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# AUDITING IN TRANSIT

By HAROLD A. SENTMAN

*Mr. Sentman, Internal Auditor of the Capital Transit Company, Washington, D. C., has been associated with electric interurban railways and city transit lines since 1922. He was elected president of the Washington, D. C. Chapter of The Institute of Internal Auditors in 1953 and has been a member of the Education Committee of The Washington Board of Trade for the past ten years.*

*This discussion of some of the conditions and problems which created the need for internal auditing in the Transit industry, and some of Mr. Sentman's personal thoughts on developing personnel suitable for the job was presented at a February meeting of the Washington, D. C. Chapter of ASWA.*

Auditing was largely a detailed checking process when I first became associated with the Transit business, or Traction business, as it was referred to in those days. The time-consuming audit procedures of those days have been gradually replaced by an emphasis upon service to management. The greatest change in internal auditing has come about during the last ten years, during which business has been gradually growing more complex. With this growth in complexity, management is gradually being forced to delegate more and more of its authority in order to properly discharge its responsibility. Because of this delegation of authority it becomes necessary to set up controls, and it is at this point that the new emphasis in internal auditing appears.

## Controls

The internal controls set up by management should each meet these tests.

- (1) Does it control something that is worthwhile to control?
- (2) Does it conform to lines of responsibility, so that individuals may be held responsible for variations and given credit for results?
- (3) Is it in proper perspective to the whole business picture or are minor items rigidly controlled because such control is feasible, while major items are less rigidly controlled because control is harder to establish?
- (4) Does it meet protective requirements on a practical basis? Whether it is a petty cash fund, a storeroom, or a retail store, the complication and cost of protective control must be appraised in relation to possible exposure to fraud, waste or loss.
- (5) Does it facilitate business operation? Controls should be like dikes that direct and control the flow of business transactions; they should not be dams

that are more hindrance than help.

- (6) Is it flexible to meet changes in business conditions? No business is static. Controls must change as risks and business conditions change.
- (7) Does it help the business to make more profit? This is the hardest question of all, as the answer may depend on the evaluation of calculated risks and the cost and hazards of alternate methods.

## Qualifications of the Internal Auditor

In order for the internal auditor to take his place in the business organization today he must be accepted at all organizational levels, and he must be free from local management pressures and organizational politics.

Auditors fall into four distinct classes:

- (1) The small-sized fellow who is always making mountains out of mole-hills; whose chief concern seems to be finding mistakes on the other fellow, thus losing sight of the real purpose of his work.
- (2) The cold-blooded fellow who disregards the feelings of others by criticizing everything not in line with his own thinking. This fellow is so concerned with his own welfare that he loses sight of the damage he is doing to others, as well as to himself.
- (3) The auditor with the broad understanding of the real issues. He senses what is audit material and what is not, the over-all effect of his recommendations, and the light in which management will view them. He has a profound understanding of the purpose of his work.
- (4) The auditor who assists management by helping employees to understand management and business principles better, in addition to having the qualities of the auditor who falls into the

third group.

This type of auditor will work with employees and explain to them the real intent of an audit, the necessity for correct preparation of the reports, and their effect upon other segments of the office and the business generally.

This fellow might be termed an educator, for, along with the conduct of his work, he is helping to train those with whom he comes in contact so that they have a better appreciation of their own particular part in the scheme of things and what management is endeavoring to do. In giving this service to management, the auditor, of course, abstains from giving direct instruction outside of his own department. Out of his broader experience, he is simply helping to explain why the Company wants things done in a certain way, and is thus assisting management in building up a better informed and more conscientious group of employees.

With respect to the internal auditing staff of our transit company, I have found that a well-rounded audit staff should include men who have experience in operations, as well as those whose training and experience are primarily along accounting lines. Sometimes personnel people fail to give sufficient consideration to the fact that the prime function of internal auditing is to promote the welfare and profitability of the entire business. Of twenty persons assigned to my department, only five have accounting degrees.

It is extremely hard to get people who possess all of the qualifications we would like to have in our employees. In addition to the qualifications listed above, we must have people who are not afraid of work, and who do not object to it. Sometimes we have to do a lot of studying to get the answer to a tough problem. We aren't always able to work the most desirable hours—sometimes we have to work at night, or more than eight hours a day, or on a Saturday, Sunday, or holiday.

For many years, going way back, industry failed to recognize the importance of its people, and made little effort to understand them and handle them intelligently. But today it is becoming a practice to choose executives not alone on the basis of their technical skill or knowledge of the business, but also on their ability to get results through the willing efforts of the people under them.

There are many qualities associated with the development of human relations, including skill, tact, good judgment, knowledge

of human nature, diplomacy, consideration, and sensitiveness to interpretations and reactions.

The importance of human relations goes up the scale with the importance of the job. Skill, or job know-how, is at least 90% for a rank and file worker. For promotion to Foreman, know-how is about 50% and human relations about 50%. For promotion to executive, know-how is about 20% and human relations about 80%.

So far as you and I are concerned in our day to day dealings with people, human relations are not complicated. Human nature is complex, but we can establish and maintain good human relations with the majority of people by observing certain principles and using simple psychological tools. All of the principles of good human relations stem from the Golden Rule. And, like the Golden Rule, they work only if we believe in them and observe them.

### ***Beginnings of Fraud***

The vast majority of employees are honest, and weaknesses which lead to fraud and waste often arise because of ineffective control measures. It is possible that more fraud and waste come from defects in administration of essentially sound systems than from inherent weaknesses in the systems themselves. Of utmost importance in the development and maintenance of adequate internal control are:

- (1) a sense of relative values
- (2) a feeling for the welfare of the business
- (3) an understanding of how people work and how they think.

Very few of the petty thieves, whose activities are detected, come into our company for the express purpose of benefiting from their ability to work a well planned systematic method of stealing. The majority of thefts start in small amounts, and are most often crudely performed by persons, who momentarily cease to use their powers of reasoning, and steal when the greater opportunity exists. This emphasizes the necessity for closing and locking the doors to theft possibilities. When the forces of need and opportunity to steal present themselves, they are no respecter of race, creed, color or sex. Among the most common motives for stealing are found:

- (1) Living beyond income
- (2) Gambling, liquor and questionable associates
- (3) Illness and hospital bills—or other unusual financial burdens.

Those who lack the strength to resist the

temptation include trusted employees, those of highly technical and academic accomplishments, and those of little education.

It is for us to provide a system which will prevent these things from happening, or detect them at an early date. We have found that being aware of certain danger signals will permit us to fulfil our responsibility to our fellow employees to try and make better men and women out of them right at the start, rather than to watch them become hopelessly entangled in some serious trouble and then demand that they be discharged or legally prosecuted to teach them a lesson. The signals we are alert for are:

- (1) Borrowing from fellow employees
- (2) Personal checks cashed and returned for insufficient funds
- (3) Collectors and creditors appearing at place of business
- (4) Gambling in any form, beyond ability to stand loss
- (5) Excessive drinking, night-clubbing, etc.
- (6) Acquiring expensive automobiles, etc.
- (7) Explaining high standard of living as money inherited
- (8) Heavy buying of securities.

### ***Controls and Auditing at the Capital Transit Company***

We had no Auditing Department in our company prior to March 1, 1941. Up to that time our very limited auditing program was carried out by Accounting Department personnel. Our present auditing program deals primarily with accounting and financial matters, but we also get into many matters of an operating nature.

As far as our general books are concerned, we are audited more than most businesses. Our books are kept according to the "Uniform System of Accounts for Electric Railways," prescribed by the Interstate Commerce Commission—and we are visited by their examiners from time to time. The Public Utilities Commission of The District of Columbia maintains a continuous audit of our accounts. One PUC auditor, for whom we furnish an office, furniture, equipment and telephone service, is assigned to full time work with our Company. We also employ a firm of public accountants. Then, of course, we have our own internal audit group.

Our Internal Auditing Department performs much the same type of work as the internal audit group in any other business—including audit of all imprest petty cash funds, accounts receivable, accounts payable, payrolls, expense accounts, suspense

accounts, inventories, etc. Our biggest problems are associated with Stores, Payrolls and Cash. It is in these areas that there is the most room for fraud and waste. Fraud is occasional but waste is continual. The waste most evident in our Company is in the use of electric current, supplies and stationery, and we are constantly observing these things to keep them under control. It has been said that the greatest source of waste in business and industry is the employees' failure to live up to their possibilities. I recently read an article written by a member of the faculty of the School of Commerce of Northwestern University, which stated that most of us use about one third of our potential capacities, and that our offices operate at only 25% or 50% of capacity.

### ***Stores***

We attempt to keep a tight control on our storerooms and their issuing procedures to prevent the theft of tools, auto and bus parts, and other items of equipment. Duplicate requisitions are called in to the Auditing Department from the issuing persons, and are compared to the original requisitions to determine that storeroom employees have not added items to cover shortages or thefts. Inventories are strictly controlled by the Auditing Department to prevent falsification to cover shortages.

### ***Payrolls***

In addition to our standard audit procedures relating to payrolls, we make every possible effort to guard against the following three practices:

- (1) Carrying of fictitious help on payrolls
- (2) Carrying employees on payrolls beyond actual severance date
- (3) Turning in time for absent employees

Due to the constantly changing of work locations of many of our Track and Distribution Department and Way and Structures Department employees, we have to guard very closely against the incorrect reporting of time. For this purpose we have assigned one man to full time payroll work. This man attempts to contact or visually check each and every hourly employee, except operators, each work day. These hourly employees include such classifications as linemen, electricians, carpenters, plumbers, welders, mechanics, laborers, etc. This time checker's report is compared to the payroll each week to determine that no employee is paid for time not worked.

### ***Cash***

Although we maintain a tight control on

all cash, our major problem is Fare Receipts. I think you will realize the magnitude of this problem when I tell you that we have about 2,300 men operating approximately 1,350 vehicles all over the District of Columbia and Montgomery and Prince Georges Counties in Maryland; and that these men are collecting fares in the amount of about \$80,000.00 every week day. The real problem stems from the fact that we do not know how much our fare receipts are for a given day until two days later. At the close of the operating day, locked vaults are removed from the fare boxes and are stored in special rooms at each carhouse and bus garage—there are ten of these locations. On the following day, our armored truck crew unlocks and empties these vaults and transports the fare receipts to the Coin Room at the General Office Building. On the next day, the receipts are run through the sorting and counting machines; and, at this point, we know for the first time how much we have.

All fare box vaults are serially numbered. Each operator must list this number on his manifest. When the vault is removed from the fare box on the vehicle, the man who removes it must list on his report the serial number of the vault removed and the serial number of the vault inserted to replace it. When the armored truck makes the collections, the crew is accompanied by an auditor and an observer from the Auditing Department. The auditor lists the serial numbers of all vaults as they are emptied, while the observer keeps the handling of the receipts under constant surveillance to see that none is lost for any cause. These various reports are compared in the Auditing Department to determine that all vaults which were in service have been removed from the vehicles and that receipts have been removed and transferred to the Company Treasury.

We began the conversion to this lock-type fare box about twenty years ago when it appeared to us that everybody was making money but the Company. Some of the conductors owned more property than most of the officials. We completed our conversion to lock boxes in 1943—this was one of the first major accomplishments of the new Internal Audit Section.

Up to 1943 we were also using a registering fare box, which had a counting mechanism in its base, through which the conductor, or operator, cranked the coins. Settlement was made by the conductor according to the readings of the box register. It didn't take the men long to find out that if

the crank was turned very rapidly, only a part of the coins would register. Some of the men would grind a depression into a penny, large enough for a dime to fit into, and keep dropping this coin into the box all day. Almost every time it came through the registering mechanism it brought a dime with it, and registered as a penny—a clear profit of nine cents per operation for the conductor. This kind of activity was ended by management's acceptance of our recommendation for the installation of the lock-type, serially numbered fare boxes, with provisions for a tight control by the Auditing Department.

After the installation of lock-type fare boxes on all vehicles, the opportunities for theft were reduced to a minimum. Of course, the operator could hand-collect fares, or thefts could occur in the Coin Room of the Treasurer's Office before the receipts were counted. Suspicion on the part of the rider almost eliminates the possibility of the operator getting by with hand collection. Just to make sure, we still maintain our force of Confidential Inspectors who ride our vehicles and report rules violations, including those relating to fare collection. It is not likely that thefts in the Coin Room would go undetected for long. We have constructed a corridor dividing the Auditing Department and the Coin Room, to which the only access is through my office. On the Coin Room side of this corridor we have one-way glass panels, through which we can observe all that goes on in the Coin Room. Persons on the opposite side can not see through—the glass looks like an ordinary mirror to them.

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major project of the Education Committee for the new year. At the first subsequent meeting, a model set of By-Laws was drawn up and a list of suggested club activities. The City bookkeeping teachers were invited to be our guests at one of our regular chapter meetings and we met with them and presented our ideas and plans. Their reaction was favorable and they promised full cooperation, pointing out, however, that they thought the activities and benefits should include both girls and boys. We agreed and changed the tentative name of the embryo clubs from Future Women Accountants to Future Accountants of America.

Membership in FAA is open to all area high-school, business school, and junior college students of bookkeeping and accounting. Each of the chapters, now numbering five, has been started by one of our members of ASWA, who will act as a "sponsor", contacting and meeting with one of the teachers and the past, present and future students of bookkeeping at the school. She explains our aims, projects, and the following purpose of FAA: