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Bank confirmations

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Bank Confirmations

AMONG the oldest of many devices employed by public accountants as a means of obtaining independent verification of facts and figures is that of writing to banks for confirmation of balances. The measure is based on the theory that the information over the signature of a bank official is more reliable than that obtained from a pass book or monthly statement. It puts the responsibility for the certification on some official rather than on a clerk or bookkeeper. It provides the accountant with evidence which he may file away with his working papers in support of his cash figures.

An outline of the historical development of the present day form would probably show that so effective was the original device in confirming the balance itself, that other matters, such as interest on balances and indebtednesses on indorsements, were added.

The cooperation of the bankers in these matters has been splendid. In the face of an ever increasing flood of requests they have generally responded promptly and gladly. They have hesitated only with regard to interest, particularly when the request covered interest for a long period rather than the last interest credited.

Because of irregularities effected through the manipulation of interest, the wording of requests to banks has from time to time been made more specific and the corresponding demands upon banks who comply more exacting.

Having in mind the irritation which such procedure may cause to bankers, we have decided to abandon the practice of asking for confirmations of interest except where the circumstances surrounding a particular case denote the necessity of so doing.

In the reprinting of Form 128, the lines now reading "The last interest credit or payment prior to .... was $...... on .... " will be omitted and in the meantime ruled out on old forms. It will then be incumbent upon everyone who has occasion to audit cash to exercise thoroughness with regard to interest on bank balances in seeing, where the daily balance is of sufficient size to carry interest, that such interest is included in the accounts.

The accountant is on notice to look for interest on bank balances. He is not expected to calculate and verify the amount of the interest, but he should be able to get a general line on the amount of the interest by a glance at the balances carried. It is the rule rather than the exception that interest is credited on daily balances. The minimum amount which must be kept on deposit varies in different localities, but in many instances is fixed at a thousand dollars. If the accountant finds no interest credited he is charged with the duty of making inquiry. Depending upon the result he may or may not be led on to investigation. Large daily balances create the presumption of interest. The absence of any interest credit, or marked fluctuations in the amounts of credits, call for investigation which naturally leads to the bank. Such are some of the circumstances surrounding a particular case which may call for an inquiry addressed to a bank.

There have been cases in the experience of the firm where a request to a bank for confirmation of interest credited would not have resulted in a satisfactory reply had the request met with answer to the question as stated literally, for the reason that the banks in question either through regular practice or in accordance with specific arrangement paid the interest by means of a bank check instead of crediting the depositors' accounts. In some of these instances, irregularities occurred through employes of clients who collected the interest and deposited the checks in personal accounts in other banks.

The abandonment of the practice of asking banks to confirm interest allowed on balances calls for maximum alertness and thoroughness on the part of accountants in this as well as all other matters affecting cash. The auditor is matched against all kinds of clever individuals who handle cash and make the records thereof. The task of formulating rules which will automatically discover all the means for accomplishing or covering up irregularities which the human mind through ingenuity or force of necessity can devise, is hopeless. The auditor must depend not only on his knowledge of business methods and bookkeeping routine, but upon his mental alertness; sometimes on instinct.

Reading the Minutes

THE operation of reading the minutes during the course of an audit is not intended to be a pastime or diversion. It has as its object the serious purpose of seeking information which may have bearing on the financial operations and accounting of the organization in question. The word "minutes" is an all-inclusive term, and covers not only those of the stockholders and directors, but also those of the executive committee and any other standing or special committees, the work of which is in any way related to the financial operations or policies of the organization. The minutes record the action of the company's legislative bodies, so to speak, and in effect become the laws governing the conduct of the organization. The minutes of the executive committee are, as a rule, the most voluminous, since that committee is the active force behind the company's operations. The actions of the executive committee are usually subject to adoption by the directors, while many of the acts of directors require ratification by stockholders in order to become effective.

Minutes frequently disclose conditions, stipulations, authorizations, or restrictions, which have a direct bearing on the accounting, and to which attention is not always given by company employes in the accounting. The reading of the minutes frequently brings to the attention of the public accountant moot questions of which otherwise he would be ignorant. These questions are becoming more and more frequent, and the prospect is that they will increase in number with the introduction of laws regulating the issue of stock without par value, both common and preferred, in various states.

One of these questions, relating to dividends, came to light recently. The moot question involved the necessity, from an accounting point of view, of showing on the balance sheet as a liability, the unpaid cumulative dividend on preferred stock. This question arises more or less periodically, but it appears that there should be no particular difficulty in deciding it. Dividends become a liability when declared and not until then. The only right which a stockholder holding preferred shares with a cumulative provision has, is that of receiving from the corporation, before any dividends are paid to common stockholders, the full amount of the dividend accumulated. It naturally follows, therefore, that if the stockholder has no right, the corporation has no obligation to pay dividends, even under the provision of accumulation, until such dividends have been declared by the directors. It seems important, as a matter of information, that some reference should be made on the balance sheet to the percentage of cumulative dividend preference. This is usually accomplished by a footnote setting forth the facts relating