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CPA Services to banks

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The public practice of accountancy began in the United States just before the turn of the century and since that time the world has turned over many times. The twentieth century has witnessed astonishing changes in economic, social, and political conditions. Industrial expansion, mass production, and the rapid increases in public ownership of business enterprises have brought special responsibilities to the certified public accountant. The early practice of public accounting was generally that of detailed audits; occasionally the CPA was asked to make a special investigation. With the expansion of the economy, the practice of public accounting gradually changed from detailed auditing and checking to examination of financial statements and the expression of an opinion on the over-all fairness of the representations in the financial statements. Other services now offered by CPAs include, to name a few, tax services, budgetary controls, design and installation of accounting systems, efficiency and organization surveys, consultation and installation of electronic equipment for processing of information, special engagements in connection with mergers, consolidations, pricing studies, and related cost justifications as required by governmental bodies. Each new tax law, changes in laws relating to securities, price clauses, government procurement of defense items, sharpen the focus of the accountant's activities. Everyone in this room, I know, will agree with me when I say that the certified public accountant is eminently qualified to render constructive services to the banking industry.

SERVICE TO LOAN AND CREDIT OFFICERS

As bankers you are custodians of other people's money and as business men you are investors of this money, and as such your decisions should be based on adequate and reliable information. Your borrowers are our clients and their financial statements are our common problems. The extent of the information required by the banker
depends on factors such as the amount of the loan, time for repayment, the nature of the borrower's business, his collateral, and the like. Let me suggest that the bankers, particularly those engaged in the loan and credit field, strive to improve their understanding of the significance of the accountant's report, particularly as it relates to scope of the examination—the observation of physical inventories, confirmation of receivables, and the like. The banker should understand such things as qualifications that generally are necessary concerning the opening inventories when a client engages an accountant after the first day of a year. When the accountant speaks of generally accepted accounting principles, the banker in the loan and credit field should know these principles, such as (a) "going concern concept"—or that accounting is based on the premise that the business enterprise will have an indefinite life and that costs incurred for the benefit of future periods will be charged against income of those periods; (b) matching of income and expenses; (c) the accrual basis of accounting, and (d) consistency.

Let me therefore suggest that through closer working relations a CPA may be of significant help to you as credit grantors. May I suggest that you invite a CPA to a seminar to discuss the technical aspects of his report with your loan and credit group; he may be asked to explain scope, accounting principles, new developments such as business combinations, pooling of interests versus cash purchase, and the differences in accounting treatment and the like.

It has been my experience in reading credit files during bank examinations that in some instances the loan officers are required to make several requests for information, sometimes of the client, sometimes of the client's independent accountant. Just a word on this: Remember that a CPA will not discuss the special problems of his client without permission. How much better it would be to arrange to discuss with the borrower and his accountant your requirements at the outset of the negotiations! There is no doubt in my mind that the accountant will be able to render a better report if he is aware of your requirements for information that is supplemental to the basic financial statements.

The CPA may be of service to the credit and loan officer in many other ways. For example, one bank has engaged our Firm to review reports of various borrowers to determine that there are no apparent violations of the loan indentures. I am sure you will agree with me that the CPA is qualified to render such a service.
SERVICE TO TOP MANAGEMENT

Speaking of accounting principles, it is difficult for me to omit references to one of my pet projects—namely, *Bank Accounting Principles*. As long ago as 1952, a committee of the National Federation of Financial Analysts Societies reviewed the annual reports of twenty-eight large banks and reported that "the variations in content of the reports are so broad as to make one wonder how there could be so many varieties of reporting to stockholders." Equalization of earnings through reserves and the understatement of assets such as banking houses are examples of some accounting practices that have been subjected to criticism in recent years by security analysts, depositors, stockholders, the accounting profession, and others. At the beginning of the century, business enterprises maintained their accounts in accordance with their own ideas, and reported to their stockholders and other interested parties very little information, if any. Examinations by independent accountants were not required. Since the turn of the century, however, corporate enterprises through the development of generally accepted accounting principles have gradually put their accounting and reporting in order. The development of accounting principles has been influenced by the securities exchanges and governmental bodies, such as the Federal Trade Commission and the Securities and Exchange Commission, and by the complexity of doing business—the last-mentioned factor being partly the cause of and partly the result of the intricacies of the income tax. In the banking field, however, the supervisory authorities have emphasized the protection of depositors and have not directed their full attention to the development of accounting principles for the fair presentation of information to stockholders, potential investors, and the general public. As the number of stockholders in banks grows, the responsibility of management for the presentation of fair and useful financial information to this group should not be overlooked.

While the urging of such action may not be a good way of becoming popular with some top management in the banking field, the time has come, in my judgment, for the industry to make a careful evaluation of its reporting and accounting practices. This is another area in which the certified public accountant may be of service to the banker. Time does not permit discussion in detail, but let me say that the AICPA Committee on Banking Accounting, of which I am a member, has under consideration a memorandum on
Bank Accounting Principles which it is hoped will have general acceptance.

Let me say that generally accepted accounting principles or, in some cases, the absence of them, are important when top management has under consideration a merger with another bank. Speaking of mergers, the professional accountant has on many occasions been a valuable asset to management in its negotiations. Many times after a merger is completed, top management finds itself loaded down with two personnel policies, two salary scales, two sets of job classifications, etc. I suggest for your consideration that the accountant can be of service in correlating personnel policies, and in the establishing of uniform and objective procedures.

During the past decade professional accountants have been asked to make operational reviews. As I began an examination of a savings bank several years ago, their President said to me, “I know the cash is there and I’m sure that our mortgages are good. I want you to make a special survey of our mortgage servicing department. Tell me if the people know their jobs. Are the procedures such as to afford the bank protection in the event of a severe depression? I would like to know whether you think we are prepared.” What was required was an Operational Audit wherein the review included: (1) personnel, (2) workload, (3) productivity, (4) quality, (5) reporting, (6) procedures, and (7) costs and expenses.

SERVICE TO COMPTROLLERS

As competition for deposits and new business becomes keener, the bankers have sharpened their interest in the cost concept. Managements are asking their comptrollers such questions as “What are the unit costs of paying checks? Is this particular account profitable—that is, do the gross earnings cover our costs of servicing the particular depositor and provide the bank with a reasonable profit?” Recently a small New York City bank, one whose total assets are less than $100 million, decided not to accept savings accounts with balances under $500; the return thereon did not cover their costs. Your industry is becoming more interested in improving control data and reports, development of unit costs, and the analyzation of the profitability of customer relationships. Many banks therefore have found it advantageous to seek the guidance of the professional accountant.
A major concern to all bankers today is, of course, taxes. The Federal Government is one of your partners—and I might add, a more than equal partner in all taxable income over $25,000. As a result of this relationship, proper tax planning is a sine qua non. Each transaction must be thought of in terms of its tax effect. While many banks prepare their own tax returns, it is difficult for the comptroller to keep up with all the various rules and the ever-changing decisions; to be completely informed requires a substantial investment in time. The necessary research can best be done, I believe, by the professional tax accountant. Have you considered using the services of a professional accountant in tax planning, in reviewing your returns, and as a source of contact with the Internal Revenue Service for such things as formal and informal rulings?

As the gap between income and expense narrows, comptrollers are turning more and more to automation as a panacea, and I suspect that many banks have done so without proper planning. Electronics is a marvel of this age and promises to be even more useful in the time to come; but remember—a machine cannot think. Professional accountants provide services to management (in my Firm they are called management advisory services) which include advice and consultation on the processing of information by electronics or conventional machine-accounting equipment. The use of professional accountants for projects such as feasibility studies enables a bank to obtain the benefit of the experience and know-how of the accountant’s staff gained from similar engagements.

SERVICE TO DIRECTORS

Finally, the CPA can be of great service to the directors. The election to a board of directors of a bank is a high honor carrying with it great responsibilities and requiring that each director keep himself fully informed concerning his bank’s major operations. One of the board’s important duties is to have the bank’s assets, liabilities, and affairs examined thoroughly at irregular intervals but not less than once a year. As to this obligation, let me summarize the considered judgment of some authorities with respect to the use of professional accountants in performing Directors’ Examinations.

1. James Marshall Power, Deputy Superintendent and Counsel, New York State Banking Department—
   Outside accountants should be used by banks to analyze internal
audit procedures and to suggest changes based on their ex-
perience. Where the size of the bank does not permit an ex-
tensive internal audit procedure, the outside accountant should
be used to conduct periodic audits of the bank without advance
notification.

2. NABAC Bulletin, Mr. Bank Director/Trustee—

An adequate (fraud prevention) program has three main phases:
Continuous effective controls built into your systems and pro-
cedures designed to prevent any one person, alone and un-
checked, from controlling transactions from beginning to end.
Continuous internal auditing, as well as periodic direct verifica-
tions, to see that these controls work effectively.
Occasional examinations by competent people who have nothing
to do with operating your bank, to measure the adequacy and
effectiveness of the continuous phases of your program, and
to determine the true condition of your bank.

3. Joint Statement of National Association of Supervisors of
State Banks, FDIC, Federal Reserve Bank, and Controller
of the Currency—

The Board of Directors of a bank can maintain better control
of the bank's operations with a view to honesty, efficiency, and
accuracy if experienced outside auditors are occasionally em-
ployed to . . . audit the balance sheet, systems and controls,
and preferably to verify loans, mortgages, and deposits.
The cost of such outside audits for the typical bank seems a
small annual figure to pay for providing this valuable additional
measure of protection to the bank and its Board of Directors,
and from the standpoint of increasing the efficiency of the
bank's operations.

Most disturbing to me, however, is the fact that because of cost
many bankers do not employ professional accountants. Let me sug-
gest to you that proper planning and cooperation of bank personnel
can sharply reduce the time required and hence the related charges.
For example, bank personnel can be used in typing confirmations and
other such functions. Consider the following good reasons for an
outside audit: (1) The bank can receive constructive advice and
recommendations on its system of internal control and accounting
procedures, and (2) the examination is on a surprise basis and there-
fore is a deterrent to irregularities. (Please note I did not say it
prevents them or even guarantees discovery.)
I have just mentioned internal control, and in the remaining moments, let me address myself to a very important part of internal control—namely, internal auditing. I believe that the directors should satisfy themselves about the adequacy of the internal auditing program and competence of the personnel—their training, their experience, and the like. I am sure that such a review falls well into the province of the professional accountant.

Gentlemen, time has permitted mention only of some services a CPA can render to the banker. It has been a great pleasure to be here in Milwaukee this morning. Let me close by quoting the old Roman dramatist, Terence—

The nature of all men is so formed that they see and discriminate in the affairs of others much better than in their own.