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Cutting Time and Cost on Stock Brokerage Audits

BY J. S. SEIDMAN

IT IS NO secret that neither brokers nor auditors are very happy about fees in brokerage audits. The brokers frequently feel that auditing service costs them too much. The auditors in turn feel that the present scale of audit fees in brokerage work is hardly adequate. Perhaps if some of the time-saving channels here outlined are traveled, there will be greater cheer for all.

The broker's attitude is in no small measure the product of external conditions. Dull security markets have dug deeply into his earnings, and have compelled him to button the vest on expenses. Annual surprise audits, now on the "must" list, are an important item of expense. Hence, down with the size of audit bills!

In many cases auditors have been able to reduce bills without added despair over the fee situation. The saving factor has been that brokerage audits involve a tremendous amount of preparatory detail, that need not all be done by the auditors. Much can be done by the broker's own staff, without in any way impairing the quality or effectiveness of the independent check that is the foundation of an audit. And, since auditing cost is based largely on time, an hour of the auditor's time saved is several dollars earned.

The work that the broker's own staff can do, though substantial in quantity, has really nothing to do with the essentials of the audit. It is rather in the nature of clerical or bookkeeping work *preliminary to* the audit. What's more, most of this preliminary work is of a character that can be attended to after the audit gets under way, and while the auditors are engaged in more vital

matters. The requirement that the audit be on a "surprise" basis is therefore no deterrent.

In the ordinary commercial audit, it is taken for granted that the bookkeepers, not the auditors, will do all this preliminary work, as a matter of efficiency and economy. The brokerage office, however, has not fully kept pace. There is, of course, a difference between the commercial and the brokerage audit, but that does not relieve the broker's staff from preparing many things that would correspondingly be expected from the commercial bookkeeping staff.

There are various explanations as to why this approach to the reduction of audit time and bill has not, thus far, been universally applied in the brokerage field. The brokers themselves have frequently feared mixing the auditing with the bookkeeping. Not knowing just where the line can safely be drawn, they have erred on the side of increasing the auditors' domain. Recommending work that the broker's staff can do has also frequently met with resistance by the staff. Like as not, the additional work would fall to the lot of fellows already overloaded by their immediate chores. Their psychology, therefore, usually is to let well enough alone.

None of these things, however, really justifies adding to the auditors' time and bill. Clerks capable of keeping the records in the first instance are certainly capable of looking after the added clerical detail preliminary to the audit. Nor is there any occasion for piling additional work onto the shoulders of those who are already snowed under. Most of the additional work is of such

character that it can fairly well be handled by any of the clerks from any of the clerical departments. Furthermore, in times of dull markets, there need be no worry about jamming things up by additional temporary work. If anything, the work is frequently a blessing in disguise, especially for those clerks who otherwise would be "staggered" without pay.

It is not intended to imply here that either auditors or brokers, or both, have been asleep at the switch. Maximum reduction in audit time and cost has undoubtedly been effected in many cases. These may even preponderate. But general observation also makes for the conclusion that in some instances there is still a great deal to do before it may be said that all that can be done has been done.

Getting down to cases, below are a few of the opportunities for savings that have proved practicable.

In every brokerage audit worthy of the name, the auditors build up their own security record. In fact, that is the nub of the audit. The process generally entails having a sheet for each security, arranged in some convenient order or binder. The heading up of each sheet with the name of the security and arranging the sheets is a task of no small proportions. It is something that can be effectively assigned to the broker's staff and a chunk of auditors' time saved.

The auditors' check on vault positions offers another opportunity. As in the case of the stock record, the broker's staff can head up the auditors' sheet for each security in which there is a vault position. Furthermore, since the vault position is supplementary to the stock record, and is basically controlled by the stock record, it is sometimes feasible to admit the broker's staff into some of the actual checking work.

Verifications offer another fertile field. *There is no reason why the auditors*

should have to write up any ordinary verification. Nor should the auditors have to address or stamp envelopes for verification. On the contrary, it is a usurpation of audit time and cost when the auditors do these things.

Verification requests on bank loans, street positions, transfers, partners' and house accounts, and all positions carried on the general ledger and requiring audit confirmation, can be written up in the first instance by the broker's staff. Any error or irregularity on the part of the staff will show itself in the auditors' independent stock record or check-back to the ledgers. In the meantime, the saving of audit time will be sizable.

Additional audit-time contraction valves may be opened in various other directions. Reconciliation of bank accounts as of the audit date can, in the first instance, be effected by the broker's staff and copies turned over to the auditors for checking and for their working papers. (Spot reconciliations for a period following the audit date should be an exclusive reserve of the auditors.) Reconciliation of dollar and security positions in interoffice accounts may be similarly handled. The staff can also prepare analyses of accounts and report schedules for the auditors.

None of these savings thus far mentioned, however, can hold a candle to the sharp contraction of audit time that still is possible. Just as in the ordinary commercial audit the auditors may find the financial statements all prepared, and the auditors' function is then to pass on the statements, so in a brokerage audit the answers to the Stock Exchange questionnaire can frequently be prepared by the broker, leaving to the auditors the checking and attestation.

Where that is done, the reduction in auditing time is tremendous, for then the broker's staff, not the auditors, classifies and values each security and each customer's account. In addition,

the trial balances of the different ledgers and the classification of each item then become initially the task of the broker's staff. To be sure, the auditors then have the job of checking this material but, in terms of time, it is one thing to check a completed product and another to start from scratch and prepare the product. The specification of savings is far

from complete. Of course, even with delegation to the broker's staff of the maximum detail, the fact remains that there is still a whale of an amount of work that the auditors must do, for an effective audit. But the net dollar-and-cents saving to the broker as a result of having his staff do the preliminary detail is likely to be considerable.