

10-1935

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Edward T. Perine

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Recommended Citation

Perine, Edward T. (1935) "Auditing Municipal Accounts," *Journal of Accountancy*. Vol. 60 : Iss. 4 , Article 5.
Available at: <https://egrove.olemiss.edu/jofa/vol60/iss4/5>

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Auditing Municipal Accounts*

BY EDWARD T. PERINE

An associate of mine in the long ago, one of New York City's financial editors, once wrote a memorable definition of bookkeeping. It came after a wild Wall street day, with values smashed, several firms ruined, current financial news and theories all in a daze.

Said he, in an *Evening Post* leading editorial: "Bookkeeping is not a science; it is clear accurate presentation of business fact."

If I seek here to drive home no other argument about auditing municipal accounts, let this much be set down as undeniable: an audit only has to be a clear, common-sense proof of fiscal facts. And I mean that auditing, both public and commercial, is too often a stupid routine checking of items and a laborious footing of columns. Not often enough is it, from the first ten minutes of looking into a comptroller's ledger on through to the writing of the last ten words of an audit certificate, a skillful, penetrating hunt for possible crime. On this theme, that of the need of keen investigative service by examining officers and accountants, I wish to dwell, rather than to go into much of discussion of the technique of systems, forms, current budgets, the equally important subject of capital budgets or any other matters of mere fiscal theory.

Now it is a fact that state controls and municipal bookkeeping methods, both in New York and elsewhere, have in recent years advanced with much of standardization; but a further fact is that if any one nation-wide crop ought to be plowed under, it is the annual crop of defaulters.

Witness the record of a county of this state where within very recent years a treasurer was found to be \$87,000 short, his speculations being spread over a period of two and a half years, and of the chief city of that county where, around the same date, an aggregate of \$262,000 of another treasurer's misappropriations was unearthed by state examiners. Witness the record of New Jersey where, over fifteen years past, in spite of compulsory annual auditing by licensed public accountants, the municipal stealings have aggregated some \$750,000, with the yearly average

*An address at the 1935 conference of Mayors, Syracuse, New York.

on the increase. Witness a report from Ohio that, during 1933 and 1934, the irregularities discovered in subdivisions of the state by the state bureau of inspection and supervision of public offices aggregated over \$1,700,000, with more than half of this sum originating in counties, and with total recoveries and adjustments (before the filing of reports by state examiners) bringing back less than \$400,000.

What do these figures mean? Ought these things to be? If municipal dollars are being stolen by millions in states where powerful controls exist, and with ever increasing unwillingness if not sheer inability of bonding companies to make the losses good, what of the many commonwealths where no supervision is exercised at all?

Consider this story of neglect and delay in high places. As lately as February of last year in the city of New York certain facts were developed like these: The accounts of the department of water supply, gas and electricity as to the revenues of the four boroughs had not been audited since 1928, and the records of the police department pension fund had not been audited since 1929; the revenues of the department of education had been without audit since 1926; the health department, antitoxin and serum account, had been last audited in 1921; while an audit of City College, started in 1933, was admitted to be a first undertaking of its kind. The understanding is that orders have since been given to catch up these arrears, but it is a perfectly fair claim that this picture of the city of New York's lack of auditing arrangements is reflected in a very large number of other communities. Especially is this so in that predominating number of states in which no municipal supervision is provided; yet even in the others there are long delays, generally because of insufficient appropriations for a reasonable number of competent examiners. But shame upon those American counties, towns and villages which, no differently from New York City College down to two years ago, have always kept their books according to their own lights, without either the benefit of state supervision or a willingness to employ professional accountants, or both. In particular, shame upon Cook County, Illinois, after last month's shocking revelation; its treasurer short \$400,000; news headlines screaming "No Audit Since 1871—the Year of the Great Fire in Chicago."

I must say, in passing, that these conditions of insecurity and indifference are inexcusably a part of our American political order

of things. Financial, industrial and commercial businesses have these many years believed that they can not operate except on a certified basis. The same is true abroad, having been earlier learned; while the required standards of municipal auditing in at least one other country, namely, England, are fully up to those of general business.

As I write these words I take down for proof two volumes from the library shelves. One is an annual report for 1933 of the city of Manchester, England. It is a book of 827 pages of text and figures, accompanied by 45 pages of a seven-column subject index. Manchester is a city of 766,000 people; its balance-sheet foots for 81 millions of pounds sterling; independent auditors report the results of their work in considerable detail and with a most comprehensive program; yearly they are paid a fee of 1,250 pounds sterling.

A second report is that of the city and county of Canterbury for 1934. The population is 25,000; in a 204 page document it is stated that a mayor's auditor is employed in addition to two city auditors; revenues and expenditures are thoroughly listed and summarized; the balance-sheet foots for 255,000 pounds sterling; the audit fee is 42 pounds sterling—in our money \$210 a year.

I speak of these two fiscal documents, claiming that few American cities, large or small, present as much detail. Also I know of no large American municipality which publishes so complete a report as that of Manchester or pays as much of an annual audit fee as \$6,250. As to the Canterbury report, it is fairly comparable, both in scope and as to the fee paid, to a few, a very few, of our American annual reports. But the point is that of the whole number of our municipalities, probably not one out of four is regularly audited; while the publication of an audit certificate occurs perhaps not more than once in any twenty different reports.

Now as to the matter of scope and method in audit work, let me make one or two general observations. An audit should be penetrating, should dig deeply, but not be of itself, at least in the first instance, a graft hunt. The original line has to be drawn just short of a search for favoritism or underground and underworld connivings; for collusion, when it exists, is usually too subtle a thing for detection by ordinary accounting methods. Unhappily a treasurer and one comptroller's office boy in cahoots may be able to wreck any ship of state.

There is, however, one side of all accounts to which first the mind and then the fingers of the wrong-doer are inevitably addressed, namely, the receipts. Comparatively little money is directly stolen on the disbursement side. A reason is that the controls are better; vouchers and payrolls do at times contain fictions and maintenance charges do get padded, but disbursement records have budget control and official approvals, and bank cheques are grim witnesses, even if silent ones. This leaves the whole range of receipts or of mis-stated assets as a preferred field for criminal exercises.

I have listed from exactly a half dozen reports which tell of representative irregularities, as filed in the Albany bureau of municipal accounts, twenty different methods used by dishonest officers and clerks. This is the list of the particulars:

(1) They altered items of cheques, as reported in monthly bank statements, and forged changes in the balances shown at the beginning and end of months.

(2) They diverted for a time sums of state and county inward remittances, as well as incoming sums of capital and trust funds.

(3) They withheld credits for advance tax collections, year by year, substituting current tax receipts at later dates.

(4) This required the misappropriation of current taxes (and incidental special assessments) corresponding in the aggregate, taken from each succeeding fiscal year.

(5) Water rates were also taken, so completing a vicious circle of shortage by the end of each of several fiscal years.

(6) Trust securities were pledged in personal loans.

(7) Trust securities were sold outright in the open market.

(8) Funded debt was overissued with forged evidences of authorization.

(9) Petty cash was taken, without voucher or immediate entry, while complacent, wondering clerks looked on.

(10) Proceeds of tax sales were stolen, the cheques being substituted for other currency receipts en route to banks.

(11) A fictitious loan was secured at a bank in which a county had no other account; cheques for instalments received on the loan went into an individual pocket long enough to be substituted for legitimate currency receipts thus diverted to the same pocket.

(12) Licence moneys were taken.

(13) Court fines were taken.

(14) Street permit collections, the same.

- (15) Sinking-fund mortgage interest, the same.
- (16) Rents from municipally owned houses, the same.
- (17) Interest on certificates of deposit, the same.
- (18) Filing fees were diverted.
- (19) The proceeds of merchandise sales were stolen.
- (20) Probably the coolest act anywhere, by any of the six embezzlers, was the appropriation of a dividend on a compensation insurance policy.

What should the remedy be? What price safety? I offer a ten-point program, a sort of municipal auditing decalogue. I do not claim for it that it will stop all crime, but I confidently assert that its provisions, joined to a forceful plan of applying ordinary checks and balances, will stop much of crookedness. If I do not especially provide for one important feature, that of running down all cases of minor infractions of charter provisions and statutes, it is because this must be the work of public examiners, not of professional accountants. And in a final recommendation I shall argue for more organization in state bureaus and for larger personnel.

Now in general terms of showing a great need, here are the ten commandments:

(1) Beware the office in which the books are not regularly written up and balanced, including precise controls of open taxes and assessments. Let a good old bank principle be everlastingly enforced: balance the day's business or stay until you do. And the same as to monthly trial balances of all descriptions.

(2) Dig into the reasons for arrears of underlying clerical work. Too often trouble lurks beneath the surface of piled up months of unreconciled bank accounts and uncanceled coupons.

(3) Insist on a policy of having and exhibiting live inventories of public property and supplies. Goods are as valuable as cash and are more easily misappropriated. Moreover the custodian should be an officer of rank and responsibility.

(4) Get at true costs of utilities operations. It is as important municipally as under private ownership, or more so.

(5) Do not let a vast set of records of revenues be run without a credit voucher for each item of incoming money, and demand that those vouchers bear serial machine numbers.

(6) See that units of tax bills, as rendered, have arrears charged in as well as current amounts due. It is the only sound practice of modern days.

(7) As in commercial affairs, confirm a reasonable number of receivables, including open taxes, assessments and other capital balances. It may not be practicable to confirm every detail, but postage stamps often prove a wonderful investment at two dollars per hundred.

(8) Lay down the law that in no office shall any person whose duty it is to handle money also do bookkeeping, making (or having a chance to unmake) ledger entries—and vice versa as to a bookkeeper in a cashier's cage, even to help out at the lunch hour. A commandment, perhaps the most fundamental of all business is: Thou shalt not invite to steal.

(9) Fight for one principle of comptroller's office administration: let at least one third of the staff be delegated to the auditing of other departments. The ratio existing almost everywhere is about six bookkeepers and clerks to one traveling auditor. Let not the general books suffer, but forever keep watch on every spot where money and supplies are handled.

(10) Audit frequently. Annual visits are not enough. Quarterly or monthly check-ups are needful to throw the fear of the Lord into wrong-doers. Go to the task frequently but go to it at irregular intervals. No audit is ever equal to the "surprise" audit.

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Briefly now, how long must it be before public control and investigation of municipal facts and figures everywhere shall be with adequate man power, as in banking and insurance departments and with pro rata assessments for the cost of the work?

In a great state like Michigan only a part of the field can be covered because of a staff limited to eleven examiners. Again, as to some even larger states, it is pitiful to own that Pennsylvania examines only into revenues collected by mayors, aldermen and justices of the peace, while in Illinois subdivisions of government have no bureau of control whatever. Against which be it remembered that the subject is at last stirring in several adjacent commonwealths, with plans for bureaus—inchoate but promising—in Connecticut, Vermont and Maryland.

Just a word of bibliography. On the side of technical authorities let me mention as exceedingly worth while:

As a manual of facts and live data, *State Conference Publication No. 28*, Mr. Lafferty's thesis on "The Auditing of Municipal Accounts"; then for a complete program, the New Jersey man-

ual of *Requirements of Audit*; and, for a most useful classification of accounts, that of the city of Buffalo.

Finally let us look forward to that desired day when state supervision shall be what is needed; let a hope be expressed, for example, that Comptroller Tremaine may soon have at least 122 instead of 22 examiners. Until then, although not to talk shop, is it too much to suggest that one fixed expenditure be inserted in every municipal budget, namely, a sum to cover the cost of a professional audit? Canterbury in England is so served, and at a rate equal to less than \$20 a month. At rates not greatly different every American municipality of 25,000 people might be served, and larger and smaller places in degree. Under today's ten-point program, hardly otherwise, this could and should be accomplished.