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## What the Pharmacist Should Expect from His Independent Accountant

by J. WILLIAM STEWART, JR.  
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*Presented before the Annual Meeting of the American College of Apothecaries, Montreal, Canada—September 1968*

WHEN making arrangements last month to address this group today, your executive secretary furnished me with some background information about the college. Included was the fact that there are presently about 425 full fellows in the college, who operate a total of about a thousand pharmacies. This works out to an average of about 2½ pharmacies each. Although I have no knowledge of what the size of a typical pharmacy might be (on the basis of annual revenues), I must assume that even the largest enterprise in which any college member has an ownership interest would still fit the category of "small business" as that term is defined by the U. S. Small Business Administration. (This classification includes retailers or dealers in services with an annual volume under \$1,000,000.) It might be of interest to note that of about 5 million separate business entities estimated to exist in the United States a few years ago, probably over 95 per cent would be considered small by SBA standards. "Small business" obviously is of great importance to the economy as a whole, and of course comprises the majority of clients, and major source of potential clients, of independent accountants. Accordingly, my remarks today will be applicable to the relationship of small businessmen in general with their independent public accountants. But I hope some specifics concerning pharmacists will evolve from what I shall have to say.

To introduce this subject, it may be appropriate to direct a few words to those not familiar with independent public accountants to describe just what an independent CPA (in the United States) or CA (in Canada) is and what comprises his business.

The CPA or CA is a person who, in most cases, decided early in life to pursue a career as a professional examiner and advisor in the world of business. His education has included specialized training, but nevertheless has been well rounded. When the profession was younger, it generally was not required that he be a college graduate,

but a degree in some subject (not necessarily accounting) is now required in most parts of the United States and Canada, and soon no doubt will be required throughout both countries. He has passed a written uniform examination covering accounting theory, accounting problems, auditing, and commercial law, thereby indicating a high degree of technical proficiency on a theoretical level. And probably most important of all, he has spent a certain number of years, generally in the employ of accountants engaged in public practice, in acquiring experience while on the job, which is something no textbook can ever teach. Such practical experience usually is the final stepping-stone toward acquisition of a person's CA or CPA certificate, but it is only the beginning of a public accountant's career in learning and thinking on a practical level and in the development of professional judgment. Probably more than in most professions, accountancy, because of its close working relationship with ever expanding business and industry, is changing and expanding constantly; and the professional accountant is constantly learning and growing with it.

The practice of public accountancy can be divided into three general areas: auditing, tax services, and management advisory services. In larger public accounting firms, the separate divisions are readily discernible, and there is substantial specialization by individuals within these firms; in smaller firms, specialization may not be practicable or even possible. Yet even in larger firms, those accountants who are specialists in some particular end of their profession must also be conversant with the important aspect of practice in other areas in order to provide clients with all the services to which they are entitled.

## **AUDITING**

What should the pharmacist expect from his independent CPA or CA? If the pharmacist's business is large enough, or if other circumstances so dictate, he may be utilizing the services for which independent accountants are best known—auditing—for this is the side of their business reserved to them alone by law (tax work is shared with attorneys, and management advisory services are shared with any persons calling themselves consultants). For the benefit of those who do not employ an auditor and possibly are not familiar with what auditors do, I should say the usual purpose of an audit is to allow an independent accountant

to express an opinion on whether or not the financial statements examined by him present fairly the financial position and results of operations of an organization. An audit includes examination of the records from which such financial statements have been prepared and the testing of underlying evidence to the extent the auditor considers necessary in order to reach an informed opinion. The examination must be made in accordance with the several generally accepted auditing standards established by the profession. Among other things, these standards require the auditor to state whether or not such principles have been consistently applied in the current and preceding periods. The question of just what constitutes "general acceptance" is a matter of some controversy within the accounting profession, particularly in instances in which there is more than one acceptable way of doing a thing. This is also true for new developments, when it may be felt that not enough time has elapsed to test adequately the application and acceptability of new principles. This controversy is a whole subject in itself, which need not be considered further here; on the contrary, it appears fair to state that there are a great many accounting matters concerning which the proper treatment has over the years been thoroughly established and which in total constitute a common body of knowledge and principles upon which much of the practice of accountancy is based. Some of the basic expectations you would have of your independent accountant, then, are that he will conduct his examination of your financial statements in accordance with the auditing standards set by his profession, that he will be familiar with whatever accounting principles have been established as generally accepted, and that he will exercise professional skill to ensure that the financial statements on which he renders an opinion conform in all material respects with such principles.

Furthermore, something else you can expect of the independent accountant engaged to do an audit of your business is that he will soon become the most thoroughly knowledgeable person connected with the enterprise except you and perhaps certain other members of your management group. This knowledge is more than just a product of an audit; it is a prerequisite to performing an audit properly. Your auditor must know about all the important workings of your business in order to do his job, somewhat as your doctor must know all about your body to help keep it running properly. As a result, the independent accountant logi-

cally often becomes the principal (and sometimes only) financial advisor, and possibly also the operational advisor, to clients with small businesses. There is general agreement within the accounting profession that audit clients are entitled to more than just a routine audit and report. Our intimate knowledge of clients' business affairs not only should result in development of constructive suggestions that clients of all sizes generally should expect to receive, but also should provide a background for further consultation, in depth, that clients may request on a variety of matters. It is not necessary that a CPA or CA provide audit services in order to gain this knowledge about a client, but it surely helps. Later on, I shall describe what some of these "extra" or non-audit services might consist of.

First, I have described briefly what an audit is and the atmosphere in which an audit should be conducted. Now let's consider the question of why anyone needs an audit in the first place.

Examples of circumstances in which an audit by independent accountants would unquestionably be desirable, and in some cases might be required, are:

- When owners of a business are not part of active management (this situation is most common in publicly held corporations, but of course could occur in partnerships and proprietorships also)
- When there is significant indebtedness to third parties
- When significant portions of assets, liabilities, or operations of a business are for some reason not readily susceptible of control by the management group

The foregoing reasons for audits are by no means complete, but any of those present who have an ownership interest in a business in circumstances similar to those just mentioned, and who do not employ the services of an independent accountant, should perhaps consider doing so. I would venture to say, however, that probably many of you have no need for an audit. This thought leads to something else you can expect from your CPA or CA: If you should discuss with him the possibility of engaging him to perform an audit, and if in his opinion you have no real need for such services, you can expect him to tell you so. Would his doing so necessarily mean that you would have no use for any other services an independent accountant can furnish?

Not at all. Let me tell you something of the other ways he can help you.

## **TAXES**

The first thing that comes to mind in the way of non-audit services by accountants is taxes. Tax service is a most important field because it presents so many opportunities to save money for clients. It is a very broad, complicated field and seems to be getting more complicated every day; and it is a subject with which even the smartest businessmen, large and small, simply do not have time to become familiar. Perhaps unfortunately, tax work has become so involved that it requires a great degree of specialization by an accountant or lawyer for him to become an expert. This does put the small accounting practitioner at a bit of disadvantage in relation to larger firms whose resources afford adequate time and opportunity for specialization. In most cases, the smaller practitioners probably can cope with most small-business tax matters, but it is not uncommon for small businesses to have big tax problems. In any event, you should be able to expect a reasonably experienced CPA or CA to recognize and point out a tax problem if you have one, even if he has to get help in finding the solution.

### **Business Taxes**

The tax services you can expect your independent accountant to provide are quite varied. In a small business, they might start with advice on all the business taxes required to be paid and perhaps assistance in preparing the necessary returns. In the area of income taxes, accountants commonly prepare returns for corporations, partnerships, and individuals. You should expect your accountant to be familiar enough with all applicable tax regulations so that his computation of the taxes you must pay, based on information you have furnished him, will be the minimum required by law. Even more important than the minimizing of tax costs, after the occurrence of taxable economic transactions, is the advance planning by which the most favorable results can be obtained. Your tax accountant often can point out alternative courses of action and help you in following the one best for you.

**Estate Planning**

One of the most significant areas in which an accountant can provide valuable tax advice is in personal estate planning. In the course of rendering regular auditing, accounting, or tax services to owners of small businesses, accountants have a unique opportunity and should be expected to point out that estate planning is vitally important to everyone. Since estate problems are personal problems, they arise whether you are associated with a sole proprietorship, a partnership, or a closely held family corporation. It is all too common that, in the absence of proper planning, adequate funds are not available to meet estate taxes and other obligations at death. And since suitable arrangements have not been made for continuance of business operations, the assets may be subject to forced sale at substantial loss in value. It should be emphasized that estate planning is a lifelong process, because good estate planning is concerned as much with the creation, enjoyment, and management of an estate by a person during his lifetime as it is with the disposition of assets after death. The estate should be arranged in a manner that will provide as amply as possible for your beneficiaries.

The minimizing of estate taxes is of course a common aim in estate planning, and professional accountants are well qualified to give advice in this respect. Accountants can also be employed to prepare a comprehensive analysis of your prospective estate, showing present and potential future values of assets and liabilities—the starting point in sound planning. You can also expect your independent accountant to discuss the various tools and techniques used in estate planning. Some areas of planning, however, require the assistance from others, such as attorneys and insurance people, and they should be called in at an early stage to participate in any deliberations; no one profession has an exclusive right to estate planning.

**MANAGEMENT ADVISORY SERVICES**

The third broad area of a professional public accountant's practice consists of management advisory services, usually referred to in our firm by the initials MAS. In the larger accounting firms, the MAS staffs have been formalized and greatly expanded in recent years, although the practice of providing advisory services to management of clients is not a new one. The large staffs of MAS specialists can now undertake and

pursue to satisfactory completion projects of great magnitude, such as assistance in installation of a complete management information system for a large corporation. The initial need for MAS engagements is often disclosed during the progress of regular audit engagements, but limited time availability of audit specialists has required that separate staffs of MAS specialists be developed to follow through in helping to solve the problems an audit may disclose. The foregoing statements should not be construed as meaning that the large accounting firms cater only to big business, because all of us have many small clients. Management advisory services are rendered to small businessmen by large firms, small firms, and sole practitioners; for small businesses, the services generally are provided on a more informal basis by audit-oriented staff members and probably are not referred to by any special designation such as MAS. In the final analysis, there can be no clear dividing line between auditing and MAS, as the basic purpose of each is to render service to clients in a constructive manner.

Knowledge of an audit client's affairs should give rise to constructive suggestions by the independent accountant to increase the effectiveness of operations, strengthen financial structure, and improve accounting controls and data processing methods. In performing routine audit procedures, such as the analysis of fluctuations in accounts and operations, a trained, alert professional accountant can often detect potential problems of which management is not aware. The same services I have mentioned could also be provided without going into a full audit, if it is agreed that a full audit is unnecessary. In that case, there must be a clear understanding between the parties about just what will be done.

Examples of services commonly rendered to small businessmen by independent accountants and not resulting in the expression of an opinion on financial statements are:

- Advice concerning matters of accounting principles
- Assistance for ensuring adequate maintenance of accounting controls
- Preparation of unaudited financial statements from the books and records

(In this connection, the CPA or CA is acting merely as a skilled accountant who is translating books figures into a more widely understood form. Such services might include the calculation of taxes,



depreciation, or other accrued or deferred items. The accountant has a moral responsibility for the correctness of any such adjustments he makes, but is not legally responsible for the information contained in unaudited statements. A recent pronouncement of the American Institute of CPAs requires that a disclaimer of opinion accompany unaudited financial statements with which the accountant has become associated. Although the accountant cannot be expected to have formed an opinion about whether or not such unaudited financial statements have been prepared in accordance with generally accepted accounting principles, nevertheless, if he should conclude, on the basis of facts known to him, that those statements do not present fairly the information they purport to show, or if he should conclude that they have not been prepared in accordance with generally accepted accounting principles, then he must either insist on appropriate revision or set forth clearly his reservations as part of his disclaimer of opinion.)

- Examination of one or more aspects of business operations

(This contemplates the use of usual audit procedures employed in a general audit, but applied only to the limited areas selected by management. In such cases, the accountant could express an opinion on the work he has done, but would be required to disclaim an overall opinion on financial statements if the scope of his examination has been materially restricted. Examples of services management might find valuable could be the verification of cash balances and transactions, circularization of receivables, observation of physical inventories, and review of accounting procedures and internal controls.)

### **Other Advisory Services**

There are a number of other advisory services that an independent accountant can provide that are less closely related to the audit function. Managers of businesses of all sizes frequently seek assistance in the broad area covering the gathering and preparation in suitable form of all financial information necessary to run the business properly. In any business, the formation of a basic plan of operations is a primary requirement. It might be a common reaction of small businessmen that budgeting and profit planning apply only to large organizations, but nothing could be

further from the truth. Every facet of each enterprise should be analyzed, principally to provide a control device, but also in order to be prepared for difficulties that will inevitably arise, and to have at hand a plan for swift solution of problems as they occur. Obviously, proper planning must be a continuing process, and every year a great number of businesses fail because of the lack of it. Aided by experience with many types of businesses, the independent professional accountant is uniquely qualified to furnish expert assistance in planning. Within his capability are the design and installation of budgetary control systems, forecasting, organizational planning, including development of an organizational structure and job descriptions, and performance of feasibility studies. He can also aid in devising or improving the system of reporting the results of operations. This would include consideration of the effectiveness of reports, adequacy of the accounting system, and efficiency of the general business organization, staff, and accounting equipment. In most small businesses, perhaps none of these matters would be very complicated, and for that reason they might be considered of little importance by owners or managers, particularly those not accustomed to thinking about such subjects. In such circumstances, the advice of an outsider like a professional accountant could be a very valuable investment.

### *Inventory Management*

The management of inventories is a matter of great significance in many businesses and should be a subject of specific interest to owners and operators of pharmacies, such as you. Continuing developments in the pharmaceutical industry surely must result in an ever increasing number of items you must carry on your shelves. It therefore becomes increasingly important that you control your inventories as closely as possible in order not to tie up any more of your capital than necessary or incur unnecessary carrying charges by overstocking; and it is important to do so and at the same time maintain an adequate level to prevent stockouts and lost sales. Professional accountants can aid in developing and implementing specialized techniques in inventory control.

One means of improving inventory management in which your independent accountant could be helpful might be in the use of electronic data processing, or EDP, as it is commonly known. Perhaps some of you are already engaged in this to some degree. For those of you who are not,

I am not suggesting that you consider acquiring your own EDP equipment, as that usually is not necessary for the small businessman. Rather, I am calling your attention to the fact that by virtue of recent advances in punched-paper techniques, computer service bureaus can now offer a variety of preplanned applications at prices small businessmen can afford. Usually, for any EDP application to be more practicable than manual processing, a large volume of detail work must be entailed. In your businesses, inventory control and sales analysis may be the most likely areas in which EDP might be useful, but in the larger organizations the use of EDP might extend to payrolls, receivables, or even general ledger work. The data processing service bureaus I have referred to have had communications problems in trying to sell their packaged programs directly to businessmen, principally because they are not familiar with the businesses. Here is where the professional accountant can be a vital link between the two parties. On the one hand, he is familiar with a broad range of EDP equipment and knows what services the various bureaus can provide. On the other, he has knowledge of his client's business, its major problems, personnel, existing information system, and other background information, all of which he will treat in the usual confidential manner. The accountant can be expected to assist greatly in determining objectively which of the service bureaus' packaged programs will best suit the needs and financial capabilities of his clients.

### ***Financial Counsel***

Many small businesses at one time or another need financial assistance, and independent accountants can also serve as counselors for such clients in their dealings with financial institutions. The accountant can give advice on the facilities of the various lending institutions, interest rates, terms, restrictions imposed, and other relevant matters. A number of factors are pertinent in obtaining loans, such as the history of earnings, available collateral, and development of the lender's confidence in the integrity and general ability of the borrower. Although the small-business owner may be in a position to satisfy these requirements, it might also be that he is unable to do so because of his unfamiliarity with communication of financial data. He may not be able to support his opinions with reliable financial information, or he may not understand financial statements and the accounting theories upon which they are based; in either

case, a poor impression is created and the desired result may not be obtained. Another problem the businessman could have, because of lack of knowledge either of his own cash requirements or of the extent to which the lender might reasonably extend credit, might be in knowing how much credit to ask for. First of all, the independent accountant should be able to assist his client in presenting his story to potential lenders so as to ensure that reliable financial information is available to both sides. The assistance might include preparation of basic financial statements; that is, unaudited statements. If audited statements are required, the independent accountant will require time to make the examination. The accountant can suggest and may help prepare various types of supplemental schedules and other information and so make his client's presentation as complete as possible. Accountants can also counsel businessmen concerning the best methods of drawing up forecasts of sales, expenses, and cash flow necessary to determine the amount of credit that will be required by the business. Of all the services an independent accountant can provide, assistance in resolving financial problems probably is ranked near the top in importance by his small-business clients.

### *Organization and Administration*

Earlier, I indicated that accountants can aid small-business clients in matters of organization and administration. The need for guidance is relatively greater in the smaller enterprises, which usually have small staffs and management with little experience in organizational principles and methods, than it is in larger firms with greater administrative resources.

Getting started in business is a stage when critical decisions must be made. The professional accountant usually is in a position to give advice concerning the best organizational structure of a new venture.

In established businesses, growth frequently results in administrative problems. New employees may be hired with little regard to their qualifications, and duties may be assigned them on the basis of expediency, without considering the resulting effectiveness of the organization as a whole and frequently without delegating the necessary authority. Inefficient operations are sure to result when management or other supervisory personnel burden themselves with duties and responsibilities that should be assigned to assistants. During an audit, the professional accountant

should recognize significant inefficiencies in a client's organization relating to accounting matters and would be expected to report to management the major problems observed. The accountant can undertake a complete review and full evaluation of administrative functions, organizational procedures, and personnel qualifications. This examination in depth could proceed by using information developed during an audit, or, if there had been no audit, could be a special engagement requested by a client recognizing that he has a problem.

### ***Business Acquisitions***

Within the range of organizational matters, there is one further occasion when the professional accountant can be of great help to his client: that is when the client is contemplating expansion by acquisition of an existing business. Conceivably, the opportunity to purchase other pharmacies could present itself to some of you present today; perhaps some of you already have made such purchases. In such situations, the CPA or CA can assist by undertaking investigations to enable his client to decide on which particular business to purchase; by helping to determine a fair price; and, if there should be a choice (as in the acquisition of a corporation), by advising concerning the best method of accomplishing the proposed transaction from a tax or other standpoint. The scope of services required could vary considerably, depending on the circumstances. If recent financial statements for the business to be acquired were available, perhaps the only assistance necessary would be in analyzing and interpreting such statements. If the basic statements presented were acceptable, but the client desired more comprehensive information about certain items or requested that specific auditing procedures be carried out, the independent accountant could do this. Finally, although usually not required in the acquisition of smaller businesses, if audited financial statements were not available, but were nevertheless desired, the accountant could make for his client a general audit of the financial statements of the business to be acquired.

### **CONCLUSION**

Many of the services independent accountants can provide I have now listed. Hopefully, at least part of this information will be useful to some of you and will promote some thought on whether or not you could

utilize an accountant in ways not previously considered. If you think you might need help, I urge you at least to discuss the matter with an independent professional accountant. Unlike doctors, we usually do not charge for an office call if it turns out that there is nothing wrong with the patient. One further thing you get from your independent accountant I have not discussed—a bill for services rendered. We always strive to accomplish our assignments as efficiently as possible in order to keep our fees, which generally are based on time spent, at a minimum. We hope, of course, the value of work we perform will far exceed our fees. As professionals, our clients' welfare is our prime concern. Not only must clients be satisfied with our services; we too must be satisfied that we have served our clients properly and to the best of our ability.

