1933

Duties of the junior accountant

Alfred B. Cipriani

DUTIES OF THE JUNIOR ACCOUNTANT

CIPRIANI

Revised

AMERICAN INSTITUTE PUBLISHING CO. INC.

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Revised and Enlarged Edition

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AMERICAN INSTITUTE PUBLISHING CO., INC.
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EDITOR'S NOTE

THE history of the writing of this book is interesting. A brief review of what led up to it will help its readers to obtain the utmost assistance from it.

Fifteen years ago a series of articles appeared in *The Journal of Accountancy* under the title "Duties of the Junior Accountant". They were later collated in book form and published for the American Institute of Accountants. From the date of the first appearance of that volume to the present there has been a continued demand for the book, and its sales have been quite unusual for the field of technical literature. The authors of the book, W. B. Reynolds and F. W. Thornton, rendered a great service to the young men of their profession and consequently to the whole cause of accountancy.

But there have been many developments in business practice and in accounting, and it seemed to the publishers that a revision of the original text might make it even more useful. Accordingly, A. B. Cipriani, a managing accountant of the firm with which Messrs. Reynolds and Thornton were associated, was invited to undertake the task of revision and to prepare a text much more comprehensive. It was believed that the book would be more helpful if many subjects which had been omitted in the first text could be added and if various matters presented could be elaborated, so as to reflect the changes in accounting practice and in business procedure which have taken place in the past fifteen years. Mr. Cipriani decided to create an entirely new book of instructions for the junior accountant, based, naturally, to some extent upon the earlier book, but entirely rewritten and covering a much wider range. It seemed to him desirable to go somewhat carefully into matters of procedure; and he has written what is really a fairly complete manual of practice for staff accountants.

The American Institute's committee on publication has approved the publication of this text and gives entire credit for the authorship to Mr. Cipriani, who indeed has produced a text that may be regarded, in spite of its excellent prototype, as an original treatise.

Every junior accountant into whose hands this book will fall will find in it many things which will help him. He can consult it with confidence and follow its directions with a comfortable assurance of authority.

The senior accountant will find in this book many things which will serve to remind him of the instructions which he should give to his subordinates. Even the partner of an accounting firm will find many interesting points of procedure which he can, with advantage, suggest to his staff.

A. P. RICHARDSON, *Editor.*

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DUTIES OF THE JUNIOR ACCOUNTANT

· I ·

PRELIMINARY CONSIDERATIONS

THE junior accountant will have to work at first under the immediate supervision of a senior. At that stage, therefore, he will not have to consider the scope of the audit, the kind of audit or the instructions and requirements of the client. All these will be explained to him as necessary for the particular work assigned to him.

The more advanced junior may be required to go to the client's office and start the work himself. The supervision of his senior may be limited to periodical visits made to check his work and to review the progress he is making. In an engagement of this kind, the junior should ascertain what kind of an audit is to be made. He may do this in the case of an examination which is not being undertaken for the first time by consulting the correspondence files, any previous report rendered and the working papers. The different kinds of audits vary in the amount of checking of the detail transactions to be done. Unless the client has set particular restrictions, which have been accepted by the accounting firm, the onus of deciding how much work is to be done in verifying the detail transactions must be borne by the accountant. In forming his opinion, the accountant has to rely mainly on the client's system of internal check.

The system of internal check of any business consists of the aggregate of the precautions taken by the client to ensure that the records contain no errors of commission or of omission or of principle. During the course of his work the accountant must ascertain what these various precautions are, and, in the light of his experience, he must decide how far he can rely on them as furnishing justification for the omission of certain detail work. The working papers prepared by the accountant must contain full particulars of the system of internal check. No discussion of internal check will be undertaken here, but junior accountants should read *Fraud—Its Control through Accounts* by George E. Bennett, a book published under the auspices of the American Institute of Accountants.

Before leaving his office to call on the client, the accountant should make certain that he has all the stationery and supplies which may be needed on the work. Working paper of various sizes, blotters, scratch pads, pens, pencils, erasers, clips, etc., must be taken with him, so that he may have no reason to bother the client's employees for supplies.

Upon his arrival at the client's office, the accountant is confronted with the problem of deciding where to begin. As, at this point, he is not familiar with the accounting system and the records maintained, he should inquire whether the general ledger and subsidiary ledgers have been balanced and whether he can have trial balances of the ledgers. From a glance at the trial balance, he can tell whether there are any securities and notes receivable to be examined, and he can also get a general idea of the books most apt to be kept. If he has assistants with him, he can assign them to counting securities and notes receivable, to the verification of cash on hand and in bank and to the checking of trial balances.

From the general ledger the accountant should prepare for his working papers the classification of accounts in use by the client. With those as a guide, he should be able to make intelligent inquiries about the books and records maintained. He should prepare for his working papers a list of such books and records, and from an examination of them he should form some opinion as to the accounting system in force.

The checking of the trial balance of the general ledger is one of the first concerns of the auditor. The footings of general-ledger accounts should be verified, and, if the balances of the accounts have not been inserted in ink by the client's employees, the auditor should insert the balances in small red-ink figures. The balances should then be compared with the trial balance, and the footings of the trial balance should be verified. If the general ledger contains asset or liability accounts which have no balances at the end of the period, but in which there have been entries during the year, the names of those accounts should be included in the trial balance. The trial balance should be prepared so as to show in columnar form the balances at the beginning and at the ending of the period under review. A statement of the work done in verifying the accuracy of the trial balance should be included in the working papers.

So-called comparative working trial balances are sometimes prepared with columnar headings as follows:

- Ledger folio
- Name of account
- Balances at beginning:
  - Debit
  - Credit
- Balances at ending:—
  - As shown by the books:
    - Debit
    - Credit
    - Balance-sheet accounts:
      - Assets
      - Liabilities
    - Profit-and-loss accounts:
      - Income
      - Expenses
  - Adjustments made by the auditor:
    - Debit
    - Credit
- Balances after adjustment:
  - Debit
  - Credit

The preparation of such a trial balance, in addition to the working balance-sheet and working statement of profit and loss, is not necessary in the normal case, but it is of great assistance when the auditor has to make a large number of adjustments in the accounts prepared by the client, as it then facilitates the agreement of the final trial balance prepared by the auditor with the client's books after the auditor's adjustments have been recorded in them.

The procedure to be mentioned hereafter is applicable in the examination of the accounts of non-specialized types of medium-sized businesses. The work required is discussed in detail. It must be remembered, however, that in no specific case should it be necessary to do everything mentioned. What to do and what to leave undone are matters that experience alone can decide. In fact, it is not too much to say that the development of the accountant can be gauged by his increasing competence in knowing what to omit and when to omit it.

·II·

CHECKING AND VOUCHING

CHECKING FOOTINGS:

By "checking footings" the verification of the accuracy of totals and sub-totals is meant. These totals may be of figures arranged horizontally or vertically or both. The checking of these totals is one of the auditing details which every junior accountant has to do.

Before commencing work on the footings, the junior should decide upon the columns of which he should check the footings and cross-footings and upon the degree of accuracy with which his work must be done.

When checking the footings of the cash-books, for instance, he should verify the accuracy of dollars and cents; on inventory sheets, however, it may be that accuracy is necessary to the nearest thousand dollars only. This is an important point to remember, as the omission of unnecessary checking of footings saves work which at best is irksome. The question arises, when checking the footings of columnar records, as to which columns should be footed and which columns should not be. If one column contains details of which the periodical totals are carried to another column, it may be necessary to check the periodical totals carried to the second column and to check the footings of the second column. In the case of the cash-receipts book this would have to be done; but in the case of a sales journal, where the first column contained the detail invoices and the second column the periodical totals, checking the footings of the first column and comparing the totals of the first and second columns would be sufficient. The omission to check any columns must be justified by the junior, but he should not hesitate to omit any which he considers unnecessary. These remarks, however, do not apply to statements in reports to be rendered to clients when every footing and cross-footing must be verified.

Books of original record may contain summaries of the totals for the period, or the sundries columns may be analyzed and included in the summaries. As part of his work on the footings, the junior should check the analysis of the sundries column, check the totals to the summaries and check the footings of the summaries. These remarks also apply to inventory and other summaries.

Upon verifying footings some check-mark must be used to show the work done. Two marks in use are shown in the following example:

COL. 1	COL. 2	TOGETHER
$ 10	$ 50	$ 60√
20	40	60√
30	30	60√
40	20	60√
50	10	60√
$150	$150	$300√
√	√	√

The mark √ below the figures shows that the footings have been checked, and the mark √ at the right of the figures shows that the cross-footings have been checked.

If the auditor has to release a record before he has completed the footings, he should make a notation of the place to which he has footed and the total to that point. Very often the auditor wants a permanent record of the footings to a certain point in the client's books. In such cases small neat figures in red ink should be inserted at the desired places.

The use of an adding machine is generally to be recommended for the addition of long columns of figures. Before starting to use the machine, the junior should make certain that it is clear of all totals. On a listing machine this is shown by the printing of an asterisk or a similar symbol. The adding-machine list of figures should always be checked against the figures added to make sure that the correct figures have been listed. Adding-machine lists should not form part of the working papers; but when they must be preserved they should be pasted neatly on regular sheets of working paper; they should never be pinned to the working papers. Working papers to which these lists have been pasted should, of course, be headed appropriately to show exactly to what the lists refer.

If the client furnishes adding-machine lists, such as accounts-receivable balances and vouchers payable, the junior should not accept the accuracy of the totals shown by these lists, but he should check the footings himself. If necessary, he must prepare his own lists from the lists furnished, and he must be satisfied that the balances on the lists furnished are correct. If he is not satisfied he must list the balances from the original sources.

CHECKING EXTENSIONS:

The word "extensions" is used to describe all computations involving multiplication, with particular reference to inventories. The inventory sheets supplied to the auditor consist of numerous items for which information is given somewhat as follows:

Description of article	Quantity Amount	Unit	Unit price	Value

Under the heading "quantity" should be shown the number of units of the weight, count or measurement of the commodities and the weight or measurement used (e. g. units, pounds, cubic feet). The unit prices should be shown in terms of prices for the particular weight or measurement in which the quantities have been shown. And the value should be the result obtained by multiplying the quantity by the unit price. The word "should" is used in the previous sentence because in exceptional cases the auditor will find that the given quantity or unit price may have to be converted into some other quantity or unit price before the computation of the value can be made. This verification of the multiplication of the quantity by the unit price is what is described as "checking the extension."

The junior should obtain instructions from his senior as to how much work is to be done on the extensions. In a typical examination, he may be told to test-check all extensions over $500 and to test-check half a dozen under $500 on each page—all to be verified as accurate to the nearest $10. Before commencing each extension which he is required to check he should make certain that the quantity is expressed in the same unit of count, weight or measurement as the unit price. Extensions need only be checked to the degree of accuracy fixed by the senior. All extensions which have been verified should be indicated by the check-marks of the assistants responsible for the work.

CHECKING POSTINGS:

Posting is the name of the procedure whereby every entry in the books of original entry is carried in detail or in total to accounts in the general ledger and subsidiary ledgers. The auditor must verify the accuracy of a selected number of the postings. The extent of his verification is dependent upon his instructions from the client and upon his own opinion as to how much of this work must be done in order to satisfy himself of the general accuracy of all the postings. The junior will generally be given instructions as to which books of original entry and what periods are to be checked by him. For instance, he may be told to check postings from all books of original entry for the month of July.

Checking of postings requires that the junior must ascertain—

1—That all entries in the books of original entry have been carried in detail or in total to the general ledger and to the subsidiary ledgers;

2—That all debit entries have been posted as debits and all credit entries have been posted as credits;

3—That all entries have been posted to the proper accounts; and

4—That all entries are fully understood.

The first requirement makes it necessary that the junior calling the postings from the books of original entry should not rely entirely on posting folios appearing in such books, but that he should make certain that every entry is posted, regardless of whether or not a posting folio appears for the entry. This is essential; otherwise any omission of postings will not be discovered. When columnar records are in use, the junior must make certain that the totals of the columns are posted, if the details of the columns have not been posted. For example, the column for raw materials in a voucher register will almost always be posted in total; the column for "sundries" may be posted in detail, or it may be summarized and the postings may be made from the summaries. Certain columns, again, may be posted in total as well as in detail. An example of this is the "accounts payable" column of the voucher register. The total of this column would be posted to "accounts payable" in the general ledger and to the individual creditors' accounts in the creditors' ledger, if such a ledger is maintained.

It has been stated previously that the junior must make sure that the postings have been made to the proper accounts and that the entries must be understood. This requires that the junior should be familiar with the chart of accounts used by the client. The first thing is to ascertain the names of the accounts which the books of original entry indicate should be charged and credited. The junior should then consider the particulars of the entry and decide whether that account is one in which the entry should be recorded. As an example of this, the following entry in the journal is presented:

Work in process	$	
To Reserve for depreciation		$

To set up provision for depreciation of machinery and equipment.

The junior should read the entry, mentally noting the accounts to be debited and credited. The question that would naturally arise at once is: Why is depreciation charged to work in process and not to an expense account? Apart from this, the entry is readily understood. The junior must now decide whether the charge is correct or not. He should never check the posting of an entry which he does not understand, nor should he think that the entry is wrong because he is unable to understand it. The senior should be consulted about entries of which the junior is in doubt.

In testing postings, no object is served by checking entries at random from the various books of original entry to the ledgers. Some definite period should be selected, and the postings of all entries in the period should be checked. Testing postings by tracing entries in the ledgers is worthless as a test-check of the accuracy of the postings unless entries in the books of original entry are examined to see that no postings have been omitted.

When postings are to be checked two assistants should be assigned to the work. One should call the particulars to be checked from the books of original entry, and the other should trace them to the ledger. These assistants should sit near each other so that particulars of postings may be easily audible when called in a clear and low tone of voice. Loud calling of postings is not only extremely fatiguing to the throat but is also disturbing to the other occupants of the office. The assistants should alternate their work periodically so as to divide the burden of constant calling.

In calling the particulars of postings from the books of original entry some definite method must be adopted. The following is a recognized order of procedure:

1—Ledger folio
2—Name of account
3—Date of transaction
4—Debit or credit
5—Page of book of original entry
6—Amount

After calling the ledger folio, the assistant should pause until the ledger assistant signifies that he has found the ledger page. The assistant should then proceed with the rest of the information.

The calling of amounts presents some difficulties to inexperienced juniors. Recognized methods may be shown by the following examples:

FIGURES	METHOD OF CALLING
$37,681.50	Thirty-seven thousand, six eighty-one, fifty
7,681.50	Seventy-six, eighty-one, fifty
7,002.50	Seven thousand two dollars, fifty
681.50	Six eighty-one, fifty
681.00	Six eighty-one dollars
68.10	Sixty-eight, ten
6.81	Six, eighty-one
.68	Sixty-eight cents

The transposition of figures in calling is a common form of error against which the junior must be on guard—for example, $289.98 may easily be called as $298.89.

As the posting is proved to be correct, the assistants should place their check-marks near the respective page references in the books of original entry and in the ledgers. The ledger assistant should then repeat the name of the account, debit or credit, and the amount.

The best procedure for saving time in checking postings is to have the assistant working on the book of original entry call the first ledger folio appearing in his book. The ledger assistant should then find the page, check the particular posting, and, if there are many postings to be checked in the particular account from the book of original entry for which the postings are being checked, he should call the page references from the ledger account to the assistant having the book of original entry. In this way all postings from the particular book to the account will be checked. The assistant having the book of original entry should then call the next ledger folio, and the procedure just mentioned should be repeated.

Before deciding that all the postings for the selected period have been checked, the assistants should examine all entries for the period in the books of original entry and in the ledger to see that all bear posting check-marks.

VOUCHING:

Vouching is the examination of documentary evidence supporting the entries in the books of original entry. Vouching will be discussed under the following headings:

1—Vouching cash receipts.

2—Vouching cash disbursements.
3—Vouching entries in the voucher register.
4—Vouching entries in the sales journal.
5—Vouching entries in the general journal.

Vouching may be done in two ways: certain accounts may be analyzed on working paper and the vouchers for the entries appearing in the analyses may be examined; or the entries in the books of original entry for selected periods may be checked against the vouchers. As an example of the first type, vouching of the analyses prepared for fixed-asset accounts may be cited; the vouching of transactions recorded in the voucher register for the month of June would be an example of the second type. In both cases the principles to be observed are the same so far as documentary evidence of the transactions is concerned.

The question of internal check is of vital importance when the auditor is called upon to vouch the transactions, as the acceptability of the documentary evidence submitted for his approval is often dependent upon the system of internal check in force. Vouching, therefore, is not adequately done by merely accepting documents which appear to support the record of the transactions. The auditor must always go further and satisfy himself that the documents themselves are all that they purport to be. For instance, the auditor may be presented with an invoice to which is attached a receiving report. Both documents appear to him to show that the goods had been ordered and have been received. He should not, however, consider that indication sufficient, but he should obtain some general idea of the methods of ordering, of receiving goods and of passing invoices for payment. He should obtain facsimile signatures or the initials of those authorized to approve invoices. In short, he should satisfy himself that the accounting methods in force are such that he is entitled to regard the documentary evidence submitted to him as correctly prepared.

In vouching cash receipts, the auditor should obtain the daily report of incoming remittances prepared by the mailing department and should ascertain that all receipts have been entered in the cashbook. In some cases, he may examine the customers' remittance statements and the correspondence files. The work done on the vouching should be directed to making certain that the cash receipts as shown by the cashbook are in order and that all receipts have been recorded. To satisfy himself that all receipts have been accounted for, the auditor has to rely on the system of internal check and on tests made during the verification of other assets. For instance, sending circular letters to debtors to verify the accounts receivable should afford a test of whether or not remittances from debtors are being correctly entered on the books.

When vouching cash disbursements, the auditor must satisfy himself that the disbursements were actually made as recorded and that the disbursements should have been made.

Petty-cash disbursements should be supported by invoices wherever possible. These invoices should be approved by the employees responsible for the receipt of the goods or services for which the invoices were rendered. Carfare, travelling expenses and similar payments should be supported by vouchers prepared in the office. These vouchers should be signed by the employees receiving the money. Vouchers for petty-cash payments should be scrutinized with more than usual care, as they are more often falsified than any other vouchers.

The work necessary on the cash disbursements depends on the form of cashbook in use. The more progressive concerns generally record all bills to be paid in the voucher register, and the payments when made are recorded in the cashbook to be charged to accounts payable in the general ledger. In such a case, the auditor need examine the paid cheques only. This examination should show (1) that the date of each cheque, the name of the payee and the amount agree with the cashbook entries, (2) that the cheques were signed by the authorized officers and (3) that the original endorsements were made by the payees. When cheques are made out to "Cash," to an employee, or to a nominal account such as "Payroll," the auditor should take extra precautions to find out whether the payment should or should not have been made. If the cheque is in favor of anyone other than the creditor whose name is listed in the cashbook, the auditor's suspicion will be aroused and he should have the client obtain a receipt from the creditor named in the cashbook. The auditor should find out why the cheque was drawn payable to someone else.

It is unusual nowadays to give receipts, as the endorsement of the cheque by the recipient is commonly considered sufficient protection. However, when the client insists on obtaining receipts for all payments made, the auditor must examine them, and he must take every precaution to see that they have not been forged in whole or in part.

Where payments recorded through the cashbook are charged to accounts other than accounts payable, the auditor must examine the invoices supporting each payment in addition to the paid cheques. In examining invoices the auditor must pay attention to the following points:

1—The invoice must be on the creditor's own form, and not on a form made up in the office of the client;
2—The date of the invoice should be inspected so that the auditor may find out if bills are being paid regularly on their due dates or not;
3—The invoice should be addressed to the client, and not to persons in his employ;

4—The goods or services should have been received by the client, and the invoices must either have receiving reports attached or they must bear the approval of the employees authorized to approve them;

5—The invoices should be approved for prices and calculations by persons authorized to approve them;

6—The invoices should be charged to the proper accounts.

In vouching entries in the voucher register, the invoices for goods and services must be examined, and the matters mentioned in the previous paragraphs must be verified.

Entries in the sales journal should be supported by customers' orders, shipping reports and copies of invoices rendered. The auditor should examine all these documents for the entries which he has elected to vouch. The auditor's main concern here should be to satisfy himself that all the invoices rendered are for genuine sales which may correctly be recorded as sales for the period under review. In vouching cash sales, the auditor must be particularly careful to determine whether or not every precaution is being taken to ensure that the proceeds of all sales are properly shown in the accounts.

The general journal may consist of journal vouchers, which may or may not be recorded in a journal record, or of a journal record with explanations appended to the entries. If there are journal vouchers, they should be examined to see that they are signed by the authorized employees, and the attached evidence for the entries should be scrutinized to verify their correctness. The explanations for journal entries should be investigated, and the auditor should have some responsible employee approve of those entries of which the auditor desires additional assurance as to their correctness.

When the auditor has to analyze and vouch certain accounts, he should prepare the accounts in skeleton form from the general ledger somewhat as follows:

Analysis of furniture and fixtures

12/31/—

Debits

Date	**Name**	**Details**	**Vo. No.**	**Ref. No.**	**Amount**
					$
					$

Credits

Date	Name	Details	Vo. No.	Ref. No.	Amount
					$
					$
		Balance 12/31/—			$

The date, the number referring to the book of original entry and the amount should be obtained from the general ledger. Plenty of space should be left between entries, so that adequate explanations can be inserted.

On referring to the books of original entry, the voucher number should be obtained, and, if the vouchers are filed alphabetically, the name of the customer or account should be ascertained. The vouchers should be obtained from the files and, after examination and approval, the required details should be inserted in the working papers.

The particular method of going about the vouching will depend upon the way in which the vouchers are filed. The filing of vouchers is usually either alphabetically, by names of customers or accounts, or numerically. If the vouchers are filed numerically, the auditor need only obtain the numbers of the vouchers required; if they are filed alphabetically he will need the name of the customer or account as well as the number of the voucher. In exceptional cases, he may find it easier to do the vouching by working back from the files to the books of original entry or even directly to the general ledger or his working papers.

As the auditor completes the vouching of each item, he should stamp the voucher with his audit stamp (or he should initial the voucher when he has no audit stamp), and he should place a check-mark (usually $\surd$ or $\surd$o) next to the figure vouched. The audit stamp should be placed on a conspicuous part of the voucher so that the mark of the stamp may not be cut off or obliterated. The audit stamp should be properly safeguarded so that no dishonest person may obtain possession of it and stamp vouchers which the auditor has not examined.

A common cause of friction with the client's employees is the failure of assistants to protect the vouchers while in their possession and to return them to their proper places in the files. Assistants should be careful to give no cause for complaint about their handling of vouchers.

When assistants have to permit a book to leave their possession or when they discontinue vouching for a time, they should make notes of the missing vouchers to the point which they have reached. This will prevent a dishonest employee from inserting the auditor's check-mark against items which have not been vouched. The final list of missing vouchers should be reviewed with responsible employees of the client who should be asked to try to obtain any which may be missing.

If there are large numbers of vouchers to be examined, two assistants should be assigned to the work. One man can examine and stamp the vouchers; the other can call the details shown by the book of original entry and insert the check-marks on the books. As in similar cases, where the work is voluminous, the assistants should switch duties now and again.

· III ·

WORKING PAPERS

THE accountant has to keep a complete record of the work done by him as well as of the figures verified, so that he may be prepared to defend his work if called upon at any time to do so. These records are referred to as working papers. A set of working papers is prepared on each engagement and, on the completion of the work, is filed away for future reference.

The procedure in preparing working papers varies in different accounting firms in minor ways, although there are certain well recognized general principles which should be borne in mind.

A typical set of working papers consists of the following:

1—Comparative working balance-sheet,

2—Comparative working statement of profit and loss, 3—Adjusting journal entries,

4—Comparative trial balances of the general ledger,

5—Leading schedules,

6—Supporting schedules.

The comparative working balance-sheet and statement of profit and loss contain the figures for the previous period and those for the current period in comparative form. These enable the accountant to obtain a grasp of the changes during the period as well as a general view of the verification to be done.

Adjusting journal entries contain the adjustments of the accounts which are finally considered necessary by the accountant. When these adjustments have been discussed with the client, they are given effect throughout the working papers.

Leading schedules are made out for every balance-sheet caption, the amount of which has to be verified. These leading schedules are followed by what are called supporting schedules. For example, on the comparative working balance-sheet the caption "Cash on hand and in banks" may appear; a leading schedule "Cash on hand and in banks" would be prepared and would be supported by schedules showing details of the cash counts, bank reconciliations, etc.

The usual procedure in making up working papers, in the case of an examination which is not being done for the first time, is to obtain a copy of the general ledger trial balance and to insert the figures in the comparative working balance-sheet and statement of profit and loss, using the same classification as at the end of the previous period. The statement should then appear somewhat as follows:

JONES CORPORATION

COMPARATIVE WORKING BALANCE-SHEETS
DECEMBER 31, 1930 AND 1931

		December 31, 1930	December 31, 1931			
				Adjustments		
	Assets	Books	Books	Dr.	Cr.	Adjusted
A	Cash in bank and on hand	$ 10,000	$ 12,000			
B	Notes and accounts receivable, less reserves	60,000	73,000			
C	Inventories	100,000	120,000			
D	Properties, less reserves	550,000	525,000			
		$720,000	$730,000			
	Liabilities					
AA	Accounts payable	$ 10,000	$ 10,000			
BB	Accrued expenses	5,000	3,000			
CC	Funded debt	100,000	100,000			
DD	Capital stock	500,000	500,000			
EE	Surplus	105,000	117,000			
		$720,000	$730,000			

JONES CORPORATION

COMPARATIVE WORKING STATEMENT OF PROFIT AND LOSS
FOR THE YEARS ENDED DECEMBER 31, 1930, AND 1931

	Years ended December 31,				
	1930	1931			
			Adjustments		
	Books	Books	Dr.	Cr.	Adjusted
Sales—net	$120,000	$ 96,000			
Cost of sales	84,000	67,000			
Gross profit	$ 36,000	$ 29,000			
Selling, general and administrative expenses	20,000	16,000			
	$ 16,000	$ 13,000			
Other income	1,000	1,000			
	$ 17,000	$ 14,000			
Other charges	3,000	2,000			
Net profit	$ 14,000	$ 12,000			

A leading schedule should be prepared for each caption in the balance-sheet. The one for notes and accounts receivable, less reserves, might be as follows:

JONES CORPORATION

NOTES AND ACCOUNTS RECEIVABLE, LESS RESERVES
DECEMBER 31, 1931

	December 31, 1930	December 31, 1931			
			Adjustments		
Particulars	Books	Books	Dr.	Cr.	Adjusted
Notes receivable	$ 10,000	$ 15,000			
Accounts receivable	70,000	85,000			
Together	$ 80,000	$100,000			
Reserves:					
Discounts	$ 1,000	$ 1,500			
Allowances	5,000	8,500			
Doubtful accounts	14,000	17,000			
Together	$ 20,000	$ 27,000			
Net	$ 60,000	$ 73,000			

This schedule would be supported by schedules showing details of the notes and accounts receivable and analyses of the various reserve accounts.

The amounts appearing on the comparative working statement of profit and loss should be similarly analyzed on supporting schedules. For instance, the selling, general and administrative expenses would be shown in comparative form, distinguishing between salesmen's salaries, commissions, travelling expenses and the other accounts under which the expenses may be classified by the client.

The important, though apparently trivial, points to which the junior accountant should pay particular attention in preparing working papers may be summarized as follows:

1—Head each schedule with the name of the client;

2—Under the name of the client insert the name of the balance-sheet or profit-and-loss caption to which the schedule refers, e. g., if the balance-sheet caption is "Cash on hand and in banks," then the leading schedule should have under the client's name, "Cash on hand and in banks"; if the latter schedule has as one of the items making up cash on hand and in banks, "Petty cash—factory," then the supporting schedule should have under the client's name, "Petty cash—factory";

3—The last date of the period under review should be written in the right-hand corner of each schedule;

4—Leading schedules should provide space for comparative figures, adjustments and the figures as adjusted;

5—Separate supporting schedules should be prepared for each account to be verified —for example, where there are six petty-cash funds to be verified, six schedules should be made up, instead of attempting to include the verification of two or more funds in one schedule;

6—Each schedule should contain a statement of the work done and should be initialed and dated by the assistant responsible for the accuracy of the work.

Before beginning to prepare a schedule, the junior accountant should try to visualize the information of which he desires a permanent record in his working papers. If this were always done, the making of a great many comparatively useless schedules, on one hand, and the omission of vital information, on the other, would be avoided. As an instance of what is meant, let us take the case of the verification of the liability for accrued wages at the end of the period under review. The problem here is that the period under review ends on a Saturday and wages are paid every Tuesday for the week ended on the previous Wednesday. The client computes his payroll for each week and not for days. If a schedule were prepared showing the payroll for the entire period by weeks, a great deal of time and effort would have been wasted. The only information required could be scheduled as follows:

	Amount of	Accrued payroll	
Week ended	payroll	Proportion	Amount
Wed. Dec. 21	$20,000	....	....
" Dec. 28	16,000	All	$16,000
" Jan. 4	11,000	5/11	5,000
" Jan. 11	22,000	.	...
			$21,000

The amount of the liability is not dependent upon the payroll for the entire period. Similarly, in normal circumstances a statement of profit and loss by months is unnecessary in verifying the operations of a year. The same remarks apply to statements of cash receipts and disbursements by weeks or by months, when the cash balances at the end of a period are being verified.

The amount of detail which should be shown on the working papers is largely influenced by the purpose for which the work is being done and by the size of the organization whose accounts are being examined. The junior accountant should beware of becoming immersed in unnecessary detail and missing "the elephants which may be running all around him" —the important matters which may be staring him in the face.

It may seem almost unnecessary to say that schedules should be neat and legibly written, should contain no errors in arithmetic, and that the balances shown thereon should agree with the ledger accounts and with the leading schedules. Slovenly written schedules create a bad first impression and increase the amount of time that seniors have to spend in supervision.

In all cases where the junior is in doubt as to the amount of detail which should be shown on the schedules, he should consult a senior assistant. Juniors seem to have a natural diffidence in consulting seniors prior to starting work which they may not know exactly how to go about, and they often prefer to rely on their own knowledge rather than admit the need of help. While it is desirable that the junior accountant should be allowed to exercise some initiative, yet there is no reason why, after having thought out the matter for himself, he should hesitate to consult his senior before actually starting the work.

At the conclusion of the work on the examination as a whole, or some particular section of it, the junior is often required to "index" the working papers. There are several equally good methods of indexing, but the one in most common use involves designating asset captions by letters from A onwards, and liability and net worth captions by double letters from AA onwards. It will be noticed in the comparative working balance-sheet given on page 32 that the index letters are shown on the left-hand side. Schedules for notes and accounts receivable, less reserves, are indexed with the letter B and the statement of profit and loss may be indexed with the letters FF. Therefore, all supporting schedules for the leading schedule B would be indexed B1, B2 and so on. Similarly the supporting schedules for profit and loss would be FF1, FF2 and so on.

In addition, in order to afford easy reference between schedules, they should be cross-indexed. As an example, if B5 represents the reserve for doubtful accounts, the balances at the beginning and at the end of the period should be cross-indexed to the leading schedule B. The amount provided from operations for doubtful accounts as shown on B5 should also be cross-indexed to the profit-and-loss schedule on which the provision appears.

The working papers should be finally brought together in one or more bundles. It is usual to bind these bundles by inserting them in binders or covers. The name of the client whose accounts were examined and the nature of the examination and the period covered should be written on the covers or binders.

In addition to the file of working papers, a so-called permanent file is kept for each assignment. Copies of certificates of incorporation, by-laws, minutes, trust indentures, abstracts of various documents and agreements and other matters which will be of use to the accountant in subsequent examinations are kept in this file, so as to have the information readily available for future years.

In concluding this chapter, it may be stated that the junior accountant must have a thorough knowledge of how to prepare, to index and to cross-index working papers. Without an ability to do this he never will be an efficient junior, even though he may eventually become a good senior.

· IV ·

CASH

ONE of the first matters usually undertaken in an examination is the verification of the cash on hand and in banks. The junior accountant should therefore be thoroughly familiar with the procedure, as he will find that this is the work that he is most often required to do during his first year or two in public accounting practice.

It is desirable that before commencing his work the junior should be supplied with the leading schedule, or at least the details of the balances which he is required to verify, though in practice it is often found that much of the detail work is completed before the junior knows the amounts of the cash accounts. In any event, the composition of the cash balances should be obtained as soon as possible, so that the location and amount of each of the petty-cash funds and the names of the various bankers of the client, together with the amount on deposit with each, may be known. A supporting schedules should be prepared showing the amount of each of the balances to be verified.

CASH ON HAND:

Wherever possible, arrangements should be made to count the cash on hand after banking hours on the last day of the fiscal period for which the accounts are being examined. If this is not practicable, the accountant should generally count the cash when beginning his examination, although, in some cases, the desirability of postponing this work, especially where the custodians of the funds have had notice of the date on which the accountant may be expected, should be considered. The introduction, so far as possible, of the element of surprise into the time of the cash count should be the aim of the accountant, as this renders more difficult the manipulation of the cash fund which would be necessary in the event of a shortage. A cardinal principle to be kept in mind when undertaking a cash count is to make certain that all cash funds, notes receivable, securities and treasury bonds and stocks are counted or verified at the same time. This must be done so as to preclude the possibility of the purchasing, hypothecating, selling or otherwise dealing in these items in such a way that each item could be correctly accounted for, if the dates of the verification of any of them differed from those of the others. This safeguard must be rigidly enforced where there are several companies occupying the same accounting office. Where the examination of the accounts of all the companies is being undertaken, there should be no difficulty about insisting on this simultaneous verification whether or not the fiscal years end on the same date. Where the examination is restricted to less than all the companies, the possibilities of manipulation should be noted on the working papers and called to the attention of the senior.

If there are reasons why a simultaneous verification of the cash and securities can not be undertaken, the accountant must attempt to foresee all possibilities of manipulation, and he should deviate as little as possible from the ideal plan described in the preceding paragraph. In every case where the verification is made at some time after the close of the fiscal period, the accountant must verify the cash and security balances at the close of the fiscal period as well as at the date of the count.

The junior should find out the names of the custodians of the petty-cash funds, whether the funds are kept on the imprest basis or otherwise, and whether a petty-cash book is or is not maintained. Enquiries should also be made to ascertain what other cash funds (such as unclaimed wages and other similar funds which may not appear on the records) are under the control of the petty cashiers.

The assistant, when actually counting the funds, should insist that an employee remain with him continuously until the count has been completed and the fund has been returned to the custodian. This will prevent the possibility that the auditor may be accused of having mislaid or appropriated part of the fund. It is also a good practice to have the custodian sign a statement at the bottom of the auditor's schedule somewhat as follows:

"The petty cash fund of $ ..... as summarized above was returned to me intact."

The cash, vouchers and other items making up the fund should be listed on a supporting schedule. Currency should be listed by the various denominations of the notes and metallic money; vouchers should be listed in detail, showing dates, particulars and amounts for each; and cheques and vouchers for advances should be listed in detail, showing dates, names of drawers or persons to whom advances have been made and amounts of each. Vouchers should be examined to see that they bear the proper signatures and that they appear to be in order. The auditor should have someone in authority approve the composition of the fund and the inclusion therein of items other than currency by signing the auditor's schedule. The auditor should trace the cheques as subsequently cleared through a bank account of the client. The fund may be found to include one or more of the client's own cheques which have been issued to reimburse the fund. These cheques must be traced to the cash-disbursements book. If they were issued prior to the end of the period, they must be entered as of a date prior to the end of the period, and they must then be traced to the bank reconciliation statement as outstanding at the end of the period.

It is often found that part of the petty-cash fund is kept in a bank account. If this is so, the bank account must be reconciled as of the date of the count as well as of the end of the period.

If a petty-cash book is maintained, the auditor must verify all entries for a selected period, usually not more than thirty days, ending at the close of the period for which the accounts are being examined. However, if the fund is not counted until some time after the close of the period, the transactions between the close of the period and the date of count should also be verified. The footings of the petty-cash book for the periods verified should be checked.

Any discrepancies in the fund should be called to the attention of the custodian, who should be given a reasonable opportunity to explain them. Unexplained discrepancies should be referred to the senior.

When the funds have been counted at some date subsequent to the end of the period, the working papers should contain the following schedules for each fund:

1—Composition at date of count.
2—Summary of transactions between the end of the period and the date of count.
3—Composition at the end of the period.

The transactions between the end of the period and the date of count should be verified, as already described, and the composition of the fund at the end of the period should also be verified as far as possible. It will often be found that although the fund at the date of the count is composed of cash, yet at the end of the fiscal period the fund may have consisted largely of vouchers. If this is so, the fund at the end of the period should, of course, be reduced by the amount of these vouchers, and charges should be made to the appropriate expense and other accounts.

Cash receipts on hand at the date of the count, whether held by the general cashier or the petty cashier, and not yet deposited, should be listed in detail, showing dates of cheques, names of remitters and amounts. The details of this list should be compared with the entries in the cash-receipts book and with the bank deposit slips for the date of the count or for the next day, and they should be traced to see that they have been paid into the bank accounts. This may be done by referring to the bank statements or by communicating with the banks.

It is no longer considered good practice to record cheque and currency transactions in the same cashbook, but, wherever the auditor finds this method still in use, he must make a complete check of the cash transactions for a selected period. In the usual examination, which contemplates certification of the financial statements, it is generally sufficient to choose the last month of the period for that purpose. When the cash is verified at some date after the close of the period, the cash transactions should also be checked up to the date of the count. The work done in this checking should consist of the usual tracing of receipts to bank deposit slips and to bank statements, the comparison of returned paid cheques with disbursements, as shown by the cashbook, and, in addition, the examination of vouchers supporting disbursements made in currency. The cashbook should be footed and the balances checked. As additional proof of the accuracy of the balances a statement should be prepared as follows:

Cash transactions for month ended December 31st.

		Cash	Banks
December 1,	Balances		
	Receipts		
	Transfers		
	Disbursements		
December 31,	Balances		

Cash transactions from end of period to date of count.

		Cash	Banks
January 1,	Balances		
	Receipts		
	Transfers		
	Disbursements		
(Date of count)	Balances		

CASH IN BANKS:

When the accountant has been able to count the cash funds, securities and negotiable instruments at the close of the period under examination, he must also verify the bank balances at that date. Where he is unable to undertake the counting of cash, etc., until some subsequent date, he must also verify the bank balances at the subsequent date.

An acceptable program of work to be done, in the typical case, follows:

1—Obtain the client's bank reconciliation statements at November 30th and December 31st.

2—Obtain the bank statements for December and for January of the following year.

3—Obtain the canceled cheques paid by the banks in December and in January of the following year.

4—Obtain duplicate bank deposit slips for December and for January of the following year.

5—Trace deposits in transit as shown by the November 30th reconciliations to the December bank statements.

6—Sort all November canceled cheques paid in December; examine them for signatures and endorsements; and trace them to the November 30th bank reconciliations.

7—Trace all cheques outstanding at November 30th and not paid in December to the cashbook and to the reconciliation statements at December 31st.

8—Mark off in the cash-disbursements book for December all canceled cheques paid in December after examining perforations (to see that they were paid in that month), signatures and endorsements.

Note: Perforations are made on the cheques by the banks to show that the cheques have been paid. The perforations generally show the day, month and year of payment. When the bank uses a rubber stamp instead of a perforating machine, the rubber-stamped information must be examined.

9—Trace to the December 31st bank reconciliations or to the cash-receipts book for transfers and cancellations all cash disbursements not marked off.

10—See that cash disbursements not marked off or traced as described in (9) above are verified from bank statements, as bank charges, etc.

11—Trace in detail to bank deposit slips cash receipts as shown by the cash-receipts book, for the month of December.

12—Foot bank deposit slips and trace the totals to bank statements for December or to bank reconciliation statements at December 31st for deposits in transit at that date.

13—See that receipts not traced to deposit slips are accounted for as transfers and credits on the bank statement.

14—Foot the cashbooks, after agreeing the opening balances with the bank reconciliations at November 30th; and check the balances at December 31st as appearing on the bank reconciliation statements at that date.

15—Check all bank transfers and see that all cheques drawn toward the end of the period have been entered in the cashbook as of the month of December.

16—Make copies of reconciliation statements for all bank accounts in the following form—

Balance per bank statement
and certificate 12/31/— $
Add—Deposits in transit
Date Amount
Deduct—
Cheques outstanding
No. Date Payee Amount

Balance per cashbook 12/31/—$

17—Check deposits in transit at December 31st to January bank statements, and obtain confirmations of such deposits direct from the banks.

18—Verify cheques outstanding at December 31st, by referring to cheques paid by the banks in January, after examining cheques for perforations, signatures and endorsements.

19—Make out copies of bank deposit slips for the last few days in December and for the first few days in January, and ask banks to certify the slips and to return them direct to the auditor's office.

20—Request banks to furnish direct to auditor's office certificates as to the balances at December 31st.

If the bank balances have to be verified at a date subsequent to December 31st as well, similar work should be done for the period from December 31st to the date of verification.

The auditor's reconciliation statements should show, at least for the cheques of large amounts, the names of the payees. Where the names are those of subsidiary companies, branch offices or petty-cash custodians, the cheques should be traced, as deposits in transit, to the reconciliation statements prepared for subsidiary companies and branch offices or to the schedules showing the petty-cash counts.

Cheques drawn in favor of "Cash" or to an employee or to some account such as "Payroll," should be carefully scrutinized for endorsements. The junior should trace the disposition of the proceeds by the person obtaining the funds, who, of course, should be an employee of the client, as cheques issued to creditors should always be drawn in the names of the creditors.

In addition to verifying the accuracy of the cashbook footings for the selected period, statements similar to those shown on page 49 should be prepared.

As has been said, all paid cheques must be examined and traced to the cashbook or reconciliation statements. The examination of the cheques should consist of an inspection of (1) the date of each cheque, (2) the names of the payees, (3) the signatures on each cheque (which should be those of the officers authorized to sign cheques), (4) the endorsements and (5) the date on which each cheque was paid—the so-called perforations. The comparison of the cheques with the cashbook entries should include the date, the name of the payee and the amount.

The endorsements on the cheques should be the names of the payees of the cheques. All cheques bearing the endorsement of some other person or bearing more than one endorsement (particularly where the second endorsement is that of an employee of the client) should be called to the attention of the senior.

A form of request for a bank certificate is shown on pages 58 and 59. The auditor should prepare one of these forms for each bank from which he requires a confirmation as to balances and liabilities. The auditor should insert the date, the name of the client, the name and address of the bank, and the dates as of which the balances and liabilities are to be confirmed. The requests should be signed by the client and should be mailed by the auditor himself. Stamped envelopes addressed to the auditor should be enclosed for the convenience of the banks in replying.

When the certificates are returned by the banks, the auditor should compare the balances with those shown on his reconciliation statements. The attention of the senior should be called to any liabilities reported by the banks.

The balances in banks often include amounts on time deposit. The auditor should examine the certificates of deposit issued by the banks; and he should note on his working papers the name of the bank, the number of the certificate, the date of the certificate, the name in which the certificate was issued (this should be the name of the client), the amount of the certificate, the due date on which the money can be withdrawn and the rate of interest payable. Of course, confirmations of the amounts on deposit must also be obtained direct from the bankers. The working papers must contain full information relative to all balances which are not subject to withdrawal at once. The auditor must be careful to ascertain if any of the bank certificates have been signed by national or state bank examiners, or on behalf of federal or state banking authorities, or whether the words "in liquidation" may have been inserted or may appear in or after the name of the bank. Any suspicion which the auditor may have that the funds are not currently withdrawable should be referred to in the working papers and called to the attention of the senior.

PAYROLL BANK ACCOUNTS:

Payroll bank accounts and similar bank accounts (e. g. dividends), whether they are kept on the imprest basis or not, must also be verified in the regular way.

..........19..

Dear Sirs:

We shall be obliged if you will kindly complete the attached certificate *and forward to our Auditors,* ——————, *New York, N. Y.*

Yours very truly,

....

By ....

DETACH HERE

Certificate from

....

....

....

If this form is not used in replying, please mention reference..........

Messrs. ——————,

——— Street, New York, N. Y.

Dear Sirs:

We hereby certify that at the close of business on..........19..........our records showed the following balance(s) to the credit of ...., subject to withdrawal by cheque except as noted.

Amount	Designation of Account	Remarks (State if balance is not subject to withdrawal by cheque, etc.)
$		

We further certify that the above mentioned depositor was directly liable to us in respect of loans, acceptances, etc at the close of business on that date in the total amount of $, as follows

Amount				Date of Loan etc.	Due Date	Interest		Description of Collateral, etc.
						Rate	Paid to	
$								

and was contingently liable as endorser of notes discounted at the close of business on that date in the total amount of $, as below:

Amount				Name of Maker	Date of Note	Due Date	Remarks
$							

Other direct and/or contingent liabilities, open letters of credit, etc. were:

Except as stated above the said depositor was in no way obligated to us.

Yours very truly,

(Bank) ....

By ....

Date.............................. **19**

Cashier
Treasurer

·V·

NOTES RECEIVABLE

A LIST of notes receivable at the end of the period should be prepared, or obtained from the client, showing for each note the number of the note, the date of the note, the names of the makers, the names of the endorsers, the due date, the rate of interest, the date to which interest has been paid, the amount of the note and the collateral held.

This list should be checked to see if it is in agreement with the control account in the general ledger and with the details of notes shown by the notes-receivable book.

The notes should be examined, preferably at the close of business on the last day of the period, and those not on hand should be confirmed by certificates obtained direct from the custodians. This refers especially to notes held by bankers or attorneys for collection and notes under discount with banks. However, in every case where notes are not on hand, the accountant must consider whether the custodian of each note is a proper party to be holding the note and whether a certificate from that party is sufficient verification of the existence of the note.

Wherever notes are held by banks or others on behalf of the client, the possibility that the notes are held as security must be considered, and if necessary the holder must be asked to furnish a certificate in writing setting forth that the note is either held for collection or is under discount or giving information relative to any other pertinent facts.

If the accountant begins his verification after the close of the period, he must examine the notes actually on hand and obtain confirmations from custodians for notes held by them at the end of the period under review and at the date of count. The receipt of cash must be traced to the cashbook for notes which have been or should have been paid between the end of the period and the date of count. Renewal notes also must be examined.

Certificates obtained from custodians of notes, in cases where the accountant examines the notes on hand on a date subsequent to the close of the period, must enumerate the notes held at the close of the period as well as at the date of count, and changes must be vouched from the notes-receivable book and other records so as to preclude the possibility of fraud. For instance, a note for $1,000 may be in the hands of an attorney for collection at December 31st; the attorney may have remitted the proceeds on January 5th of the new year; the accountant may count the petty-cash fund on January 6th and may find the petty-cash fund correct, although in reality there was a shortage of $1,000, which was made up by including the remittance from the attorney as part of the fund. A manipulation of this sort should be discovered if the accountant will obtain from the attorney a certificate as of January 6th, as well as one for December 31st, for it will then appear that the attorney must have either remitted $1,000 to the client or returned the note.

Collateral held as security for notes should be examined or confirmed in the usual manner, but, owing to the exceptional chances that present themselves for mishandling collateral, the parties who deposit the collateral must be asked to confirm the amount and nature of such collateral.

The best way of making sure that the notes are bona-fide obligations is to obtain written acknowledgments from the debtors. The procedure to be followed should be the same as that described later for circularization to verify accounts receivable. However, the advisability of communicating with the debtors should be first discussed with the client and his approval should be obtained.

The probable value of notes which have not been paid since the close of the period under review should be discussed with the client. It should be borne in mind that in certain businesses the possession of notes instead of open accounts is a good sign, and in other cases it is evidence of slow payment of amounts due. Care should be exercised to see that notes which appear to be current do not represent renewals. In the case of those that do, the accountant should obtain the dates of the original notes and should consider their probable value in view of the renewals made. This also applies to cases where renewals have been accepted since the end of the period. The value of any collateral held should also be determined, as the value of the notes may not be more than the value of the collateral. Where the accountant has any doubt as to the worth of particular notes, he should examine credit and correspondence files to assist him in forming his opinion of their probable value.

The working papers which are prepared on notes receivable should show separate totals for notes which mature within one year and for those maturing after one year. Notes from customers, officers, employees, affiliated companies and those arising from loans or other extraordinary transactions should be shown separately, so that they may be properly classified on the financial statements.

When the accountant finds, or has reason to believe, that payments have been made on account of notes, he should confirm the balances due on the notes from certificates which he should obtain from the debtors.

The amount of prepaid and accrued interest should be calculated for notes held at the end of the period.

Any contingent liability for notes under discount should be called to the attention of the senior. It often happens that instead of a contingent liability for such notes, there may be an actual liability because the notes have not been met at maturity, or the accountant may have reason to believe that they will not be paid by the makers. The value of notes under discount must therefore be considered by the junior, and in appropriate cases he should suggest to his senior that a reserve be provided for such notes and that an actual liability to the discounting banks be shown.

In some cases, especially where documentary drafts are drawn against foreign customers, the amounts due may still be carried as accounts receivable and not as notes (or drafts) receivable. The accountant should therefore be careful to avoid any duplication of assets by setting up the notes receivable without at the same time reducing the accounts receivable by the equivalent amount. The senior will undertake to obtain a certificate from the client stating that, subject to a reserve of $ (a specified sum), which has been or should be provided, the notes are collectible in full.

· VI ·

ACCOUNTS RECEIVABLE

When the junior accountant is assigned to verify the accounts receivable, he should obtain the trial balance of the accounts-receivable ledger from the client, who usually undertakes to have one prepared for the auditors. This trial balance should show the "aging" of the accounts as well as the balances. If the junior has to prepare the trial balance himself, he should consult his senior as to the amount of detail required in the "aging." As an example of what is considered sufficient in a normal case, where the credit terms are, say, 2% 10 days, net 30 days, the balances may be segregated according to amounts sold within 30, 60, 90 and more than 90 days prior to the date of the close of the period under review. The working schedules to be prepared by the accountant in such a case should provide for information as to the following items:

Name of customer
Amount due:
  Debit
  Credit

Sales made:—
  Within 30 days
    " 30/60 days
    " 60/90 "
  Over 90 "
Credits since closing date:
  Cash
  Others—
    Particulars
    Amount
Remarks

Before starting his work on the trial balance, the junior should find out in what way the client shows on his ledger the unpaid items making up the balances at the end of the period. Various systems of check-marks are in vogue to show on the ledger accounts what charges have been settled in full or on account. When the junior knows the client's method he can, of course, obtain the particular charges making up the balance.

While going through the ledger and preparing his trial balance and "aging" the accounts, the junior should list all payments and credits since the end of the period and all information which may appear on the ledger sheets bearing on the probable collectibility of the accounts, such as notations as to the credit risk, as to whether the customer is financially involved, as to whether the account has been passed on to a third party for collection, as to pending or probable litigation, as to disputes and as to possible credits to be issued to the customer. In short, he must make notes of any information which may affect the collection of the accounts. In the case of credits issued since the end of the period, he must note against what debits they have been applied. Where it is found that current invoices are being paid as they fall due and previous invoices are still unpaid, this information should be noted on the working papers, as the probability is that the unpaid invoices are the subject of dispute. When he has completed the trial balance, it must be footed, and the total must agree with the control account in the general ledger.

A schedule showing the current year's balances in comparison with those of the previous year may then be prepared as follows:

		PREVIOUS YEAR	CURRENT YEAR
Period when sale made:			
Within	30 days	$	$
"	30/60 days		
"	60/90 "		
Over	90 "		
		$	$

On this schedule may also be included the net sales for the last three months of the current year and the previous year, so that the proportion of sales uncollected may be computed by the senior.

Up to this point, a list of the accounts-receivable balances has been obtained, but nothing has been done to see that the entries on the accounts-receivable ledgers are correct. The accountant should therefore draw up a program of work to be undertaken in verifying the detail entries on the ledgers.

In verifying the sales it is generally sufficient to make a test-check of those toward the end of the period under review. Copies of invoices rendered for a certain period should be obtained and checked with the sales journal and the customers' ledger. Shipping records should be examined to make sure that the merchandise shown by the invoices was actually shipped and removed from the inventory records before the end of the period. The junior doing this work must constantly bear in mind that he is trying to ascertain that these invoices are not for fictitious sales and consignment sales. A test-check should also be made of returns and allowances (credit memoranda), cash receipts and journal entries for the selected period. A test-check must also be made of entries in the accounts-receivable ledger between the end of the period and the date of the audit. Books of original entry must be examined from the close of the period to the date of the audit to ascertain if there are any entries affecting the collectibility of the accounts at the end of the period. Entries for returns and allowances affecting business done prior to the end of the period must be listed, so that the senior can adjust the balances as shown by the books.

The accounts which have comparatively large credit balances should be examined in detail to see how the credit balances arose. It may be found that customers have been credited with cash received from them for goods which they have received but for which they have not been charged. Information as to the composition of the debit balances on the accounts-payable ledgers must also be obtained.

The most satisfactory method of verifying the accounts receivable is to obtain confirmations direct from the customers. The auditor should suggest to the client that a circularization of at least a large percentage in value of the accounts be made. If the client agrees to this, he should be asked to prepare duplicate statements of account for the particular accounts which the auditor desires to verify. The original and duplicate for each account when received from the client should be checked by the auditor in detail with the customers' accounts. The original of each should then be attached to one of the stamped addressed envelopes of the auditor's firm and to a confirmation request (see page 73). The auditor should fill in the top half of this form himself. He should get the client to sign each of the requests in his (the auditor's) presence. The auditor should then have prepared stamped addressed envelopes, bearing the auditor's return address in the left-hand corner, and he should himself insert the contents of the envelopes and mail them. As the confirmations are returned, discrepancies between the accounts of the client and those of the customers should be investigated and settled to the satisfaction of the auditor. The auditor should retain in his possession the duplicate copies of the statements which were sent to customers, and from these duplicates he may ascertain the names of customers who have not replied to the first request.

He should then send a second request to each customer who failed to reply in the first instance.

The junior should attempt to find out by reference to correspondence, journal entries and other sources, if any accounts receivable are pledged or assigned. Any information of this kind must be brought to the attention of the senior.

REQUEST FOR CONFIRMATION OF ACCOUNT RECEIVABLE

........................19......

....

....

....

Dear Sirs:

Enclosed is a statement of your account at the close of business on

........................19...... which shows an unpaid balance against you of

$ ....

Kindly compare the enclosed statement with your records and *return this letter to our auditors, Messrs.* ———— after completing whichever of the following certificates is applicable. Please note that transactions subsequent to date of the enclosed statement should be ignored for the purpose of this confirmation. *This is not a request for payment.*

A stamped addressed envelope is enclosed for your convenience in replying.

Yours very truly,

....

By ....

Messrs. ————————,

———— Street, New York, N. Y.

Dear Sirs:

The balance of $ .... mentioned above *is correct.*

(Signed) ....

Date........................19...... By ....

The balance of $ .... mentioned above *is not in agreement* with our records, which show a balance of $ .... The details are as follows: *

(Signed) ....

Date........................19...... By ....

* *Please be specific; if the space provided above is insufficient, use the reverse side of this sheet.*

Proper classification of the accounts receivable must also be considered by the auditor. Credit balances on the accounts-receivable ledger must be transferred to accounts payable, and debit balances on the accounts-payable ledger must be transferred to accounts receivable. Accounts due from officers and employees, subsidiary companies, affiliated companies, suppliers or contractors for advance payments and other accounts which are not those of trade debtors must be segregated. Accounts due within one year must also be segregated from those due further in the future. These segregations of accounts must be brought to the attention of the senior so that he can decide upon their final classification in the balance-sheet.

So that the senior may have all the necessary information before him when he discusses the amount of the reserves required against the accounts, accounts such as reserve for returns and allowances, reserve for discounts, reserve for quantity discounts and reserve for doubtful accounts should be analyzed for the period under review and for the period to the date on which the audit work is being done. In analyzing these reserve accounts, working papers should be prepared as in the following example:

ANALYSIS OF RESERVE FOR DOUBTFUL ACCOUNTS

Balance, January 1, 1931	$
Add:	
Amount provided from operations	
Amount recovered from doubtful accounts previously written off	
	$
Deduct—Doubtful accounts written off	
Balance, December 31, 1931	$

The amount provided from operations should be traced and cross-indexed to the profit-and-loss working papers. The other debits and credits should be supported in as much detail as is considered necessary. Doubtful accounts written off should usually be shown in detail for all except the smallest accounts. In the case of allowances of various kinds, only the largest items need be listed separately. The auditor should be careful to make certain that allowances to customers and accounts written off have been properly authorized and that all precautions are being taken to safeguard the client against the manipulation of cash receipts and the covering up of such shortages by entering fictitious allowances or writing off accounts which are collectible or have been collected.

The junior should include in his working papers statements of sales policies and credit terms of the client. These should include policies as to returns, allowances, rebates, cash discounts, post-dated billings and similar matters which might reduce the amount of the accounts receivable which is collectible.

With the information supplied by the junior and with his knowledge of the client's affairs, the senior will be able to discuss the collectibility of the accounts and the adequacy of the reserves with the credit manager or other responsible employees of the client. The senior will also undertake to obtain a certificate from the client stating that the accounts are genuine and collectible in full, subject to the reserves provided.

·VII·

SECURITIES

When assigned to the work of verifying the securities, the assistant must do the following things:

1—Prepare working papers analyzing the security accounts.
2—Vouch entries appearing in these analyses.
3—Check the income receivable from the securities.
4—Check the market value of the securities.
5—Assure himself that the client actually owns the securities.

The first work done on the verification of securities is almost always to count the securities held and to send out requests for confirmations to bankers and others who may be holding them as custodians or otherwise.

As stated previously when describing the verification of cash balances, the count of securities should preferably be made at the close of business of the period for which the examination is being done. At all events securities, cash and negotiable instruments must be verified simultaneously so as to prevent manipulation between them. For instance, if the cash balances are verified at the close of the period and also at a subsequent date, then even though the securities were examined at the close of the period, they must be verified again at the subsequent date on which the cash was verified. This is necessary to make certain that a shortage in the cash has not been concealed by selling securities and using the proceeds to cover up the defalcation.

When the securities are not verified until some date after the close of the period, the cash must be verified at the same time. The working papers should contain schedules showing the reconciliation of the balances of cash and securities at the date of count and at the end of the period under review, and the changes in the balances between the two dates should be vouched.

The auditor must examine the securities himself or he must obtain confirmations of their existence direct from the holders. All securities must be submitted to the auditor at the same time, and he must keep them under his control until he has completed his examination of them. He must never examine securities except in the presence of a representative of the client who must remain with him until the count has been completed. Failure to insist on this may lead to an allegation by the client that the auditor has misappropriated any securities which may be missing.

Before commencing the verification, the assistant should obtain a list of securities from the client, or he should prepare a list himself. If there are many securities, the most expeditious procedure is to have one assistant examine the securities while the other checks against the list the information called by the first assistant.

In examining securities the following information must be obtained:

1—Description of securities.
2—Denominations of shares or bonds.
3—Number of shares or bonds.
4—Coupons or warrants attached.
5—Ownership of securities.
6—Authenticity of securities.

In listing or checking the description of securities, the correct name of the obligor must be obtained, and the type of security must be carefully noted. For instance, securities may be issued by The X Railway Company, The X Railroad Company and The X Company, which may be three distinct corporations with somewhat similar names. Similarly, The X Company may have issues of 7% preferred stock class A and 7% preferred stock class B. These issues may have different rights and market values. It is important to get the exact name of the obligor and of the security. Maturity dates and interest rates of bonds should be listed.

The denominations of the securities must also be verified. Bonds may be of $100, $500, $1,000, or any denomination, and may not be distinguishable by color, size or printing. Stocks may have a par value or may be of no par value. Bonds and stocks may have warrants attached. The number of bonds or shares must, of course, be verified. Coupon bonds must have all unmatured coupons attached.

The fact that securities are held by the client is no proof that they are his property.

The auditor must therefore undertake to ascertain that the client is the actual owner of the securities. In the case of registered bonds, it must be seen that they are registered in the name of the client. Bearer bonds, of course, can not be identified as the property of any persons other than the actual holder. The auditor should see that shares are (1) registered in the name of the client or (2) endorsed to the client or (3) endorsed in blank or (4) accompanied by a power of attorney enabling the client to have them transferred. The auditor should list on his working papers particulars as to how the ownership of the securities is held—that is, whether by endorsement in blank or by registration in the name of client or otherwise.

There is not much that the auditor is normally required to do in verifying the authenticity of the securities, but he should at least see that stock certificates and bonds purport to bear the signatures of the officers by whom they are supposed to be validated, and that they appear to have been authenticated by the transfer agent and registrar, if such authentication is required.

On the completion of the count, the assistants responsible for the work should note on the schedule the time and place of verification and the names of the client's employees present during the count. The assistants should then sign the schedule.

Confirmations of the existence of securities must be obtained by the auditor direct from the custodians of all securities which are not available for examination. If the cash balances are verified at some date after the close of the period under review, the custodians must be asked to confirm their holdings of the securities at that date as well as at the close of the period under review. Custodians should also be asked to state in what capacities they are holding the securities—e. g., as custodian, as escrow agent or for collateral. Requests for confirmations should be mailed by the auditor himself. The requests should be mailed in envelopes bearing the auditor's own return address in case of non-delivery. The auditor should also enclose with each request a stamped envelope bearing his own address for the convenience of the person replying to his request. The auditor should remember that certain people are not proper custodians of securities; and he must always be prepared to justify himself in having accepted confirmations as proof of the existence and ownership of securities. A bank is generally a recognized custodian of securities, but in a particular instance the auditor may refuse to be satisfied with a confirmation from a bank. As an example, where a bank president is also president and controlling stockholder of the corporation whose accounts are being audited, the auditor might insist on counting the securities held by the bank for his client.

The working papers to be prepared analyzing the securities accounts should contain the following information:

Description of securities:
- Names of obligors.
- Types of securities.
- Denomination of securities.
- Maturity dates.
- Interest rates.
- Interest dates.

Balances at opening date of period:
- Par value of bonds or number of shares.
- Book value.

Purchases:
- Date.
- Particulars.
- Par value of bonds or number of shares.
- Cost.

Sales:
- Date.
- Particulars.
- Par value of bonds or number of shares.
- Book value.

Profit or loss on sales.

Balances at closing date of period:
- Par value of bonds or number of shares.
- Book value.
- Market value.

Interest and dividends receivable (including accruals at beginning and end of period).

Verification of ownership of securities.

The balances at the opening and closing dates should be checked with the ledger accounts. The purchases and sales should be vouched by reference to brokers' advices or other invoices and to minutes of meetings, to see that the transactions have been approved. Transactions with related companies or employees of the client should be called to the attention of the senior accountant.

Interest and dividends receivable must be verified if possible from financial journals showing dates on which interest payments were due and dividends were declared. Accrued interest must be calculated. The total of income receivable must be checked to the profit-and-loss working papers. The total profit or loss on sales of securities must also be traced to the profit-and-loss working papers.

The market value of the securities must be obtained if possible from financial journals. The quotations of market values usually give a "bid" and an "asked" price. The bid price is the price generally used. If a price quoted is "ex div.," it must be seen that the dividend is accrued on the books of the client. No accrual should be made for a dividend if the price quoted is "cum div."

The working papers must contain full particulars of any securities pledged or not free for the client to dispose of readily.

The proper classification of securities on the balance-sheet as between current assets, permanent and long-term investments and treasury stock is a matter for the senior to consider.

VIII

INVENTORIES

THE assistant should obtain from the client the typed inventory sheets and summaries. These sheets should show for each commodity the name and description, number of units of count, weight or measurement, unit price and inventory value. The summaries should bring together the information on these sheets and should amount in total to the inventory value which is to be verified.

The work to be done in verifying the inventories may be described under the following headings:

1—Clerical accuracy of footings, extensions and summaries.
2—Quantities, quality and condition.
3—Basis of pricing.

CLERICAL ACCURACY OF FOOTINGS, ETC.:

The assistant must undertake to do enough checking to satisfy himself of the substantial arithmetical accuracy of the inventories. The nature and extent of the work to be done have already been explained under the headings "Checking footings" and "Checking extensions." It need only be added that before beginning the work the assistant should obtain instructions from his senior as to the degree of accuracy with which the footings and extensions must be checked—the value of the individual items for which all the extensions must be checked and the value below which a selected number of the extensions must be checked. Any errors discovered in footings and extensions must be listed and called to the attention of the senior on completion of the work. Errors should be listed on separate sheets of working paper headed somewhat as follows:

ERRORS IN FOOTINGS (EXTENSIONS)

Inventory page	Commodity	Per inventory sheets	Per auditor	Difference	
				Add	Deduct

QUANTITIES, QUALITY AND CONDITION:

The extent of the work to be done must be decided by the senior after he has inquired into the system of internal check in force and the method of taking the inventories.

The assistant will generally be required to make an examination of (1) the original inventory tickets, (2) the inventory records, (3) receiving reports and (4) shipping reports.

When a physical inventory has been taken, the inventory sheets should be compared with a selected number of the original tickets, cards or memoranda showing the results of the actual counting, weighing or measuring. These original tickets should be signed or initialed by the employees who were responsible for the counting. Every precaution should be taken by the auditor to make certain that the original tickets are presented to him. If any discrepancies are found they must be listed in the working papers and called to the attention of the senior. Such a list may be made up in the form shown on the next page.

Differences between inventory sheets and tickets, cards, etc.

Inventory page	Commodity	Quantity inventory sheets	Difference in quantities		Unit price	Amount add or *deduct*
			Quantity tickets cards, etc.	Quantity add or *deduct*		

Specific instructions will be given by the senior as to the amount of work to be undertaken on the detail entries in the inventory records for selected periods. In addition to this, the assistant will be required to check certain items on the inventory sheets by reference to the inventory records. For instance, he may be told to check to the inventory records all items in the inventory sheets amounting to $500 or more. He should first find out whether quantities alone are to be checked or whether he must also verify unit prices and amounts. If the inventory sheets were compiled from physical inventories, there will probably be numerous differences between the sheets and records. On the other hand, if the sheets were prepared from book inventories, the sheets and records should be in agreement. In either case any major discrepancies found must be listed in the working papers and called to the attention of the senior. This listing may be done in the following form:

Differences between inventory sheets and records

Inventory page	Commodity	Quantity per sheets	Quantity per records	Remarks

While examining the inventory records, the assistant can obtain valuable information on slow-moving material, as the records will show the purchases or production and the sales in the account for each commodity. The senior should be consulted to determine what is to be considered slow-moving in the case of each examination, and all commodities slow-moving, within the terms of the definition adopted, should be listed in the working papers. An alert assistant should also obtain information as to discontinued products, damaged merchandise, etc., which should all be listed and called to the attention of the senior.

The receiving records for a selected number of days prior to the end of the period and after the closing date should be examined to see that all material received or billed by vendors up to the end of the period has been included in the inventory and that the liabilities for all material so included have been correctly recorded. The procedure in a typical case is to call for the receiving records for the period, say, from December 26th to 31st, if the period ends on December 31st; to trace to the inventory sheets all items received, probably by seeing that such items were recorded in the perpetual-inventory records prior to December 31st and that the book quantities and physical quantities are in close agreement; to examine the invoices rendered by the vendors for all such items; and to make sure that these invoices have been credited to liability accounts prior to or on December 31st. Omissions from the inventory and unrecorded liabilities must be listed in the working papers. In examining the receiving records from January 1st onward to verify the merchandise in transit, the assistant should have a list of such merchandise prepared by the client. If the client can not furnish such a statement, the assistant must prepare one himself. This list should show separately items included in the inventory and taken up as liabilities by the client and items not so recorded by the client. The essential information to be obtained for the working papers on material in transit is (1) date of invoice, (2) date of receipt of material, (3) particulars of material, (4) name of vendor, (5) amount of invoice and (6) accounts to be charged. All large invoices for material received for a selected period commencing on January 1st should be examined, and those dated before or on December

31st should be considered to be for material in transit.

As part of his work in verifying the inventory quantities, the auditor must examine the shipping records to ascertain (1) that no fictitious billings have been made and (2) that merchandise billed to customers has been excluded from the inventories.

Fictitious billings may include billings when no shipments or sales have been made and billings which on further examination do not really represent genuine sales for which the client is justified in taking credit during the period under review. While no definite instructions can be given here for the detection of fictitious billings, as possibilities for manipulation are numerous, there are certain tests which must be included for the period selected. First of all, copies of invoices rendered to the customers must be examined to see that the sales appear to be regular; shipping records, preferably the originals made out by the shipping department, must be examined to see that the merchandise was actually shipped to the customer; customers' original orders must be examined to ascertain (1) that the goods were definitely ordered and (2) that the terms of the orders support the client's treatment of the shipments as sales.

In order to see that all merchandise billed has been excluded from the inventories, the billings for a selected period up to and including the end of the period under review should be compared with the shipping records. The perpetual-inventory records should be examined to make certain that all material shipped and billed has been deducted from the quantities. Material billed but not yet shipped must be excluded from inventories. If the inventories are book inventories and not the result of a physical count, it is sufficient to see that such material has been excluded from the quantities on hand as shown by the perpetual-inventory records. But, if physical inventories of the quantities on hand at the end of the period were taken, further investigation must be made to see that material billed but not shipped has been excluded. The existence of material billed but unshipped should always remind the auditor that the billings may not be for bona-fide sales.

The inventory should include nothing which is not owned by the client and should exclude nothing which is owned. For this reason, merchandise held by the client on consignment from others should be excluded, and merchandise consigned to others should be included. Confirmations from consignees should be obtained for merchandise held by them. Consignment records and accounts sales should be examined to prove that the inventories have been correctly prepared.

If the inventories include material in public warehouses or elsewhere not on the client's premises, the assistant must consult his senior to find out whether or not letters of confirmation should be obtained from the custodians.

The work to be done, in a particular case, in the verification of quantities, quality and condition must be determined by the senior, and the assistant generally must limit himself to the doing of specific work assigned to him.

BASIS OF PRICING:

It is not part of the duty of the junior accountant to determine the propriety of the basis of pricing the inventory. Whether the inventory should be priced at cost, cost or market whichever is lower, net selling prices or in any other way is a matter which the senior must consider and discuss with the client. The junior is generally told to draw up pricing schedules for all items in the inventory amounting to more than a specified value. These schedules should be prepared as follows:

Left side of schedule:

Inventory page	Commodity	Unit of count	Previous audit			Present audit		
			Quantity	Unit price	Amount	Quantity	Unit price	Amount

Right side of schedule:

Verification of pricing						
Voucher number	Date	Vendor's name	Particulars	Quantity	Unit price	Remarks

The first thing to do after heading the schedules is to insert the required information from the inventory sheets. The comparative information for the previous audit (or previous period if a first examination is being made) should be obtained from the working papers prepared on the previous audit or from the inventory sheets for the prior date. A comparison of the quantities and unit prices at both dates should furnish valuable information as to quantities overstocked and as to price trends.

The right side of the pricing schedules is used by the auditor to insert particulars of his verification of prices. The ruling shown is suitable for a straightforward verification of the pricing of purchased materials. Changes in the headings and the number of columns would be necessary in verifying manufacturing costs of work-in-process and finished material and in other cases. When market prices have to be inserted for each item, columns must be provided for quotations and sources of information. In verifying the pricing of work-in-process, for instance, columns might be headed as follows:

Costs used (specify periods).
Production for periods for which costs were used.
Unit costs for periods for which costs were used.
Latest unit costs (replacement costs).
Remarks.

The junior should consult his senior about the headings to be inserted on the schedules to be used for the verification of pricing.

The verification of pricing will be described under the headings "raw materials," and "work-in-process and finished goods."

RAW MATERIALS:

When verifying the pricing of raw material, the most recent invoices for purchases approximately equal to the quantities in the inventories must be examined. The prices as shown by the most recent invoices should be approximately the same as those used in valuing the inventories. Duties, freight, insurance and other direct charges are perfectly legitimate additions to the invoice prices, and if they have been included in valuing the inventories they should be test-checked by the auditor. Trade discounts must be deducted from the prices used in valuing the inventories. The auditor must ascertain that all invoices examined by him have been recorded on the books of the client. Voucher numbers of the particular invoices required to make up approximately the quantities on hand may usually be obtained from the perpetual-inventory records. The best procedure when this is so is to insert the numbers of the required vouchers on the pricing schedules and then to get the vouchers from the files, all at the same time. Invoices must be examined for the particular quantities actually in the inventories. When physical separation of the quantities purchased is not made by the client, the quantities purchased most recently are assumed to be the quantities in the inventories. However, when the client segregates purchases in identifiable lots, the invoices for the particular lots still on hand must be examined. If the prices used by the client are average costs, tests must be made to see how the averages were obtained.

When verifying the market prices of raw material, the assistant will be instructed by his senior to what sources he is to refer for information. In consulting trade papers and trade price lists he must be careful to obtain the prices for the actual commodity in the inventory. Differences in sizes, grades and chemical composition will affect the quotations. It is almost always advisable to ask one of the client's employees from the purchasing department to help in obtaining the market quotations. Of course, the assistant must not blindly accept figures furnished by an employee; he must satisfy himself that they are correct.

WORK-IN-PROCESS AND FINISHED GOODS:

The verification of the pricing of work-in-process and manufactured goods requires that an examination be made of the costing system. This, however, is work to be undertaken by the senior. The junior will be required to carry out specific instructions for checking labor, material and burden distributions to the cost records. The insertion on the pricing schedules of the costs for the commodities listed is merely copying work to be done after the completion of the test-check of the cost records.

Cost prices of purchased finished goods must be verified in the same way as in the case of raw materials.

The compilation of costs based on current prices for labor, material and burden will be closely supervised by the senior, and no further mention need be made of it here. The costs so obtained should be included in the working papers to show that tests have been made to determine how the replacement costs compare with the actual costs used.

Market or selling prices for finished goods must be obtained from trade papers, price lists, catalogues and other sources. The question of what adjustments must be made to such prices to ensure that no material included in the inventories is valued in excess of net realizable values is one which must be considered by the senior accountant.

GENERAL:

On completion of the verification of pricing, schedules should be prepared showing the principal differences between the prices used by the client and those which the auditor thinks should be used. This schedule may be drawn up as follows:

Differences discovered from verification of pricing

Inventory page	Commodity	Quantity	Amount	Client Unit price	Auditor Unit price	Difference	
						Unit price	Amount

While verifying the quantities and pricing of inventories, the possibility that material has been pledged, or that there may be liens on any material, must be constantly borne in mind. Any information of this kind and any suspicions must be brought to the attention of the senior.

The proper classification of the inventories in the final accounts must be decided by the senior, who must also undertake to obtain a certificate from the client's employees, on the completion of the examination, as to quantities, quality, condition, ownership and pricing of the inventories.

· IX ·

FIXED ASSETS

UNDER the classification "fixed assets" are included tangible assets such as land, buildings, machinery and equipment, intangible assets such as goodwill, patents and trade-marks, and the reserves applicable to them.

The work to be done by the junior accountant in verifying these assets may be summarized as follows:

1—Preparation of schedules.
2—Vouching of additions to asset accounts.
3—Vouching of deductions from asset accounts.
4—Vouching of additions to reserve accounts.
5—Vouching of deductions from reserve accounts.

The junior before being called upon to start work should be furnished with the leading schedules for the fixed assets and reserves. He should obtain the working papers for the previous period, if the audit is not being done for the first time, and, after studying the leading schedules and the papers for the previous period, he should decide what type of principal supporting schedules he is going to prepare. These schedules in every case should be similar to the following:

Summary of changes in fixed assets:

Particulars	Balances Dec. 31, 1931	Changes during year			Balances Jan 1, 1931
		Additions	Deductions	Other changes	
Land					
Buildings					
Machinery					
Equipment					
Any other					
Goodwill					
Patents					
Any other					

Summary of changes in reserve accounts:

Particulars	Balances Jan. 1, 1931	Changes during year				Balances Dec. 31, 1931
		Additions		Deductions	Other changes	
		Rate	Amount			
Land						
Buildings						
Machinery						
Equipment						
Any other						

It is often possible, and always highly desirable, to combine these two schedules on one double-width sheet of working paper, as then a bird's-eye view of the changes in the fixed asset and relative reserve accounts may be obtained.

In many cases, the accountant, with the help of information furnished by the client, should be able to insert at once the changes during the year. In other cases he may have to complete his analysis and vouching of the ledger accounts before he is able to proceed. The opening and closing balances, of course, can be taken from the leading schedules, or from the ledger accounts, and the totals of these columns must agree with the totals as shown on the leading schedules.

The additions to the fixed-asset accounts may be listed from the general ledger, or from subsidiary ledgers, somewhat as follows:

Additions to (name of account):

Date	Ref.	Amount	Auditor's verification		
			Date of bill	Supplier	Particulars

The deductions from the fixed-asset accounts may also be listed from the same sources as the additions, thus:

Deductions from (name of account):

Date	Ref.	Amount	Accrued depreciation	Profit or *loss*	Particulars

A similar type of schedule may be prepared for other changes in the fixed-asset accounts.

These schedules form the foundation of the fixed-asset working papers and will be found to be applicable to almost all types of examinations. If there are several plants, it may be necessary to make a separate schedule for each plant and to introduce columns for interplant transfers.

In the case of an examination which is being made for the first time by the firm by which he is employed, the junior should consult his senior about the period for which the fixed assets should be verified.

Before listing the additions and deductions, enquiries should be made of the senior as to the value of the items which are to be verified. If his instructions are that no items under $100 each are to be verified, then, in listing, all such unverified items may be grouped under the heading "Sundry items unverified, under $100 each," so as to have the total additions and deductions in agreement with the figures on the chief supporting schedules.

Additions may be purchases from outsiders or they may be the result of work done by the client's employees with material taken from the client's store-rooms. In the case of purchases from outsiders, the bills rendered should be examined, and the particulars should be listed on the schedules. It should be seen that the bills are made out to the client, that they appear to be bona-fide, that the materials or services have been received (demonstrated by the approval of employees authorized to make certain of this) and that the materials or services are proper additions to the fixed-asset accounts. It is not the purpose here to define the nature of capital expenditure (that is, expenditure which may legitimately be added to the book value of fixed assets) but every junior accountant should have a clear conception of the fundamental distinction between capital and revenue expenditure. For those purchases which represent the acquisition of land, the title deeds should be examined, and if a deed appears on the face of it to have been recorded, a note of the date of recording and of the state and county in which recorded should be made on the working papers.

When charges are made which represent payments on contracts, the contracts themselves should be examined, and abstracts of them should be included in the working papers. Uncompleted contracts should be called to the attention of the senior.

The examination of bills rendered does not of itself justify the acceptance of charges by the accountant. He must also consider the question of internal check and its bearing on the possibility that bills presented in support of additions have never been paid or have been paid more than once or have not been recorded as liabilities. It may, therefore, often be necessary to examine the creditors' ledger as well as cheques and statements sent to creditors. The junior should consider this carefully, and he should consult his senior if in doubt as to the extent to which he should accept the bills presented to him as sole evidence of the charges.

Additions may consist also of wage payments made by the client to his employees, material used from the client's store-rooms and a charge for overhead applicable to such labor and material. When this is so, it will generally be found that these costs are accumulated by construction-order numbers in a construction ledger, which is a subsidiary record controlled by a construction account in the general ledger. All such orders exceeding in value a certain amount, as decided by the senior, should be listed to show the following:

1—Order number
2—Particulars
3—Charges (net)
  Labor
  Material
  Overhead

The senior should be consulted to find out how much detail work is to be done in the case of the payroll and the store-room records. At all events, a sufficient number of payroll reports and material requisitions must be examined to satisfy the auditor of the correctness of the charges. In examining payroll charges, the actual time and work reports must be demanded, and they must be checked with the client's payroll distribution as shown by the journal voucher or other entry forming the basis of the charge in the construction ledger. Similarly, original material requisitions must be obtained, and the prices used must be checked from original bills or other sources. The requisitions must then be traced to the material or store distribution voucher or entry. This matter of the examination of payroll and material reports often presents certain difficulties in practice. For example, the time reports and material requisitions may be at the plant, whereas the audit is being done at the head office. Juniors should, therefore, always consult the senior-in-charge before undertaking this part of the verification. Details as to the method of adding overhead to the labor and material costs must be obtained and called to the attention of the senior who will determine the propriety of the charge.

In a well-organized business, all capital expenditure amounting to more than a certain minimum sum should be authorized in writing by the issue of what are often called "authorizations for expenditure." These authorizations in turn should be approved by the board of directors. The authorizations should specify the nature of the expenditures, indicating whether or not they are capital charges, and the amount authorized to be spent. The accountant should examine these authorizations, which should be signed by the proper officers, and he should call the attention of the senior to all expenditures for which he has seen no authorizations or in which the amount authorized has been exceeded by a substantial sum. The minutes of the meetings of the board of directors should also be examined and, on the working papers relative to the fixed assets, notations should be made showing expenditures authorized in the minutes.

In the vouching of additions, the possibility of discovering unrecorded liabilities should be constantly kept in mind. This is vitally necessary in the case of contracts for which amounts may be withheld pending expiration of guaranty periods or for which billings have not been received up to the end of the period under examination. Purchases of machinery, etc., on an instalment or so-called rental basis must also be carefully checked to see that the entire liability has been taken up on the records.

The deductions from fixed assets for dismantlements and sales, the accrued depreciation thereon and the amount of profit or loss should be checked with detailed property records or other available sources of information. The method adopted to notify the accounting department of dismantlements and sales must be ascertained, and the auditor must satisfy himself that all precautions are taken to have the property accounts relieved of the book values of the assets dismantled and sold. The amount of accrued depreciation must be computed in cases where the client's policy is to record the difference between book value and accrued depreciation in a profit-and-loss account.

The additions to and deductions from goodwill, patents and other intangible-asset accounts should be scheduled and vouched. Additions to patents will probably include fees paid to lawyers for making application for patents, and for defending the client's right to existing patents. The working papers should contain concise particulars of all such payments, especially where it is evident that the client is engaged in litigation. Separate schedules should be prepared showing the method used to write off the book value of the patents over the periods for which they were granted with the resulting computation of the amount written off under this method.

Land owned by the client may be subject to a charge for depletion, and, if this is so, schedules must be prepared showing the amount and basis of the credit to the reserve for depletion. If, for instance, depletion is provided at a given rate per ton of coal removed during the year, the number of tons mined should be obtained from production records, and it should be seen that the amount provided has been computed on the correct tonnage and at the given rate.

There are several methods of providing for depreciation, but the one in almost universal use is the so-called straight-line method, whereby a constant percentage of the asset account is provided yearly. The accountant should ascertain the rates used and the method of computation (whether computed on the balances at the beginning of the period or in some other way), and he should check the computations to see that the provisions have actually been made on the basis and at the rates indicated.

Charges to the reserve accounts for plant dismantled and sold should have been verified when working on the property accounts.

Other changes in the reserve accounts should be scheduled and full particulars should be included in the working papers, so that the senior may have the information necessary to enable him to determine their propriety.

It will sometimes be found that, under certain methods of accounting for property, replacements may be charged to the reserve for depreciation. These items must be vouched in the same way as those which are added to the fixed-asset accounts.

The attention of the senior should be called to all instances in which reserves are provided at rates which differ from those used in the previous period. The question of the adequacy of the rates is one which the senior must decide.

After the completion of the work mentioned above, the junior should consult his senior about obtaining a certificate from the client stating that all capital expenditure has been charged to fixed-asset accounts, that all charges to fixed-asset accounts were properly capitalizable and that all dismantlements and disposals have been properly recorded. In addition, the senior may want the client to include in this certificate statements on other matters affecting the fixed assets of which the accountant may desire a written opinion. One instance of such a matter occurs when the accountant wants to be assured that a plant or unit thereof has not been abandoned.

Before turning his papers over to his senior, the assistant should prepare a schedule of work done and statements of all matters which he desires to call to the attention of the senior. The working papers should also be indexed and cross-indexed.

· X ·

DEFERRED CHARGES

AMONG the typical items of deferred charges which the junior accountant will most often be called upon to verify are prepaid expenses (insurance, rent, taxes and interest) and unamortized discount on bond issues and expenses incident to such issues.

PREPAID INSURANCE:

The working papers relative to prepaid insurance should furnish the following information about each insurance policy:

1—Number of policy.
2—Name of insurance company.
3—Risk against which insured.
4—Amount of coverage provided by policy.
5—Date of commencement of insurance.
6—Date of termination of insurance.
7—Amount of premium.

8—Prepaid insurance—
a—Proportion of premium prepaid.
b—Amount of premium prepaid.

This information should be obtained from the register of insurance and should be verified by examining the insurance policies. The accuracy of the register of insurance should be tested by checking selected entries in the prepaid-insurance account in the general ledger against the vouchers and other records, such as the cash-receipts book for refunds of premiums, and by tracing the entries to the register of insurance.

If no register of insurance is kept, the information will have to be obtained direct from the policies. When this method has to be adopted, a thorough check of the prepaid-insurance account in the general ledger must be undertaken so as to make certain that all policies in force have been examined, that no policies on which premiums have been refunded and the policies thereby canceled in whole or in part have been included, and that the premiums on the policies examined have been adjusted for refunds received. The possibility that premium refunds may be misappropriated should be constantly kept in mind.

In computing the proportion and amount of premiums prepaid, it is sufficient to calculate in months and fractions of months—e. g., a premium of $2,400 has been paid for insurance from March 15, 1931, to March 15, 1932; on December 31, 1931, the proportion prepaid would be 5/24ths, which is $500.

When examining insurance policies attention should be paid to the following points:—

1—The policy should be the signed original and not a signed copy. If it is a copy, the accountant should insist either on seeing the original or on knowing who has it. If it is in the hands of a third party, the accountant must ascertain the interest of the third party in the policy, as there is always a chance that unrecorded liabilities will be found. For example, a client may be borrowing money by mortgaging its real property, not accounting properly for the proceeds and making no record of the transaction on its books.

2—The policy should be in favor of the client. If it is payable to some one else, or to the client and some one else as their interests may appear at the date of the event insured against, the accountant must ascertain the interest held or liable to be held by another in the client's property. Again, this may show that there are liabilities which have not been recorded on the client's books.

The question of the adequacy of the amount of insurance which is being carried by the client is generally not a matter upon which the accountant has to comment, but he should always be in the position of knowing how the amount of coverage compares with the book values of the assets insured.

For certain forms of insurance, notably workmen's compensation insurance, the insured is required to pay a deposit based on an estimate such as the average number of workmen to be employed. The insurance company periodically sends its representatives to check the actual number employed during, say, each quarter and renders a bill for the premium calculated on its findings. As these periodical examinations are generally at least three months late, the accountant, at December 31st for instance, has to compute the prepaid insurance by estimating the amount due for the period from the date on which the last bill was received up to December 31st. The amount so computed should be deducted from the premium deposit in determining the amount to be treated as prepaid at December 31st. In some cases, the amount payable exceeds the premium deposit, and the excess must be shown as a liability. It is often more correct to treat the entire amount as a liability and to show the premium deposit as a deferred charge.

The account for prepaid insurance should be analyzed on the working papers somewhat as follows:

ANALYSIS OF PREPAID INSURANCE
DECEMBER 31, 1931

Balance—January 1, 1931		$10,000
Premiums paid or accrued during year	$60,000	
Premiums refunded during year	5,000	55,000
		$65,000
Insurance charged to operations		59,000
Balance—December 31, 1931		$ 6,000

PREPAID RENT:

The analysis of the prepaid-rent account should be shown as follows:

ANALYSIS OF PREPAID RENT
DECEMBER 31, 1931

Balance—January 1, 1931		
(rent for month of January)		$ 3,000
Payments during year:		
January	$ 3,000	
February	3,000	
And so on	27,000	
December	3,000	36,000
		$39,000
Rent charged to operations		
12 months at $3,000		36,000
Balance—December 31, 1931		
(rent for month of January)		$ 3,000

The vouchers for the payments made should be examined. The lease or leases should be inspected and extracts from them should be included in the working papers. The rent paid should be in accordance with the leases, and the rent charged to operations should be traced to the profit-and-loss accounts.

The special points to be noted in the examinations of leases are;

1—Date of lease.
2—Names of parties to lease.
3—Term of lease.
4—Renewal privileges.

5—Rent payable for original term and in event of renewals.

6—Special stipulations as to sub-letting privileges, payment for necessary repairs, options to purchase, etc.

PREPAID TAXES:

Prepaid-taxes account should be analyzed as follows:

ANALYSIS OF PREPAID TAXES
DECEMBER 31, 1931

Balance—January 1, 1931:				
Real-estate taxes for period January 1, 1931, to March 31, 1931			$1,000	
New York state franchise taxes for period January 1, 1931, to October 31, 1931			600	$1,600
Payments during the year—				
Date	Particulars	Period covered	Amount	
May 15	Real estate—Fostoria	1st half 4/1/31 to 3/31/32	$2,000	
Oct. 15	do	2nd half 4/1/31 to 3/31/32	2,000	
Dec. 15	New York state franchise	11/1/31 to 10/31/32	1,500	5,500
				$7,100
Taxes charged to profit and loss				4,850
Balance—December 31, 1931				$2,250

made up as follows:

Real estate taxes, January 1, 1932, to March 31, 1932	$1,000
New York state franchise taxes, January 1, 1932, to October 31, 1932	1,250
	$2,250

The important matters which should be shown on the working papers in analyzing tax accounts are these:

1—The composition of the opening balance of the accounts.

2—Details of the taxes paid, particularly the periods for which the payments have been made.

3—The composition of the closing balance.

Vouchers and tax returns must be examined to substantiate all payments that have been made. The accountant must see that all taxes have been paid or otherwise are recorded as liabilities. For instance, in the pro-forma analysis of prepaid taxes which was given above, the New York state franchise tax might not have been set up as a liability or paid until some time after December 31st, and in that case the accountant should have noticed it and should call attention to it in a note on the supporting schedule for taxes, so that his senior could make the necessary adjusting journal entry to record the omission. Of course, the accuracy of the amount of taxes prepaid at December 31st should be verified by reference to the information shown on the analysis of the tax account.

PREPAID INTEREST:

The account for prepaid interest should be analyzed as follows:

ANALYSIS OF PREPAID INTEREST
DECEMBER 31, 1931

Balance—January 1, 1931—						
First National bank—interest at 6% on $100,000 from January 1, 1931, to February 28, 1931						$ 1,000
Payments during the year						
Date	Particulars	Rate	Principal	Period covered		
3/1/31	First National	6%	$100,000	3/1/31 to 5/31/31	$1,500	
(and so on for each payment)						60,000
						$61,000
Interest charged to profit and loss						59,000
Balance—December 31, 1931						$ 2,000

made up as follows:

First National bank—interest at 6% on $200,000 for period from January 1, 1932, to February 28, 1932	$ 2,000

Vouchers and other evidence of the interest paid must be examined. The amount prepaid at December 31st must be checked by reference to the payments and the periods covered by such payments. Details of the payments or accruals, as shown in the analysis given above, must be included in the working papers, not only to facilitate the calculation of the prepaid amount at December 31st, but also to bring to light any unrecorded liabilities on which interest may have been paid during the year.

* * * * *

The amount of insurance, taxes, and interest charged to profit and loss should be traced to the profit-and-loss working papers to which they should be cross-indexed.

The amounts paid for insurance, rent, taxes and interest are, in many cases, charged direct to profit-and-loss accounts, and the prepaid amounts at the end of the year are charged to prepaid accounts and credited to the respective profit-and-loss accounts. The procedure in preparing the supporting schedules and vouching the entries should be the same as that which has been already described. The only difference should be that the schedules should be part of the profit-and-loss working papers and should be cross-indexed to the leading schedule on deferred charges, instead of being supporting schedules for deferred charges and cross-indexed to the profit-and-loss accounts.

At the end of a period, rent, taxes and interest, instead of being prepaid, are often unpaid for a part of the period, and therefore the amounts unpaid are shown as liabilities. The information required in the working papers relative to accrued rent, accrued taxes and accrued interest is substantially the same as is necessary when these expenses appear as prepaid charges.

UNAMORTIZED DISCOUNT AND EXPENSES:

The discount on bond issues and expenses incident to such issues should be carried as deferred charges and spread in some equitable manner over the life of the bonds so as to charge the profit-and-loss account of each year with a fair proportion of the actual cost of borrowed money. This cost is composed of the yearly charge for interest and a part of the discount and expense.

The working papers should contain an analysis of the unamortized discount and expenses in the following form:

UNAMORTIZED DISCOUNT AND EXPENSES
DECEMBER 31, 1931

Balance—January 1, 1931	$500,000
Amount charged off during the year	50,000
Balance—December 31, 1931	$450,000

The amount charged off during the year should be traced and cross-indexed to the profit-and-loss accounts. The verification of the correctness of the amount charged off and of the balance carried forward at December 31st should be made by the senior accountant.

Deferred charges may also include prepaid royalties, deferred experimental and development expenses and similar expenditures, but the procedure relative to any of them should present no difficulties if the preceding portions of this chapter have been understood. To summarize and to generalize, the procedure in verifying deferred charges is as follows:

1—To make an analysis of the account.

2—In an audit which is not being done for the first time, to accept the opening balance as being accurate if it is in agreement with the working papers of the previous year—unless, of course, it appears to be wrong.

3—To verify the additions during the year.

4—To trace the amount charged off to profit and loss, after verifying the accuracy of it.

5—To verify the accuracy of the balance at the end by reference to the best available evidence.

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CURRENT LIABILITIES

NOTES PAYABLE:

THE first work to be done in the verification of notes payable is to prepare an analysis of the notes-payable account for the period under review. This analysis should give the following information:

1—Date of issue.
2—Name of creditor.
3—Interest rate.
4—Tenor and due date.
5—Name of endorser.
6—Collateral hypothecated.
7—Balances at beginning of period.
8—Additions during period.
9—Deductions during period.
10—Balances at end of period.
11—Accrued or prepaid interest at end of period.
12—Remarks as to confirmation of existence of notes.

The required information should be obtained from the notes-payable book, and the balances at the beginning and the end of the period must be in agreement with the control account in the general ledger.

The names of employees authorized to sign notes must be obtained and included in the working papers.

Canceled notes must be examined for all notes paid during the period. It must be seen that the information on the notes is in agreement with the details as shown by the analysis of the notes-payable account. The auditor must also ascertain that the canceled notes bear the signatures of employees authorized to sign notes on behalf of the client.

A test-check of the payments on notes must be made by referring to the cashbook. Part payments on notes must be verified in a similar manner.

An analysis of the interest-expense account should be made to uncover any payments which may have been made on obligations not recorded on the books. This analysis should also assist in the verification of interest accrued or prepaid at the end of the period.

Requests for confirmation of notes payable should be sent to all persons whose names appear as payees of notes in the analysis of notes-payable and of interest-expense accounts. The requests to the client's bankers are usually included on the form of request sent them for the confirmation of the bank balances. These requests should ask for all information of notes payable held at the end of the period, of interest accrued or prepaid to the end of the period and of collateral held at the end of the period. The requests should be mailed by the auditor in envelopes bearing his own return address. The requests should ask that replies be sent direct to the auditor. In addition to obtaining direct confirmation from the holders of all notes outstanding at the end of the period, the auditor should examine canceled notes for all notes paid after that date.

The procedure mentioned is also applicable to the verification of drafts and acceptances payable, though for trade drafts and trade acceptances it may often be found impracticable to obtain confirmations from the holders. This is especially so when there are large numbers outstanding. However, the senior should be consulted on this matter. But for bank acceptances, drawn against letters of credit, confirmations should always be obtained direct from the bankers, who should be asked to include in their certificates the amount unused on every letter of credit still in force at the end of the year. The accountant should include in his working papers a schedule of the letters of credit opened by the client during a selected period to be decided on by the senior (the period selected should always be a sufficiently long time prior to the end of the period under review to account for all letters of credit open at the end of the period), the details of the acceptances applicable to each letter of credit and the letters of credit unused at the end of the period. This schedule may be drawn up as follows:

- Letters of credit
  - Number
  - Date
  - Bank
  - Amount
- Acceptances
  - Date
  - Drawer
  - Amount
- Balance
  - Amount

The amount in the balance column should agree or should be reconciled with the balances shown on the certificates obtained from the banks. However, the accountant should not accept this agreement as proof of the accuracy of the balances, because drafts may have been drawn against the letters of credit prior to or on the last day of the period and may not be presented to the banker for acceptance until some date subsequently. The accountant must therefore obtain and include in his working papers particulars of all acceptances dated within the period under review but accepted by the bankers after the close of the period. These acceptances must be recorded as liabilities, and must be deducted in determining the correct balance of unused letters of credit at the end of the period. In order to obtain this information, the accountant should examine the transactions after the closing date, and if necessary he should communicate with the bankers to find out what drafts they accepted on behalf of the client after the closing date of the client's financial period. On the schedule of drafts drawn within the period, but accepted after it, the accountant should include particulars of the purposes for which the drafts were drawn and the names of the accounts to be charged.

ACCOUNTS PAYABLE:

The client should furnish or the auditor should prepare a trial balance of the accounts-payable ledger or a list of the unpaid vouchers, if a voucher register is kept in place of an accounts-payable ledger. The footings of this trial balance or list must be proved, and the total must agree with the accounts-payable account in the general ledger.

The amount of detail checking to be done on the accounts-payable records will be decided by the senior. A test-check of the transactions for a selected period is generally adequate. This test should include checking the accounts-payable postings to the general ledger and to the subsidiary ledgers and a verification of the accuracy of a selected number of the transactions for which the postings were checked.

The balances on the subsidiary ledger or the unpaid items in the voucher register should be checked with the list of balances. All balances which have been outstanding for a long time should be investigated to find out if there are any later bills which should be recorded as liabilities and if there is a dispute which may involve having to pay more than the liability recorded. Interest may be accumulating on bills outstanding for a long time.

A list of debit balances must be prepared. The nature of the debit balances must be ascertained and the large ones must be examined. Advance payments on contracts for raw material should be verified by examining the contracts and the most recent transactions in the vendors' accounts. The possibility that the goods have been received, included in the inventories and not credited to the vendors' accounts must be borne in mind. As debit balances in the accounts payable will be classified in the final accounts among the assets, the question of the valuation of the balances must be considered. If the balances are accounts receivable, reserves for doubtful accounts may be necessary; if they are advance payments for merchandise, reserves to reduce the goods to the lower of cost or market prices may be required.

Monthly statements from the larger creditors should be inspected to see that they are in agreement with the liabilities set up by the client. In cases of important differences, or where the auditor is doubtful of the amount of the liability to any creditor, he should obtain confirmation direct from the creditor.

Original bills must be examined at least for a selected number of the unpaid items If an accounts-payable ledger is kept, it may be sufficient to examine all bills entered in the purchase register for, say, the last fifteen days in the period under review. If a voucher register is kept, all unpaid vouchers must be examined. One of the main objects of this examination is to find out what bills for goods or services received on or before the end of the period, or for goods in transit, have been omitted from the books in the period under review. As an example of this, an unpaid voucher may be for advertising for the month of November. As soon as he sees this, the auditor must find out where the advertising bill for December is. It may be unrecorded as a liability, and in that case he must list it on a schedule of unrecorded liabilities.

Lists of accrued expenses must be prepared or obtained from the client. Bills must be examined and accruals verified. Among typical accrued expenses are wages, interest, taxes, commissions and legal expenses.

In verifying accrued wages, the amounts of the last payrolls paid during the period, the first payrolls of the next period and the periods covered by the payments should be obtained. With this information available, the amount of the accrued payroll can be easily calculated.

Accrued interest, accrued taxes and similar accrual accounts should be analyzed in detail. The corresponding profit-and-loss accounts (interest, taxes, etc.) should be analyzed at the same time. The interest accounts may be analyzed as follows:

ANALYSIS OF ACCRUED INTEREST

Date	Particulars	Amount
January 1	Balance (credit) ..	$
	Charge to interest expense for the year	$
		$
	Payments during the year .	$
	(Give full details, including period for which interest has been paid)	
December 31	Balance (credit)	$
	Accounted for as follows—	
	(Give full details, including period for which interest has been accrued)	

The balance of the interest-expense account must be summarized so as to be in agreement with the "Charge to interest expense for the year" as shown above. Similar remarks apply to other accrued-expense accounts. In the case of accrued-interest account, the period covered by the interest payments is essential information; for the accrued-taxes account, the period for which the taxes were paid must be shown. For example, the New York state franchise tax for certain corporations is payable on or before January 1st of each year, for the fiscal year beginning the previous November 1st. The tax payable on or before January 1, 1933, is for the tax year 1932–33. Vouchers for payments made, as shown by the analysis of the accrued-expense accounts, must be examined, and the auditor must satisfy himself that provision has been made for all accrued expenses.

UNRECORDED LIABILITIES:

The principal duty of an auditor in verifying the liabilities is to see that none has been omitted. The important work to be undertaken is to examine all transactions recorded since the close of the period under review. For this purpose, the auditor should examine the vouchers and invoices from vendors (including all invoices not yet vouchered or recorded in the books); and he should scrutinize payments made, debit and credit memoranda issued, journal entries, receiving reports and stock records. In short, some examination must be made of all the books of original entry.

As a general rule, all invoices dated prior to or on the last day of the period should be recorded as liabilities at the end of the period. Invoices dated after the close of the period for goods or services received during the period under review should also be recorded as liabilities at the close of the period.

Certain entries made after the end of the period may not be unrecorded liabilities, but they may nevertheless be applicable to the period under review. Allowances for quantity discounts, based on the sales of the period, credit memoranda issued for goods returned, either during the period or subsequently, when the sales were recorded during the period, are examples of such entries.

The amounts and particulars of all unrecorded liabilities and entries applicable to the period under review should be listed in the working papers and called to the attention of the senior accountant. In listing unrecorded liabilities for merchandise, the important information to be shown on the schedules is the name of the account to be charged, the date of receipt of the merchandise, and whether the merchandise has been included in the inventory or not. The name of the account to be charged, the nature of the expense and the period for which billed must be shown for all unrecorded invoices for expenses. For credit memoranda applicable to the period, information must be given as to the date of original sale, the date of return of merchandise and whether the merchandise returned was taken into the inventory or not.

Any additional work that the junior may be required to undertake will be on specific instructions of his senior.

The senior accountant on the completion of the work will be responsible for obtaining a certificate from the client stating that provision has been made for all liabilities.

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BONDED AND MORTGAGE DEBT

THE work that the junior accountant is required to do may be considered under the following headings:

1—Examination of mortgages and trust indentures.
2—Preparation of analyses of accounts.
3—Verification of transactions in accounts.
4—Verification of debts outstanding.
5—Verification of treasury bonds and sinking-fund assets.
6—Verification of interest expense.

All mortgages, trust indentures and other legal instruments signed by the client must be examined. The principal terms should be noted in the working papers. Among these will be the following:

1—Date of instrument.
2—Parties to instrument.
3—Name of trustees.
4—Exact title of bond issue.

5—Authorized amount of issue.
6—Rate of interest and dates on which payable.
7—Particulars of maturity, redemption, convertibility and similar stipulations.
8—Sinking-fund provisions.
9—Definitions of current assets, current liabilities and other accounting terms.
10—Date and place of recording the mortgage on the public records.
11—Stipulations as to insurance, proceeds of sale of mortgaged property and any other matters of which the auditor should be informed.

Analyses must be prepared of the transactions in all bond accounts and sinking-fund accounts. Analyses of accounts for bonds outstanding may be prepared somewhat as follows:

ANALYSIS OF 6% SINKING-FUND GOLD BOND ACCOUNT:

January	1	Balance at beginning		$
April	1	Sinking fund paid this date	$	
October	1	Sinking fund paid this date	$	
December	31	Balance at end		$

Analyses of accounts for bonds held in the treasury should be prepared to show balances at the beginning, purchases, sales, transfers to sinking-fund accounts, premiums and discounts, profit and loss on sales and balances at the end. Sinking-fund accounts and accounts with trustees must be analyzed to show all transactions during the year.

By reference to the extracts from the bond indentures, the auditor should make sure that the sinking-fund requirements have been met. He should examine either the canceled bonds themselves or the cremation certificates from the trustees. This is necessary in order to be certain that bonds turned into the sinking fund have been either canceled or destroyed. Changes in the accounts for bonds held in the treasury must be vouched by examining brokers' "bought" and "sold" notes. The premiums and discounts and profits and losses on sales must be traced to the surplus or to the profit-and-loss accounts. All transactions in the sinking-fund accounts must be verified.

The trustee for the bondholders should be requested to furnish the auditor with a certificate as to the bonds outstanding, collateral held and any other matter of which the auditor may desire confirmation. In verifying mortgage debts for which there are no trustees the auditor should obtain certificates from the mortgagees as to the amounts of the mortgages, the due dates, the interest rates, the collateral held and the dates to which interest has been paid.

Treasury bonds and sinking-fund assets must be verified in the same way as other securities, i. e., by actual count or by confirmation from the holders.

The interest expense of the obligations must be checked for the year, and the accrued interest to the end of the period must be computed. The auditor must satisfy himself that interest on bonds held in the treasury and for the sinking fund has been received by the client. To do this he must ascertain either that interest has been paid on the net amount of the bonds outstanding at the interest dates or that, if interest has been paid on the gross amount outstanding, interest has been collected on the bonds held in the treasury.

·XIII·

CAPITAL STOCK

IN THE verification of capital stock, the usual work which juniors must be prepared to undertake may be summarized as follows:

1—Making abstracts of certificates of incorporation.
2—Making abstracts of by-laws.
3—Examination of stock-transfer registers, registers of stockholders and stock-certificate books.
4—Making abstracts of minutes.
5—Analysing stock accounts and vouching entries in them.

CERTIFICATE OF INCORPORATION:

When making an abstract of the certificate of incorporation or similar document issued by the authorities of the state as evidence that the company has been properly incorporated, the principal points to be listed are—

1—Name of state under laws of which the corporation has been formed;

2—Date of incorporation;

3—Name of corporation—this should be listed exactly as shown in the certificate of incorporation, e. g., The John Jones Corporation; John Jones Corp.; John Jones Inc.; John Jones Incorporated; John Jones Co., Inc.—all these are different;

4—Particulars of authorized capital stock, showing details of various issues authorized, par values, stated values, preferences as to dividend and capital, redemption and conversion features, sinking-fund provisions, voting rights and restrictions and other matters of a similar nature;

5—Duration of charter; and

6—Any other information which may have a bearing on the accounts of the corporation.

If there are any amended certificates of incorporation, the date and nature of each amendment should be listed.

The original certificate, or at least a copy certified by the secretary of state or other state officer, should be examined.

BY-LAWS:

The by-laws usually contain restrictions as to the handling of funds, the declaration of dividends and provisions affecting the rights and interests of stockholders. Extracts should be made of all matters which are apt to have a bearing on the accounts of the company.

CAPITAL-STOCK RECORDS:

When the accounting for certificates of capital stock is done on behalf of the company by trust companies, the accountant need only obtain from the trust companies in their capacities as registrars and transfer agents certificates as to the number of shares outstanding. However, where the company maintains capital-stock records itself, an examination must be made of such records to determine the number of shares outstanding. The records generally kept are registers of transfers, registers of stockholders and stock-certificate books.

A list should be made from each stock-certificate book and should show the details of shares issued and subsequently canceled and of shares outstanding. The working papers should be prepared as shown on the following page.

NAME OF COMPANY

Examination of stock-certificate book—7% preferred stock December 31, 1931

Cert. Nos.	Issued to	No. of shares
1	Canceled	—
2	John Jones	20
3	Richard Smith	40
4	Canceled	—
5-10	Canceled	—
11	John Doe	40
12-100	Unissued	—
		100

It should be seen that the stubs of all certificates bear transfer stamps; canceled certificates should be examined; the total number of shares outstanding should agree with the control account in the general ledger and with the total as shown by the list of shareholders, which should be prepared from the register of stockholders. The details of the individual shareholdings should agree with this list. A test-check should be made of entries in the register of transfers by examining the canceled certificates turned in and accounting for the new certificates issued in exchange for them. A test-check should also be made of the postings from the register of transfers to the register of stockholders. This is the minimum amount of work that should be done for each kind of stock issued. The purpose of the work is to assure the accountant that the company has not issued more stock than it has been authorized to issue and that the number of shares outstanding, as shown by its accounts, is correct.

MINUTES:

The minutes should contain a permanent written record of the proceedings at meetings of shareholders, directors and committees of the directors. All transactions of an exceptional nature should be approved in the minutes, which should be accepted by the accountant as authority for transactions which he may otherwise question or for the recording of which he desires to have the approval of the shareholders or their representatives. It is not unusual for accountants to insist that certain transactions shall be formally authorized by the directors, and in fact it is highly desirable that this be done where the nature of the transaction is of sufficient importance.

In examining the minutes it is essential that all matters relative to the accounts, or authorizations of transactions which may have a bearing on the accounts, be abstracted for the working papers. These working papers should contain the following information—

1—Date of meeting.
2—Kind of meeting: directors, shareholders, etc.
3—Abstracts of all matters which may have a bearing on the accounts.
4—Name and position of person signing the minutes.

When the minutes of a meeting contain no information which it is considered necessary to abstract, the phrase "Nothing of importance" can be written in the working papers. Reference to a meeting should never be omitted merely because nothing of importance took place at the meeting. The working papers prepared from the minutes should refer to every meeting held, including meetings postponed for lack of a quorum or for other reasons.

The names of directors, officers and others appointed to or resigning from certain positions are generally of no importance.

In certain cases, the resolutions adopted at the meetings should be copied verbatim, but usually brief extracts of the salient points are adequate.

CAPITAL-STOCK ACCOUNTS:

Analyses should be prepared of capital-stock accounts, showing the opening and the closing balances, as well as all transactions within the period under review. These transactions must be verified.

Accounts for stock held in treasury should be similarly analyzed, and the entries should be vouched. Stock held in treasury should be examined or verified by obtaining certificates from the holders.

The work to be done in the verification of dividends is mentioned in a subsequent chapter dealing with the surplus account.

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SURPLUS AND PROFIT AND LOSS

When the junior is called upon to verify the surplus account, he should prepare a schedule starting with the balance at the beginning of the period, showing all changes during the period and ending with the balance at the close of the period. One of the items on this schedule will be called "Profit-and-loss account for the period." The verification of this amount will be considered in the succeeding paragraphs. Other debits and credits in the analysis must be supported by schedules showing details of the entries which must be verified. Dividends declared must be verified by reference to the minutes, and the payments made should be checked with dividend bank accounts. When the concern issues its own dividend cheques, dividend lists must be examined and test-checked from the stock records to make sure that the proper stockholders received dividends of the correct amounts. Paid dividend cheques must be examined and checked to the dividend lists. Dividend bank accounts must be reconciled with the balances shown on certificates obtained direct from the depositaries. The auditor must see that dividends declared but unpaid have been recorded as liabilities. The treatment of dividends on treasury stock must be investigated and recorded on the working papers. If dividends are paid on the gross amount of stock issued, the auditor must ascertain that dividends on treasury stock are correctly entered in the accounts.

In support of the "Profit-and-loss account for the period," appearing in the analysis of surplus, the auditor should obtain or prepare a detailed statement of profit and loss, showing in comparative form the corresponding figures for the previous period. The figures should then be expressed as percentages of sales or in dollars and cents per unit of the commodity sold. Explanations must be obtained for large differences in absolute amounts and in percentages or unit prices.

A statement of sales must be prepared, showing in comparative form sales by months for the current period and for the previous period. Any variations in the seasonal nature of the sales, or large variations in corresponding months, must be investigated and satisfactory explanations must be obtained in justification of them. Whenever possible the volume of sales must be reconciled with the inventory at the beginning of the period, plus the purchases or production during the period, less the inventory at the end of the period.

Analyses similar to those for sales must be prepared for returns and allowances and other accounts deducted from sales to determine net sales.

Some test must be made of the accuracy of the sales records to be sure that only genuine sales have been included. This work is usually done in conjunction with the verification of the accounts receivable. The period to be selected and the nature of the verification will depend upon instructions from the senior. Generally speaking, however, the work must include examination of the shipping records, the perpetual-inventory records, the copies of invoices rendered to customers and the sales journals. Credit memoranda issued after the end of the period and entries in the returns and allowances journals must be scrutinized to see (1) if any sales have been canceled or adjusted since the end of the period and (2) if the returns and allowances should be increased for subsequent entries.

A complete check must be made of the payroll for a selected period or periods. This check must include an examination into the methods of recording time and piecework, preparation of the payroll and disbursing of the payroll. Time and job tickets must be examined for the selected period, payroll rates must be checked, the payroll lists must be verified and checked to the payroll voucher, and the cheque for the total payroll and the individual cheques, payable to the employees, if payments are made by cheque, must be scrutinized. The payroll bank account must be reconciled, even though kept on the imprest basis, and the balance must be confirmed by obtaining a certificate direct from the bankers.

Income from rentals and from investments must be checked to see that all income receivable from real estate, bonds and stocks has been properly entered. Leases and rentrolls must be examined in verifying the amount of rental income. Interest dates for bonds and dividend dates for stocks must be obtained to verify the interest and dividend income.

Depreciation provisions will have been computed when working on the fixed-asset accounts. A schedule should be prepared and filed among the working papers on the profit-and-loss accounts to show to what accounts and in what amounts the provisions were charged to profit and loss. Of course, the amount provided should agree with the provision credited to the reserve accounts.

Schedules should be prepared for expense accounts such as rent, taxes, interest, officers' salaries, commissions, legal expenses, patent expenses and royalties. Entries on these schedules should be vouched and cross-indexed to corresponding prepaid or accrued-expense accounts appearing among the deferred charges and current liabilities. For example, (1) where the analysis of rent-expense account shows that the rent for the first month of the next period was paid before the end of the period, the prepaid rent should appear as a deferred charge; and (2) when the analysis of commission expense shows that additional commissions are payable, an accrued-expense liability should be shown for such commissions. In preparing analyses of these and similar expense accounts, the most important information to include in the schedules is the period for which the expense was paid or accrued. A proper verification of these expenses requires that the auditor examine, in addition to the voucher and paid cheques, lease agreements, tax returns, reports of tax agents, minutes, salary, commission, patent and royalty contracts, correspondence files, etc. Abstracts of all these agreements should be included in the working papers.

·XV·

COMPLETING THE WORK

Before turning over completed work to his senior, the junior should examine all schedules prepared, to see that they (1) contain all the necessary information, (2) contain no errors in arithmetic, (3) agree with leading schedule figures, (4) have been indexed and cross-indexed, (5) contain full statements of work done and of all matters of which the senior should be informed and (6) have been dated and signed by the assistants responsible for the work.

When the working papers have all been brought together, the junior should undertake to file them in binders or otherwise. He should see that all indexing and cross-indexing has been completed, that all adjusting journal entries have been correctly posted to the working balance-sheet, to the working statement of profit and loss and to the leading schedules. The adjusted balances on the working balance-sheet, on the working statement of profit and loss and on the leading schedules should be checked, and the adjusted balances shown on the leading schedules should agree with the corresponding figures on the working balance-sheet.

The preparation of the report and exhibits for the client will be undertaken by the senior. The checking of the typed draft report and exhibits will have to be done by the junior, at least so far as footings, extensions and calculations are concerned. Figures appearing in the report should be checked with the working papers and wherever possible with the exhibits as well. All references in the report to the exhibits by name and by number must be checked with the exhibits themselves to see that the names and numbers are exactly as given on the exhibits. Names of corporations given in the report must be the exact names as shown by the certificates of incorporation. For instance, The A. B. Corporation, Incorporated, must not be referred to as A. B. Incorporated. All footings, extensions and other calculations in the report must be checked, even though previously verified in the working papers or handwritten draft of the report.

The accountant's report and exhibits often contain percentages or calculations per unit of some commodity. The most common example of this is where all items in the statement of profit and loss are expressed either as percentages of net sales or as dollars and cents per unit of the commodity sold. When making these calculations the junior must obtain instructions as to the degree of accuracy with which the work must be done. For example, percentages in some cases may have to be correct to the nearest two places of decimals—in others, only to the nearest whole number. In approximating these figures the computation should always be made to two more places of decimals than are required; .5 and over should be considered as one whole number; under .5 should be considered as zero—e. g. 10.50521 to the nearest two places would be 10.51, and to the nearest three places 10.505. It is particularly important to see that the additions and subtractions of these percentages or unit values are correct. Differences often develop on account of the approximations made. These approximations must, where necessary, be corrected, not at haphazard, but by adjusting those in which the figures show that the errors in approximation occur. An example of this is given below, where the three figures shown have been correctly calculated and are to be approximated to the nearest two places of decimals:

Gross profit	20.98420%
Selling expenses	10.08520%
	10.89900%

	Wrong	Right
Gross profit	20.98%	20.98%
Selling expenses	10.09%	10.08%
	10.90%	10.90%

After the senior is satisfied of the accuracy of the draft report and exhibits, they are approved by a managing accountant and a principal of the firm. After they have been approved by the principal the report and accounts are ready to be typed in final form. If the junior is required to take them to the stenographic department to be typed, he must give instructions as to the number of copies required. When the typing has been completed, one copy (the so-called office copy, which is retained in the accountant's files for reference) will be sent to him by the stenographic department to obtain approval of its accuracy. The reports and exhibits must again be checked completely as to wording, footings, extensions and calculations, and, if correct, must be initialed or approved as the stenographic department may require. Errors must be called to the attention of the stenographic department, where they will be corrected. The junior must see that all corrections required are properly made. He should then also instruct the stenographic department as to the type of report covers required, the wording of the report covers and the disposition to be made of the copies of the report. The signing of the report and the preparation of the letter to accompany the report will be done by the senior accountant.

At this stage the junior will be instructed to dispose of the working papers by taking them to the filing department, where they are kept for future reference, and to report to the office manager for another assignment.

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MISCELLANEOUS CONSIDERATIONS

THERE are several matters which should be called to the attention of the junior accountant but have not been considered in previous chapters.

CHECK-MARKS:

The junior should familiarize himself with the check-marks used by the auditing firm by which he is employed. It is important that the check-marks in use by the firm should be adopted so that fellow employees can always tell by examining the check-marks referring to each set of figures what work has been done in verifying the figures. Check-marks should be neat and small and should give the client no legitimate cause to complain that his records are being marked unnecessarily. Of course, all marks should be made in ink. The junior should obtain an audit stamp if it is the practice of the firm by which he is employed to require the use of one. Vouchers and other documents should be stamped in a conspicuous place, but the client's records must not be defaced by unnecessary and indiscriminate use of the stamp. The auditor should always keep his stamp under lock and key when he is not using it.

CARE OF CLIENT'S BOOKS:

The accountant must be particularly careful in his treatment of the books and records of the client. Warnings about untidy check-marks and indiscriminate or slovenly use of the audit stamp have been given. It seems almost unnecessary to add that finger prints should not be left on the client's records. The auditor should try not to make "humps" in the corners of the pages of the books. A book should never be opened on top of another open book nor placed face downwards on a dirty surface.

One of the commonest criticisms of the accountant's handling of the records arises through his failure to replace the vouchers and other documents in the client's files. In some cases clients assign one of their employees to obtain the required vouchers for the accountant. In those instances the accountant is generally relieved of all responsibility when he returns the vouchers to the client's employee. However, where the accountant has to obtain the vouchers from the files himself, he must undertake to see that the vouchers are subsequently replaced in the files in their proper places.

No vouchers or documents should be taken away, even temporarily, from the client's office, unless the accountant has obtained the client's permission. Even then, the accountant should take precautions lest he be accused later of having a document after he has returned it.

Information obtained from the client's books and records is of a confidential nature, and the accountant should properly safeguard his working papers. The precautions to be taken, of course, vary. The client's employees may be allowed access in varying degrees to all or certain schedules. But it may be laid down as a definite rule for the junior accountant that no one should examine or be able to examine the working papers unless the junior or senior accountant is present. For this reason it is essential that working papers left overnight in the client's office be collected and kept under lock and key.

ACCOUNTING FOR TIME:

Every assistant is required to account for the time spent by him during working hours and for any overtime. This information is necessary to enable his employer to maintain cost records, and it often forms the basis of the fee charged to the client. Assistants are required to render time reports periodically. The time charged to each client should be only for time actually spent on the particular client's work, except in those cases where the senior authorizes charges to be made when men are being kept available for special assignments.

The accountant will find that between assignments and especially at certain periods of the year he will have no work to do. This so-called available time should be utilized by the junior at least in part by reading on accounting and related subjects. Men who are attending classes or taking correspondence courses will find this available time suitable for studying and completing their written work.

Normally assistants are required to conform to the client's office hours. If the client's employees commence work at 9 A. M. and leave at 5:30 P. M. assistants are expected to adhere to those hours and not to leave at 5 o'clock because their own office hours end then.

CONDUCT, ETC.:

The junior accountant should at all times remember that he is a representative of the accounting firm by which he is employed. The junior should also appreciate that he is a professional man, at least in embryo. For these reasons, if for no others, he must do nothing to reflect on the professional reputation of his employers, and he must do everything that he can, within the scope of his limited opportunities, to enhance that reputation and to deserve the respect of the clients.

It goes without saying that accountants must be clean in person and quiet in dress. The question of wearing apparel is one of individual taste, yet the spirit of free enterprise and ragged individualism should not be abused.

Assistants should maintain dignified businesslike relations with the client and his employees and should avoid familiarity. Conversation, when not about the work being done, should be limited in scope and time.

The accountant should regulate his work in such a way that he will interfere as little as possible with the regular office procedure of the client. When the accountant requires records that are being used by the office staff, he should coöperate with the employees by postponing his use of the record, if he is able to do so, or by making some suitable arrangement to avoid friction and complaints by the employees. If the employees are approached properly, it will be found that they are almost always willing to allow the accountant to have the records whenever he needs them.

Clients often question the junior accountant to find out how the work is progressing, and some ask his opinions on accounting, business and even legal matters. The accountant should be chary about giving information and should refer the questioners to his senior.

The junior accountant is often in a better position than anyone else to discover petty abuses in the client's office. Such matters should be brought to the attention of his senior.

The junior should never undertake to discuss these matters critically with the client or his employees. Similar reserve should apply to errors discovered and to criticisms of the accounting system. Criticism is not one of the functions of the junior accountant, but he is expected to bring to the attention of his senior all information he may obtain of errors, abuses, unsatisfactory accounting methods and other matters of which he thinks his senior should know.