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Management advisory services on the local scene——

Here's the story of how one small Boston CPA firm, which firmly believes management advisory services are an integral part of every accounting engagement, has fared under its philosophy —

IT ALL STARTED WITH AN AUDIT

by Robert M. Smith

A FEW short years ago, a CPA engaged on a routine audit for a shoe manufacturer in New Hampshire discovered a major inaccuracy in certain of the client's accounts receivable controls. The briefest of investigations revealed the reason; a number of sales returns resulting from defective merchandise had not been properly recorded or supported by subsidiary records.

The normal auditing requirements would have been principally to check the accuracy of the records and supporting documents, review the internal control, evaluate the ultimate collectability of the accounts, and expand the reserve for future losses if indicated. But the CPA felt the discrepancy was too serious to be so easily dis-

missed. He felt the errors indicated that the entire system for handling returns of merchandise should be investigated and improved.

His principal, however, did not agree with him. Even though the CPA agreed that the client should be consulted before what amounted to a management services type of engagement could stem from the audit, the principal demurred. Such matters should be avoided during the audit and all attention should be confined to completing the examination, he decreed.

And there the matter rested—and the New Hampshire shoe manufacturer presumably is still experiencing chronic and unexplained shortages in his accounts receivable file.

The CPA involved, Kenneth Gordon, of Boston, Massachusetts,

says that the New Hampshire incident was not unique; it was one of a long series of such events that convinced him the practice of accounting by too many firms was limited too strictly to auditing clients' books and records, preparing financial statements, and fulfilling state and Federal tax requirements.

He felt accounting should be much more, and, to prove its full dimensions, he went out and started his own firm, Kenneth Gordon & Co., of Boston. His statement of purposes delineated the difference he hoped to establish between his firm and most of those for which he had worked:

“While continuing to recognize the importance of these basic functions [auditing, examination of fi-

The firm anticipates the admission of female CPAs to partnership fairly soon . . .

nancial statements, meeting state and Federal tax requirements] many progressive firms, including our own, regard them also as the *media* through which a number of constructive management advisory services may be accomplished."

That has been the keynote of Kenneth Gordon & Co. since its establishment in May, 1965. The firm is completely rooted in accounting (each staff member is a professionally trained accountant; there are no outside specialists), but it views the accounting function as a departure point for wholesale improvements of the client company.

"When you're auditing a company, you're dealing with its very heart and guts," Mr. Gordon says. "If there's anything wrong with it, that's the time to find it just as a thorough physical examination is the best way of uncovering any hidden disease symptom in a human being."

The general approach to all client companies is the same. First of all, their bookkeeping and accounting system is brought up to par. When this has been accomplished, most clients are reviewed in the light of four criteria:

1. *Financial analysis and planning*—A complete study is made of operating results and financial position. Findings and recommendations are then discussed with the management and a clear direction established for the subsequent periods.

2. *Tax management and planning*—Tax implications of the past transactions are assessed, and opportunities for tax minimization are considered and then presented to the management.

3. *Systems, procedures, and internal control development*—Critical examinations are made along the course of the firm's examinations to note areas of accounting procedure and information proc-

essing which call for improvement. Data processing facilities are made available or instituted where the need is indicated. The goals are maximum efficiency, minimum cost, and protection of the client company. Thus, all findings in these areas are reviewed in depth with the client's management and arrangements made to implement recommendations according to the client's preferences.

4. *Personnel evaluation*—Particular attention is given to the performance and qualifications of key employees in the financial, accounting, and other administrative functions. Specific recommendations are made to improve employee efficiency and create appropriate incentives.

In order to meet these responsibilities, Kenneth Gordon & Co. does not maintain a separate management services department. Rather, it holds to the "integrated services" concept wherein all the phases of an accounting and management advisory service are accomplished as a single package. Each member of the staff therefore is apt to be called on for a variety of services on any given engagement. Continuity is provided by the ongoing nature of the assignment and perennial review by a partner in charge of the entire project. Particular goals to be accomplished and special problems faced are emphasized by the partner in charge and at a biweekly staff meeting for all personnel.

Such an elaborate program is distinctive enough for a small firm. But the Boston organization has other individual characteristics. It makes no distinction between men and women on its staff. There are about as many women as men and they receive exactly the same types of assignments as the men. Mr. Gordon and his partner, Martin J. Cusack, Jr., anticipate the admission of female CPAs to partner-

ship within the fairly near future. This policy—unorthodox as it may sound—has given Gordon & Co. good results and none of the headaches other accountants fear from women professionals.

As far as taking inventories is concerned (inventories have often been cited as one instance where women might be handicapped), Mr. Cusack feels that women professionals rather enjoy such assignments. "It gets them out of the office, and they all like that," he reports.

What about client reaction to women acting as accountants and management advisers?

An early incident in the history of the firm solved that problem or at least showed the way it could be solved. The first woman hired was Mrs. Mary E. Head, who had worked years before for one of the large local firms. Although a professionally trained accountant, Mrs. Head was nevertheless restricted to the firm's office all the time she worked there. Then she married, left the firm, and had two children. When her sons were in school, she returned to the accounting profession and joined the staff of Kenneth Gordon & Co., where, of course, she was sent out on assignments in the same pattern that has prevailed there ever since.

Eventually, she was assigned to a major analytical project for one of the firm's larger clients, working under Mr. Gordon's direction. He found that her relations with the client were cordial enough except that the client persisted in viewing her as a sort of supersecretary to Gordon, referring to her as "your girl" in phone conversations and conferences.

He called on the client and reviewed Mrs. Head's qualifications in detail, expressed his complete confidence in her, and added to her responsibilities on the assignment.

The lesson took. Mrs. Head has

now left Kenneth Gordon & Co. for a post as accounting manager of a private college in Boston. But the firm that originally took the "your girl" approach was so completely converted that it now has a woman as its own chief internal accountant, and the majority of its internal accounting staff are also female.

The experience taught Kenneth Gordon something, too. Even though he finds most clients are equally receptive to either men or women staff accountants, he makes it a point to let the client know, before the first visit by a staff member, that a female accountant may very well be in charge of the engagement. If any negative reaction at all is suspected, he describes the professional training and experience of the woman who will get the assignment and the high esteem in which she is held by other clients and the staff. So far this approach has worked beautifully.

An example of the type of management advisory services work in which the Gordon organization has specialized is a feasibility study performed for one of its oldest clients, the Satcom Corporation.

Satcom (Satellite Communities Land Development Corp.) is a Boston-based group of affiliated companies engaged in constructing mass housing and supporting commercial properties at various sites around the country. As one of its interests, one of the companies in the affiliation held a mortgage on a small restaurant constructed by one of the other companies near Grand Rapids, Michigan. When the restaurant, which was being operated by the parties for whom it had been constructed originally, was unable to meet its obligation, the second company foreclosed upon the mortgage. Now it had the property on its hands and a decision was needed. Should it attempt to sell it or pour in more money, expand it, and possibly make money on it through operations?

The company just had the questions; it did not have all the answers. It therefore looked to the

Gordon firm for analytical help. ^{Smith: It All Started with an Audit.} There were several ideas. Perhaps a more stable population could turn the losing restaurant into a prosperous entity and earn money itself as well. How about a community of mobile homes located near the restaurant? What about a community of mobile homes which themselves would be sold by the company? Or perhaps a motel built around the restaurant would do the job and earn money as well.

The ideas received were just as nebulous as that; the firm's assignment was to help the management project the cost of each of them and to determine just where the best profit opportunities lay.

That assignment in turn was passed on to Mrs. Head, who had by now become a senior accountant on the Gordon staff. Her analysis progressed from the topography of the area around the restaurant all the way through to the number of units that would be most profitable if the final decision were to build a motel. For example, how far was the restaurant from the nearest competitor? What new communities lay nearby, and what was the age group of their inhabitants? Would they fall into a category whose parents might be potential customers for mobile homes in a nearby mobile home community? What influence would a planned new housing development being undertaken by Satcom in Grand Rapids have on the population mix of the area?

And if a motel were to be decided on, how large should it be? Fifty units? One hundred units? What would be the comparative costs of building fifty against a hundred units? How much would have to be charged per unit to make a fifty-unit motel pay? To make a hundred-unit motel pay? If a motel were the choice, should it have a swimming pool?

The analysis involved investigating and reporting on the topography of the region, its gas, water, and electric facilities, its road and traffic patterns, its population mix. Then, possible rental income was

Should Satcom attempt to sell the property or pour in more money, expand it, and possibly make money on it through operations?

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analyzed in terms of number of occupancy units, construction costs (or purchase cost if mobile homes were to be sold or rented), and finally the whole set of figures was meshed with the resources and liquid cash of the company that now owned the moribund restaurant.

The analysis even covered the tax results if whatever was organized at Grand Rapids were organized as a subsidiary company or an independent company and what its reporting structure to the parent company might be.

These results were presented as a series of alternatives to the Satcom Corporation, not as recommendations for one course or another. The results of Mrs. Head's analysis simply showed the expected dollars and cents outcome of each of the courses considered, assuming that the anticipated costs and revenues, supplied by the management, were to materialize.*

This is an invariable procedure at Kenneth Gordon & Co., which is very cognizant of the management advisory services committee's statements on possible conflicts of interest when one accounting firm serves as both auditor and MAS specialist for a client. Alternatives are always presented, and the decision is always that of the client management. In effect, the MAS recommendations—or rather the MAS reports of the firm—are like a verbal decision tree in which possible consequences of each course of action are analyzed in detail. But the decision is still the client's to make; the CPA firm merely does the analysis, makes computations, and organizes the data.

This is the pattern of most of the Gordon firm's merger and acquisition work, which makes up so large a portion of its MAS business. To investigate every aspect of the company that is to be acquired, its financial position, its

*SATCOM finally decided, on the basis of population trends, to build a mobile home court near its restaurant.

reputation, its competition, then to match it with the acquiring company's management and marketing strengths, then to check to make sure the acquisition cannot put the acquiring company in an embarrassing financial position, and then to report all the possible projected figures to management for management's decision.

Its management advisory services are rooted very firmly in the firm's first rule—bring the client's accounting and bookkeeping practices up to the highest standard as the very first step for the complete range of management services. For instance, Mrs. Head's exhaustive inquiry into the potential costs and profits in the various developments proposed for the Grand Rapids project was aided by her intimate knowledge of the resources available for such a project in the Satcom complex—a knowledge that was gained through her long experience with the annual audits of Satcom.

A common language

Strict adherence to AICPA auditing and accounting standards in effect gives accountants across the country a common language, Mr. Gordon says, in which each term has a universally understood meaning. This can prove an immense advantage to a local firm, he maintains, since it can in effect make it possible to establish an out-of-town office by simply retaining an out-of-town firm that recognizes the same standards. He has already done this in the Grand Rapids project. After satisfying himself on the standards it observed, he retained a Grand Rapids CPA firm to act as his firm's agent on the work Satcom is doing in the Michigan area.

His insistence on rigid audit standards has proved an immense advantage to his firm in another way, Kenneth Gordon believes, and he has at least one concrete example to prove it.

One of his oldest audit clients was a security guard service based

in Boston. In keeping with their total "integrated services" concept, Kenneth Gordon & Co. partners advised the firm's president, then close to retirement age, that he should be thinking in terms of a successor. Since the man had no son in the business, they suggested he either train a successor from within his own company, seek to merge with another company which had capable, vigorous management, or sell his company to another concern in the field.

Nothing further was said, but a few weeks later the Gordon people heard from a CPA firm in the South. The callers said they represented a large security guard organization which had been contacted by the Boston organization regarding possible merger. Could they, the callers asked, send a representative to Kenneth Gordon's office to make sure that all the financial reports of the client company presented its financial positions and results of operations in accordance with AICPA standards. Gordon and Cusack agreed instantly, subject, of course, to obtaining proper authorization from their client.

After a visit to the client's offices and a review of the Gordon & Co. workpapers, the visiting CPA felt completely satisfied with the financial stability of the security guard organization and the reliability of the audited financial statements.

The results: The merger was consummated, and the larger guard organization has substantially expanded its operations. As a result of association, during the merger procedures, with both the larger company and its independent CPAs, Kenneth Gordon & Co. was thereafter retained to regularly participate in the audit function in its locality and to render additional services relating to other mergers and acquisitions for the entire firm.

So a traditional auditing engagement in this case led to a management advisory service in executive replacement. This in turn led to an examination of the accounting prin-

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EXAMINATION IN TAXES (BUSINESS AND CORPORATION)

THIS EXAMINATION IS INTENDED TO HELP DETERMINE YOUR FAMILIARITY WITH AND KNOWLEDGE OF BUSINESS AND CORPORATE TAX PRINCIPLES AND PROCEDURES. YOUR ANSWERS SHOULD BE BRIEF AND CLEAR. IT IS NOT NECESSARY THAT ALL QUESTIONS BE ANSWERED IN ORDER TO GAIN SUBSTANTIAL CREDIT. MOVE ALONG AS RAPIDLY AS POSSIBLE. GOOD LUCK!

1. What is an instalment sale, and to which types of transactions can it apply? What rules govern the reporting of an instalment sale?

which can be used in computing

TEST OF KNOWLEDGE OF BASIC BOOKKEEPING

Prepared and Administered by: Kenneth Gordon, C.P.A., Boston, Mass.

On answer sheet, write your name, address
Number your answers to correspond

1. What procedures are used in trial balance?
2. What are reversing entries?
3. List the various types of adjustments.
4. Under what circumstances are entries made quarterly?

A. Federal

5. The following accounts are listed. For each item listed, indicate the appropriate category. Use this code: E for income; and E for expense.

ACCOUNT

SALES
SALARIES AND WAGES
LOSS ON BAD DEBTS
DIVIDENDS RECEIVED
BANK CHARGES
DONATED SURPLUS
ADVANCES TO EMPLOYEES
INVENTORIES
ACCRUED EXPENSES
F.I.C.A. TAX DEDUCTIONS
PREPAID INTEREST
ACCOUNTS RECEIVABLE
RESERVE FOR REVALUATION OF REAL ESTATE

6. What is meant by a "control account"?
7. What are some of the meanings of the term "control account"?
8. What is the meaning of the term "control account"?

KENNETH GORDON & COMPANY

THIS EXAMINATION IS DESIGNED TO PROVIDE A BASIS FOR EVALUATING YOUR KNOWLEDGE OF AND FAMILIARITY WITH VARIOUS PHASES OF AUDITING. MANY DIFFERENT ANSWERS MAY BE APPROPRIATE FOR EACH QUESTION. BE SPECIFIC AND TO THE POINT. IF THE ANSWER TO ONE QUESTION DOES NOT COME TO MIND QUICKLY, IT IS ADVISABLE THAT YOU GO RIGHT ON TO THE NEXT ONE. ALL THE QUESTIONS HAVE EQUIVALENT APPLICATION TO AUDITS OF LARGE, SMALL AND MEDIUM SIZED COMPANIES. GOOD LUCK!

1. What is an imprest fund, and how does it operate?
2. In examining petty cash vouchers, what particular features or practices should be looked for to assure adequate internal control?
3. Outline the steps which should be taken in reconciling cash in banks from bank statements to books of account.
4. How should voided checks be handled for proper internal control?
5. Why should cash discounts be scrutinized?
6. What should the auditor look for in examining vendors' invoices?
7. What is meant by a cut-off control on purchases, and how should it be checked?
8. Why should the auditor review the general journal?
9. What is meant by a control account?
10. What steps can the auditor take to be assured that accounts payable is not understated? How can unentered invoices be detected?
11. What audit procedures should be applied to verify quarterly payroll tax returns?
12. What information should appear on an insurance schedule, and what audit and management information can be derived therefrom.

The Gordon & Co. recruitment program makes heavy use of written tests to weed out weak prospects. Applicants who do very well on the written examinations are then given extensive interviews before a final decision.

principles recommended by Kenneth Gordon & Co., which led back to a continuation of the original auditing engagement and a new management services type of engagement—mergers and acquisitions.

Firm quite young

The Gordon firm is only five years old, so naturally its degree of staff competence in some specialized management advisory services fields has not been fully developed. It is meeting this problem by calling in outside experts whenever the problem merits it. For example, Kenneth Gordon himself has taken data processing courses and thus has gained considerable familiarity with the data processing area. But, still, he calls on one of the dozens of computer firms in the Boston area as consultants whenever the data processing involvement becomes too technical. But, of course, with each new project the Gordon & Co. staff become more proficient in the area concerned, and learn on every job to a certain degree. Thus, where they now would call on computer consultants or data processing specialists at an early stage of a possible data processing application, the next time around they should be well enough equipped to feel they need them only at a much later stage.

Also, the firm's continuing education program for all professional staff members helps in preparing for new situations.

Anthony J. Tedesco, who taught for years at Nichols College in Dudley, Mass., and who recently acquired his CPA certificate, is the research associate of the firm and is in charge of the training sessions held every two weeks for all professional staff. There is a great deal of use made of audio tapes from the AICPA, and, although there used to be heavy dependence on talks by Mr. Gordon, Mr. Cusack, and other senior members of the staff, now most of the programs are conducted by Mr. Tedesco. Staff members contribute ideas and suggestions for programs,

the planning, systems and controls, Vol. 8, 1971, No. 1, p. 5.

Recently, there has been heavy emphasis on Housing and Urban Development regulations, since the firm feels this will be a rapidly developing field, and it is already heavily involved in it through its work for Satcom. The presentations on Housing and Urban Development regulations and plans are being gathered together as the basis for a complete HUD manual that will eventually be supplied to every staff member.

Mr. Tedesco feels this will be a continuing emphasis in his programs—trying to anticipate government programs that are becoming increasingly active and to prepare Gordon & Co. staff members to serve knowledgeably for firms participating in such programs.

For example, although he does not plan it now, he anticipates a possible series on ecology as government programs to protect the environment become more prominent.

Emphasis on MAS understood

So—there is the picture of Kenneth Gordon & Co. as it exists today, a firm which in five short years has come a long way. The emphasis has been on management advisory services throughout, and each prospective audit client thoroughly understands this before the engagement is undertaken. It is a cardinal Gordon rule that no audit is complete without the concomitant management services steps felt so essential—business analysis and planning, tax management and planning, systems and procedures, and internal control development, as well as personnel evaluation. The firm would no more think of omitting these review steps than an M.D. would skip a temperature and blood pressure reading for a new patient.

Naturally, all prospective clients don't feel all this is necessary, and some that go along with the review phases do not accept suggestions for improvement on something that

looks strong. Here, the Gordon solution is fairly simple; drop the client if the deficiency is serious enough to cause deterioration of the working relationship.

"We get a feeling about clients in our first work with them," he said. "If they're going to be difficult, if they're not willing to investigate areas we know are in bad shape—either through us or other consultants—or if they try to dictate fees unreasonably, we don't want them. We feel selectivity in accepting clients is all-important."

As senior partner of a small organization he can afford to be selective; he has not had much trouble getting clients since the early days in 1965 when he did personnel recruiting and selection for other CPA firms because he didn't have enough clients of his own. As a firm in a major metropolitan area particularly rich in data processing organizations, banking sophistication, and practically any other type of business specialist that could be wanted, Gordon & Co. need not hesitate to take on almost any type of management services project, no matter how ambitious. And as a firm willing and even eager to give women accountants exactly the same opportunities as men, Kenneth Gordon & Co. has never had any trouble recruiting highly qualified accountants in a time when many MAS departments are bemoaning the lack of people in the field.

Gordon's recruiting experience has been slightly happier. Not only does he now have waiting lists of applicants—selected through the same testing techniques he developed years ago when doing so much recruiting for other CPA firms—he has found that the women accountants among them have, if anything, a slight advantage over their male counterparts in management advisory services engagements, particularly where extreme patience is needed in ferreting out obscure facts.

All in all, it's been a good five years.