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# HOW TO PREPARE FOR THE AUDITOR

By D. GIRARD MILLER, C.P.A., Partner, Lawrence Scudder  
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The subject "How to Prepare for the Auditor" automatically divides itself into two phases. First, can we devise a worthwhile program that will accomplish something for all concerned — private accountants, companies, and public accountants? Second, if it is determined that such a program will be of use, how can it be set into motion? Let us consider the first phase.

Such a program generally implies the use of what has come to be known as a "Client Help" program. Because public accountants realize the fact that, more and more, accounting and audit fees are constituting a major expense to their clients, this program has come in for a considerable amount of discussion in the past few years. They also realize that some steps which would not affect the quality or the independence of their examinations should be taken to reduce this expense. Primarily for this reason, the "Client Help" program has been advanced as a possible means of cutting down the audit time and thereby reducing the audit fee. The curtailment of audit time is the main purpose of this program because there cannot be omissions or lowering of auditing standards merely to bring about a reduction in audit fees. You will agree that lower auditing standards would eventually result in a greater cost rather than a savings to companies.

The "Client Help" program turns over to private accountants certain phases of the groundwork which must be done in practically all types of audit engagements. Generally this can be done as well, if not better, by private accountants. Let me emphasize that no matter to what extent the program is used, proper auditing standards will be strictly adhered to and all of the required auditing procedures will be followed by the auditor.

"How to prepare for the auditor" becomes "How to cut down expenses" when private accountants are prepared for the public accountant. I'm sure that all accountants are vitally interested in any possible means of reducing the expense budget of their company. You know that, along with everything else, audit fees have increased considerably in the past years. With the "Client Help" program we can reduce the expense but not the quality of auditing services.

To be a little more definite on the possibility of expense saving, let me use a few statistics from an article written by Mr. Louis H. Pilie which appeared in the October, 1954 *Journal of Accountancy*. Mr. Pilie is a Certified Public Accountant in New Orleans. Although Mr. Pilie's article deals with the application of the "Client Help" program in specific cases, it cites quite a few interesting comparisons. In 1954, a relatively large firm of public accountants made a survey of the work that had been done for their clients. This survey covered the various types of engagements that had been completed and also covered the types of opinions that had been submitted on their clients' statements. The latter included the unqualified and the qualified opinion and even the "disclaimer" type of opinion. This study revealed that the firm had completed 26 unqualified annual reports in its own current 12 month period. In these 26 reports, the firm found that over two-thirds of their clients had participated in the "Client Help" program. The survey also disclosed the fact that for this two-thirds, approximately 15 to 36 per cent of audit time had been saved. At prevailing audit billing rates, this alone would seem to make the program a worthwhile plan. One specific example: One company, with annual sales of around \$400,000 received an audit bill of \$1,160 for its 1950 audit report. The amount of this bill brought forth a long and loud complaint from the client. So the accounting firm's representatives met with company officials, explained the "Client Help" program and with the help of the company's accountant, lined up a program to be followed in the current audit year. Since that year the annual audit fee has amounted to around \$800. This represents an approximate one-third reduction in the company's auditing expense. Let me add that during this period the same type of report, the unqualified report, has been submitted by the accounting firm. In other words, all necessary auditing procedures were followed, proper auditing standards as set by the American Institute of Accountants were maintained in the preparation of the accounting firm's opinion on this company's financial statements.

This does not imply that the "Client

"Help" program will work only in the case of an unqualified report. The program can be an audit time-saver regardless of the type of engagement. Take the type of report issued without audit or verification. This report, generally issued for management purposes only, usually is for a smaller company that does not want or need an expensive, unqualified audit report. Being a small company the management is pretty close to all phases of its operations, including its accounting records. Management will have, for instance, a pretty good idea of the amount and condition of its accounts receivable, so does not think it necessary for their auditors to go so far as to confirm these accounts by direct correspondence. At the same time, however, management would like to be reassured from an outside source that its financial statements are materially correct. The public accountant who is examining these statements which will later be issued from his office, also wants to be reasonably certain of their correctness regardless of the fact that they are to be issued "Without Audit or Verification". He will make numerous inquiries, test checks and analyses of certain accounts in order to satisfy himself that the statements do present a materially accurate picture of the company's financial position. Such analyses can be prepared by private accountants.

To carry this one step further, the public accountant may be engaged for the sole purpose of preparation of a federal income tax return. Even in this type of engagement there is a place for the "Client Help" program. Here, for instance, are just two things that can be done. As you know, on every tax return detail must be submitted showing the contributions that were made to charitable organizations. If the public accountant could be handed a detailed list of these contributions, in agreement with the records, a good deal of time would be saved. Then, taxes paid must be broken down to the individual type of tax. This is required on all tax returns. If this information is available to the public accountant, it will save him the necessity of going through the year's transactions to get the breakdown. Such preparations as these help to reduce a company's accounting fees.

So far only the financial savings that can be made through the use of the "Client Help" program have been mentioned. There are other advantages. Delivery date of the audit report or the tax return should be speeded up by the use of this program. If the program is carried on currently by pri-

vate accountants, possible errors in the accounts will be immediately discovered and immediately adjusted. This will keep monthly financial statements on a more accurate basis.

On the assumption that we have seen that the "Client Help" program can accomplish something for all those concerned, let us look at the second phase. How do we make it work?

Very briefly, let us review the two closely related functions of the private and public accountant. Private accountants build up the financial transactions as they occur. Later on the public accountant comes in, reviews and checks these transactions and then forms an opinion as to the fairness of the end result. To review and check, the public accountant needs certain "tools" to do his work. Unlike other workmen, however, the public accountant generally has to make his own "tools" and only after their preparation can he make his usual tests and checks and finally form his own independent opinion on the company's financial statement. Naturally, the preparation of these "tools", or analyses, takes a good deal of time. They are necessary. This is where private accountants enter the picture. Here we run into our first but actually our only obstacle to the program. No one knows any better than the public accountant that private accountants are already loaded down with their own work, but the prime requisite to the success of this program is additional time and work on their part. So let's take just a look at some of the major sections of the "Client Help" program and possibly somewhere along the way you may see at least a part that will be of advantage in an individual case of your own. Please keep in mind that here is one type of program that does not have to be used 100 per cent in order for it to be successful.

One of the most important assets on the balance sheet can be the company's accounts receivable from their trade customers. They are important because from these accounts the company will obtain the cash necessary to carry on the operations of the business. Because of their significance as a source of working capital a good deal of attention will be given to each account by the auditor. He will want to know if the detailed listing is in agreement with the general ledger control account. Next, what is their condition as to collectibility? Are there some old accounts included in the detail that are not fully collectible? If so, possibly they should be written off as uncollectible or a reserve should be set up to

cover the possible future loss. Again, are there any accounts in dispute which require a reserve for possible loss? The public accountant will also want to know whether the credit balances in the accounts are material enough to reclassify to the liability side of the balance sheet. And, if they are material, is there any particular reason?

A cut-off examination will be made of the accounts to determine whether all of the charges and credits, prior to the balance sheet date, have been entered in the records. It will be necessary to find out whether sales and cash receipts subsequent to the balance sheet date have been excluded from the accounts.

To get all this information, to help in his determination of the accounts receivable, the public accountant needs a detailed listing of the accounts as of the date of the balance sheet. Naturally each accounting firm will have its own particular form (or set-up) for its work papers, but in general the same information will be needed. This detailed listing should have the exact name of the customer and the address of the accounts if they are to be confirmed by correspondence. The listing is generally made on 14 column work sheets so that there will be room for notes as to subsequent payments, differences in the amounts shown on returned confirmations and their reconciliation, comments as to their collectibility and many other notes. Perhaps the most important part of this listing is the detailed ageing of the individual accounts receivable. This ageing helps the public accountant form his own opinion as to the value of the company's total accounts receivable.

This necessary information is a time consuming work paper that will be needed in most examinations. Considerable audit time can be saved if this listing, following the auditor's own form, can be given to him all ready for his examination and various test checks.

Quite frequently the prepaid insurance account will be a material asset and must be verified. Regardless of whether the company is on the accrual basis and carries the asset on his records, or is on the cash basis and charges off the insurance premium expense as incurred, examination must be made if only for federal income tax purposes. Under present regulations of the Internal Revenue Service only the current year's proportionate share of a long term insurance premium may be taken as a tax deduction on that year's tax return of either the accrual basis or cash basis taxpayer.

Therefore, some sort of analysis must be made of the insurance accounts. The work sheet for prepaid insurance is generally a standard form. The schedule will show the number of each insurance policy held by the company for easy identification purposes; the name of the insuring company and usually the name of the insurance agency; the type of property that is insured; the total amount of coverage on each policy; the issue and expiration dates; the amount of the premium cost and the unexpired portion of that premium as at the balance sheet date. A notation will appear on the schedule as to whether or not the policy has been issued under a co-insurance clause. Although the public accountant certainly does not pretend to be an authority in the field of insurance, many times when the company's insurance coverage is presented on this "bird's-eye view" basis, the fact that the coverage appears to be inadequate will be apparent. If it is, then he can bring this to management attention so that an insurance agent may be called in for expert advice. The insurance expense accounts will also be analyzed to see if there have been any long term premiums charged directly to expense rather than to the prepaid insurance account; or, in the case of the cash basis taxpayer, to pick out any of these long term premiums so as to properly report the insurance expense on the income tax return. Time will be saved if the schedule and analyses have been so prepared that the public accountant needs only to check the information as recorded on the work sheets against the insurance policies and the mathematical computations of the unexpired portions of the premiums.

On most balance sheets, and certainly on the balance sheets of manufacturing concerns, you will find that a major portion of the company's investment has been placed in its plant, property and equipment accounts. Because this class of asset is usually material in amount and is in an area that is subject to individual decision as to classification, the public accountant will want to make a close and careful examination of all of the property accounts. To enable him to determine that the fixed assets accounts are not overstated, or understated for that matter, he is going to need a good many detailed analyses. Here again the form may differ in the various public accounting offices but the essential information needed will be the same. The analyses of each asset account will start out with the balance of

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# ETHICS FOR THE INTERNAL ACCOUNTANT

By THEIA CASCIO, Los Angeles Chapter, ASWA

Much has been written about professional ethics, but we are inclined to relate it to the public accountant. Webster says that "ethics" are moral principles or the practice of a conscientious person. In internal accounting, professional ethics are those principles which combine correct procedures of accounting with loyalty and duty to, and consideration for the business by which we are employed.

A worthy reputation is the earmark of the successful professional person. Such reputation is acquired by excellence of performance, continued advancement in knowledge of a particular occupation or service, and good habits. All of these can be adopted by the internal accountant and become an ethical code.

Excellence of performance implies strict attention to duty and a following through on the day-to-day routine which results in an accurate recording of the transactions of the business. It means careful reporting so that comparisons may be made and trends watched. It is truthful, unbiased analysis of figures, using the same conscientiousness expected of the physician when he is diagnosing an ailment.

Continued advancement in knowledge is secured through additional study courses, reading, a wide-awake alertness on the job, and contact with accountants in other companies through accounting organizations. A good general knowledge is the result of planned study, but a quick answer to a current problem is often the result of information dropped at association meetings.

Service is an obligation of the truly successful person. No individual has acquired a reputable accounting position without some assistance along the way, nor does she keep that position without aiding others in turn. In addition to civic and welfare service, there is service to the accounting profession of which she is a part. Naturally, each person's contribution is dependent upon ability; but once you have learned to swim, never fail to dive in to rescue a fellow accountant when you hear a cry for help.

Good habits include moral and health habits. Honesty, integrity, and good behavior are considered standard requirements for the successful accountant. Good health, which leads to better work, should be just as standard. Rest, recreation, re-

laxation, wholesome food, cleanliness of person and surroundings are all conducive to good physical and mental health. If "healthy people are happy people," the accountant who combines efficiency with healthfulness, strength and poise can contribute greatly to the atmosphere of the office.

Adherence to the ethical way of life results in pride of achievement and worthy success. There is satisfaction in advancing methods, procedures, conditions, and ideas. There may well be monetary profit, also, as the able individual earns more than the less able. But more than that, there will be an increase in stature and usefulness. Yours will be the fuller life.

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the last year's audited or unaudited report. Each addition to the account during the current year must be detailed as to the exact date of acquisition; the origin of the entry; the name of the vendor and his invoice number; a very complete description of the asset purchased and, of course, the cost of the new addition. Under the 1954 Code, it also will be necessary to note on the work sheet whether the newly acquired asset is a "new" or a "used" item of equipment. That is, if the company wishes to take advantage of the new provisions in the Code for accelerated depreciation. On the credit side of the analysis, all of the equally important information must be detailed as to asset items that were sold, abandoned, traded in, or otherwise disposed of.

All of these transactions, set up in analysis form, must be prepared in order that the public accountant can arrive at his own independent opinion as to the correctness of the additions to and the deductions from the plant, property and equipment accounts.

To go further into the verification of the fixed assets, the public accountant will also want to examine, or at least scan, the repair and maintenance expense accounts. Here again a detailed analysis of all the repair accounts must be prepared so that he can examine the items charged to these accounts and can finally state that, in his opinion, the fixed assets are properly recorded.

Let me illustrate what can be done with the "Client Help" program in saving audit time in the public accountant's verification of the fixed asset accounts.

One of our clients, a rather large manufacturing concern, has a good many material and constantly changing plant equipment accounts. Shortly after our current examination and after the audit adjustments, if any, have been made to these accounts the company's accounting department puts in a requisition for a supply of our analysis paper. Throughout the year the company accountant builds up a running analysis of all these fixed asset accounts, and when we come in for the next year's audit, these papers are turned over to us complete and in our own analysis form. In addition to the work papers, and this by the way was the company's idea, we are also supplied with all of the supporting data such as the vendor's invoices, the receiving slips and the company's invoice in the case of a sale of an asset. We have never made an actual time study; however, I believe you will recognize the fact that considerable audit time must be saved each year by this company through the preparation of these analyses by its own accounting department.

There are of course other parts of the "Client Help" program that can be used on the asset side of the balance sheet but these I believe are three of the best audit time savers.

On the liability side of the balance sheet there are also many analyses and work papers that will be needed by the public accountant in his examinations. Because most of these papers, in reverse, are much the same as required in verifying the asset accounts, it doesn't seem necessary to discuss the program in relation to verification of the liability accounts.

As to the income and expense accounts, a few analyses have already been mentioned that will be needed in the examination of financial statements. There are however many other accounts that also will be analyzed in the usual type of audit engagement.

Just to name a few and without going into the form of the analysis sheet: a detail of the dividend and interest income accounts; an analysis of the salvage and scrap income—perhaps a fixed asset has been dismantled and sold for scrap and its disposal has not been recorded in the records; a detail of the items in "Miscellaneous Income"—all kinds of interesting items sometimes find their way into this account; the office supply and expense accounts will be

analyzed, as it is possible that an expensive office machine or a desk could be charged off to this account in error; the account that includes the fees paid to the directors of corporate clients will be detailed and then checked to the attendance record as noted in the minute book work papers.

There are many more of these accounts to be analyzed, not in every case of course, because the scope of the examination is governed by the type of the engagement and the particular circumstances. However, few or many, they can be prepared by private accountants and ready for the public accountant's review when he steps into the office for his annual examination.

Up to here we have discussed only the more obvious parts of the "Client Help" program. There are other less obvious but just as important things than can be done.

When bank accounts are reconciled at the end of the fiscal year, a carbon copy of the bank reconciliation can be made for the public accountant. This won't add any time to reconciliation work but it will save time for the auditor, time spent in listing the deposits in transit, in listing the outstanding checks at the year-end date and applying whatever adjustments, if any, that are necessary to reconcile the general ledger balance with the bank statement balance. Speaking of adjustments, after the year-end date advantage can be taken of hindsight over foresight. Interest on a note or mortgage paid shortly after the close of the year makes the computation of accrued interest payable at the balance sheet date rather an easy computation. The possibility of time saving here is not in the computation of the accrued interest, or the computation of any other accrued or prepaid account for that matter, but in the time required to write up the necessary adjustment and the posting to the auditor's working trial balance. In other words, don't wait for the public accountant to come in and make these usual year-end adjustments. Again speaking of adjustments, the entries closing out the income and expense accounts result in the net transfer of profit or loss to the surplus account. A lot of auditor's writing time, office footing, checking and typing time will be saved if these entries are made and posted to the general ledger rather than have the auditor include them in his audit entries. Of course, it goes without saying that if these closing entries are made, all of the usual year-end adjustments should first be made in the records. In many cases these seemingly small items can result in

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of the speaker with infinite precision. Not only must the speaker and listener be in resonance with one another, but also that relationship must continue long enough for the thoughts to get through. The listener cannot drift away mentally to some other thought pattern. If this "tuning out" takes place, the communicative process has been interrupted. The speaker may continue to push words toward the listener, but to no avail. Inattention can literally jam the reception of ideas.

These are not speculative remarks but are squarely founded on a bedrock of research and test results. Listening comprehension can and is being measured constantly on several University campuses. Also, listening as a skill of learning is now taught successfully to all age groups. Data from standardized tests reveals that the average untrained listener is only 26% effective. Based on one dollar spent in the listening situation, he gets only a quarter's worth of learning. What are the reasons for poor listening habits? Admittedly, a volume of many pages could be written in answer to that question. For our purposes we will identify only a few of the most potent reasons.

Inability to concentrate or inattention has already been mentioned. Emotional barriers often cause a serious breakdown in communication. How frequently the trained observer sees a listener pull down an emotional curtain between himself and the speaker. Often this emotional block arises from emotional garbage stored in the subconscious from many yesterdays being dragged into today. This is a sure short-circuit to communication. Personal dislike of the speaker will cause a blockage that cannot be surmounted, for who can listen and learn if the mind is filled with judgments and criticism. Rejection of the speaker or his ideas creates a wide and deep gap between the speaker and the listener.

Briefly, then, permit me to summarize. Our ability to get along with one another is essentially a test of our communicative skills. Not so much *what* we say, but *how we say it* is the important factor. To achieve good human relations, it is first necessary to learn to suppress one's own thoughts effectively and receive the deep meanings from others which their words can carry. The challenge is yours.

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a considerable saving of time on the part of the auditor.

Here's a particular phase of the program that is quite frequently forgotten. Always in the unqualified or qualified report and generally in other reports, the public accountant will need to examine and make many notes from the minute book of his corporate clients. The declaration of dividends will be noted, and from this a check will be made of the subsequent payment. The election of officers and directors, along with the approved amounts of compensation, must also be recorded in the work papers of the public accountant, if only for the purpose of filling out the various governmental forms that are required to be filed. Many times the minutes of the meetings of the board of directors will disclose contingent assets or liabilities of the corporation that should be mentioned in footnotes to its financial statements. The directors often will pass on some resolution that will have a direct bearing on auditing procedures. I have in mind one instance where the directors passed a very rigid rule as to the dollar amount that could be added to the fixed asset accounts without approval. In this case any addition to these accounts of \$500 or more had to be first okayed by a finance committee and subsequently approved by the board of directors. At each finance committee meeting and at the following directors meeting, each job order was either approved or disapproved; and the action was recorded in the minute book. Following normal auditing procedures it was necessary to check all such appropriations from the fixed asset analyses to the approval of both the finance committee and the board of directors. Think of how much audit time could be saved if the public accountant were to be given a complete signed copy of these minutes. Instead of a time consuming operation of transcribing the important and related information on to his own work paper, he could merely underline or by any other method set forth the information having a bearing on the final audit report.

These are just a few of the things that can be done with this program in preparing for the auditor. I am forced to agree with what you must now be thinking; here's a program that seems to be designed with the sole purpose of adding to the work of the private accountant. However, I do think that the program is worthwhile and that it does have possibilities for your company or your client.