Guaranties, however, may have been issued by the selling bank to the institution upon which the letter has been issued.

GENERAL

Fidelity bonds and insurance.—The documents relative to fidelity bonds and insurance should be examined and a schedule prepared setting forth full particulars, especially the amount and kind of insurance and the name and title of the person covered (or description of the property covered). Receipts for the last premium paid should be examined and noted in the schedule.

Leases should be examined and a schedule prepared giving full particulars. If the bank is the lessor, any rentals in arrears should be ascertained.

Custodies.—Any items held by the bank for safe-keeping should be examined and checked by the appropriate records. Confirmation of these items by correspondence will depend upon instructions.

Unused travelers' cheques and letters of credit should be scheduled, showing the serial numbers, denominations and the name of the issuing companies. Confirmations should be obtained from the latter.

Minute book.—An examination should be made of the minute book and abstracts of matters affecting the accounts of the bank should be made. These matters should be traced to the accounts to ascertain that the provisions of the various resolutions have been obeyed.

Safe-deposit department.—Mention was made that the extent of the examination of a department will depend upon the arrangements made, the bank's method of control over the department, etc. However, even though the examination does not include a thorough verification of this particular department, it is desirable to include in the report a brief paragraph showing:

Number of boxes installed..................................	========
Number of boxes rented....................................	
Number of boxes vacant....................................	
Number of boxes gratis to officers, employees, etc.............	————
	========

This information can usually be obtained with little trouble and is generally of interest to the manager of the bank.

System, personnel, etc.—While the usual examination does not embrace a survey of the system, personnel, etc., nevertheless, any obvious irregularities should be noted and mentioned in the report.

TRUST DEPARTMENT

The trust department is usually operated as a distinct unit. having control over its own resources, maintaining its separate books and accounts and is under the management of a departmental head known as the trust officer.

The following program is suggested when an examination of this department is to be made.

General ledger.—Prepare trial balance or obtain a statement of condition of the trust department and check the same to the general ledger, verifying the footings of the statement. Unfortunately the accounting procedure of trust departments apparently has not as yet reached the point of uniformity, particularly with regard to captions or designations. For example, one statement will designate on the liability side "Uninvested principal and uninvested income," showing any advances to beneficiaries among the resources, while another statement designates on the liability side the same items just mentioned in the following manner:

Principal balances (less overdrafts)
Income balances (less overdrafts)

The number of items appearing on the statement of a trust department will depend largely upon the volume of business handled by the department. The following statement represents a total of $3,000,000 in trusts:

Resources	*Liabilities*
Cash	*Principal balances (less overdrafts)
Bonds	**Income balances (less overdrafts)
Stocks	Corporate trust funds
Mortgages	Interest on balances
Real estate	Invested trust funds
Miscellaneous personal property	Commission

*Uninvested principal, less advances to beneficiaries.
**Uninvested income, less advances to beneficiaries.

The trust docket is subsidiary to the general ledger (when a general ledger is maintained) and will contain one or more pages representing each trust. The usual docket will include pages containing the following information:

1. History of the trust.
2. Summary or control sheet.
3. Cash receipts and disbursements.
4. Record of bonds.
5. Record of stocks.
6. Record of mortgages.
7. Record of real estate.
8. Record of miscellaneous property.

A columnar schedule should be prepared of the resources shown in the trust docket setting forth on the schedule the title of the trust and headings agreeing with the control accounts indicated by the general ledger. The totals of the respective columns should reconcile with the respective controls and the grand total of all the columns will be equal to the total of the liability side of the statement.

From the foregoing statement it will be observed that while a record of the operating income earned by the trust department is kept within the department, apparently all the expenses are directly paid and charged on the general books of the bank.

Another observation to be made is that in case of income enuring to the trusts, no segregation appears to be made between undistributed income, uninvested income and invested income (the latter apparently being included with invested trust funds). Occasionally under the provisions of wills and trust agreements, the income is not to be distributed until some future date and is to be reinvested during the interval between its receipt and distribution. Therefore the income may consist of at least three divisions, namely:

1. Distributable income—undistributed and uninvested.
2. Undistributable income—invested.
3. Undistributable income—uninvested.

While the segregation of the trust income is desirable, it would be quite a task, if indeed possible, to make the segregation unless the records were suitably kept. The safest rule is to follow along the lines of the department's statement on the ground that it is apparently satisfactory.

Resources.—The same rule and principles applicable to the examination of the banking-department resources are applicable here. That is, the resources must be either examined or confirmed, checked by the records and proper formality must be observed. The stocks, bonds (if registered), mortgages, etc., relative to recently acquired trusts will cause the most annoyance, since some of them may be away from the premises in the process of unraveling legal red-tape, transfers, etc. Confirmation of these items is necessary.

Accruals should be verified if required in the statement. A schedule should be prepared of all principal and income advances made to beneficiaries.

Liabilities.—Excluding nominal operating accounts, the resources of the trust department will equal its liabilities, or vice versa. This is good so far as the records go. But what if a trust was received, unrecorded (or only partly so) on the department's books and the resources misappropriated?

Considerable differences of opinion seem to exist as to whether the examiner should inspect the wills, trust agreements, etc., incident to the trusts. In a well systematized trust department these documents may be numbered serially corresponding to the numbers assigned to the respective trusts. Whether or not these instruments are examined in detail and the pertinent provisions thereof compared with the history sheet in the docket is a matter of arrangement. In any case, it should be ascertained that the last number used for the documents coincides with the last number used in the docket. This may uncover an irregularity, especially if the documents, investments and records are not under one control.

Receipts or releases relative to all trusts withdrawn should be examined. Where numbers are used, a break in their sequence will indicate the withdrawal or cancellation of a trust.

Inventories of assets turned over, which usually accompany the will or trust agreement, should be inspected and checked by the docket.

The history sheet in the docket should be compared with the originating instrument and it should be ascertained that the trust is being operated in accordance with the stated provisions.

Verification of the trusts' income and its disposition should not be made unless instructed. The same may be said of the operating income and expenses of the department.

Corporate trusts.—A separate record is usually maintained for corporate trusts which generally consist of corporate bonds and stocks and possibly funds. A schedule should be prepared from the docket and verification should be made of the respective items either by examination or confirmation. Agreements should be examined to ascertain that the trust department is executing the legal provisions.

General.—Unless a thorough and searching examination is made of the trust department, the report should be qualified to the extent that the resources, as shown by the records, were examined and found correct. Unless the records are substantiated, the income and its disposal verified, a mere examination of the resources shown by the records and the extraction of figures from unverified records do not permit the examiner to give the trust department a clean bill.

The report should be written and should include a clear description of the scope of the work performed, being careful to mention any limitations. The result of the verification should be reported and the report should embrace any exceptions which have not been satisfactorily explained. Proper names, designations, titles, etc., should be correctly and clearly written in the draft.