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Look at it, touch it , sample it, lift it

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“

LOOK AT IT

TOUCH IT

sample it

LIFT IT

”

Had James Bond been an auditor his greatest adventure might have started like this...

“The wind whipped the tail of his overcoat like a flag on the staff and nearly tore the glasses from his face. The bitter cold pinched his cheeks and numbed his writing hand—the other clutched a stanchion on the platform, as the ground swayed dizzily 60 feet below.”

Or like this...

“The sun hung burnished in a motionless sky, and crickets chirped in the underbrush. The sun is 93 million miles away, but the roof of the lumber shed, incandescent in its glare, was a scant four feet above him, and the sweat streamed from his forehead, blurred his sight, and reduced the paper to a soggy mass that the pencil wouldn’t write on.”

But could that great secret agent “007” have stood the strain of it? Suppose...

“The dark closed in above him and the entrance rapidly became only a pin-hole to the world of the living. The blackness surrounding him gnawed at his heart. His stomach became a void forced upward in his chest. Only the metallic rattle of the dropping cage and the clipboard he clutched gave him touch with reality.”

No, his preference would probably have run more to this...

“Soothed by the gentle hum of the air-conditioning, he checked one crew and then another down aisles shelved high and neatly on either side with boxed knitwear. Two floors below was the Company dining room, where he would soon have lunch and where a fashion show would go on for the buyers—today it was swimsuits.”

However James Bond might have reacted to observ-

ing physical inventory-taking (at a petrochemical plant, a lumber mill, a limestone mine, or a knitting mill), to the auditor it is all a part of the day's work. It can be a fascinating part that brings him into direct contact with his client's operations and shows most clearly how we accumulate "competent evidential matter"—what we must know to be able to give an opinion on a company's financial statements. Inventories make up over 20 per cent of total assets of U.S. manufacturing corporations.

Assaults on Mt. Everest are made because "It's there." Physical inventory tests are made "to see *if* it's there." As one auditing instructor used to say simply, "You look at it, touch it, sample it, lift it, kick it..." the last-named semi-serious advice said to have been followed faithfully by some accountants with sore toes, but also by the one who kicked right through an empty case and found half of the others in the inventory were empty too.

Some physical inventory observation assignments come in settings of high adventure. Like counting range cattle from the air over a 20- by 60-mile ranch, mostly unfenced, near the south rim of the Grand Canyon in Arizona. Picture breakfasting in the cool dawn after a night in the guesthouse, then bouncing in a jeep down the road to what they call "the airstrip," and taking off in a four-seater Bonanza.

The flight is made at about 1,500 feet; any lower would give too narrow a field of vision and, besides, would tend to frighten and scatter the animals. Below, windmills, watertanks, buttes, trails and dry washes are checked with the map to show location. It is round-up time for branding calves and culling animals to be sold,

but the herds are still scattered over wide areas. The best times for counting are early morning or late afternoon, when the animals are likely to gather at the surface-water ponds. At midday they are mostly unseen beneath the mesquite and cedar trees. With 15,000 head, which works out to one animal to every 40 acres, these aerial inventory observations are eminently practical. They are by no means exact or complete, but the numbers they do produce can be interpolated into close approximations by reference to ranch records.

Few physical inventory observations can be made from the air, however, and most find our accountant with his feet firmly planted on the ground or, more likely, making tracks on it. At a big strip-coal-mining operation, his observation may find him walking the equivalent of ten or more miles in a day. To get at the coal in this kind of mining, the overburden (sometimes a hundred feet thick) has to be scooped off first with huge power shovels. At the end of any accounting period there will be some amount of "work-in-process" (representing the portion of overburden removal costs applicable to coal not yet mined) and the company has to compute its cost. Part of the computation is to measure the length and width of the exposed seam (the thickness, which is typically only four or five feet, has been determined previously by test borings when the company purchased or leased the lands). The auditor's job is to observe the survey team—a transit operator, rod man, and chain men—as they make their measurements. Hazards that beset him include water holes, 50-ton trucks careening through the pits, and dynamiters "shooting the coal" loose.

“Look At It...Touch It...Sample It...Lift It...”

With any inventory, one of the auditor's first steps, and a big one, is to check on the effectiveness of the client's counting plans. Then he observes how they are carried out. But it's not always possible to make test counts with a company employee to lead the way, and then we learn by experience. On a December 31 inventory count at a furnace manufacturing plant, an assistant accountant trudged out in deep snow to count pig iron in cars on the railroad siding. Back he came minutes later to say the cars were empty. He didn't realize pig iron was so heavy that a foot-high loading was all a car could carry. When he looked over the side all he saw was a blanket of snow, and the car did *look* empty. [Ed. note: touch, lift, kick, etc. . . .] He had just come from observing cars loaded with scrap iron, and they were piled to overflowing.

The “observation” in physical inventory auditing means a lot more than checking what the client counts. Out behind the kilns of a firebrick manufacturer was a huge pile, logically described as brick broken in the kilns or in handling afterward and, therefore, not an inventory item. So our accountant was somewhat surprised later to see a truck loading up with broken brick and carting it back into the crusher room. Delving into this anomaly, he found that broken brick is better for making certain kinds of new brick than equivalent amounts of raw clay, so it was mixed in with new burns. But the plant manager kept it out of inventory and used it as needed to offset variations in other costs; his unit costs of production charted out practically in a straight line, and he never had any variations to explain to the home office.

“Observation” can mean looking at the obvious and

seeing something unexpected there. In a winter inventory-taking of a paper company's coal piles, our accountant noted with interest that most piles were snow-covered but that several were not. Deep inside the latter, spontaneous combustion was slowly burning the coal, forcing up the temperature but reducing the inventory.

Inventories of outdoor piles like coal, sulphur, iron ore or clay, can be comparatively easy to check, or quite difficult. Aside from questions of how compact each pile is, or how far it has sunk into the ground, or what its quality may be, there's the problem first of measuring what you can see. Some piles are symmetrically spread by overhead conveyors, but others look like man-made Rockies, and some are the size of a football field and forty feet high. With a certain amount of "imaginary bulldozing" on irregular piles, engineers can survey the volume accurately within five or six per cent, but this range of error on a big pile may mean several thousand tons of material. For accuracy within one or two per cent, "photogrammetry" can be used: overlapping photographs are taken from an airplane. When these are looked at through special glasses, like the old stereoscope, they have a 3-D effect, and a draftsman can draw a contour map from them (accurate to within about an inch). Then an instrument called a planimeter measures the area within each contour line. Multiply these areas by the heights between contours, and you have the volume.

Very often when it comes time to make physical counts, the plant is shut down, receipts and deliveries are stopped, and the inventory sits still to be counted. This makes the counting a lot easier and our observation easier, too. Many times, though, it's not practicable to

bring things to a halt—for such very good reasons as that lost production and delivery days are hard to make up, or that it would cost too much to stop the manufacturing process and then start up again.

In cases like these it takes a real understanding of the flow of production to assign our accountants to observing at the most effective points and to arrange their schedules so they are at those points at the right times. There is a flow of paper-work, too—job tickets follow parts along a production line; batch tickets accompany such things as paint mixes. Therefore, our accountants have to be alert to see that the client's accounting for in-process inventory is accurate. For example, the engine block at the end of the assembly line is worth much more than the one at the beginning and more, too, than the one just behind it.

Some of the examples presented here are a bit out of the ordinary, but they do dramatize an important part of auditing work. Few would call it a "romantic" part, or even good clean sport. It is, though, a part that brings the auditor into direct contact with the operations of the company and this contact can give him a special insight into the close relationship of the auditor with his client.

Much of the material here was taken by the editors from descriptive notes provided by Robert S. Amos, Charles R. Ballard, Alexander Bitker, William R. Cusimano, Daryl Drummond, Howard H. Hankins, Gary A. Johnson, Ralph D. Kennedy, Jerry W. Kolb, Norman C. Merz, Gordon L. Murray, Olney F. Otto, Charles W. Reece, Christopher F. Russell, DeWitt C. Warren, and Curtis E. Youngdahl.