

AUDIT PROCEDURE

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A PRESENTATION OF AUDITING PRINCIPLES BASED ON  
CASES CONTAINED IN THE FILES OF THE BASKERVILLE AUDIT COMPANY

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A Thesis  
Presented to the School of Commerce  
University of Southern California

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In partial fulfillment  
of the  
Requirements for the  
Degree of Master of Business Administration

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by  
Doras S. Jeppson

April 2, 1925

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*This thesis, having been approved by the special Faculty Committee, is accepted by the Council on Graduate Study and Research of the University of Southern California, in partial fulfillment of the requirements for the degree of Master of Business Administration.*

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*Huron Clark*

Secretary

*R. A. Hunt*

Dean

Date June, 1925

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## Chapter I

### INTRODUCTION

Very few individual cases embody all the many principles affecting the subject of auditing. The ramifications of such a subject are too many and varied to expect any one case to illustrate all the principles involved. As in legal cases, there are a comparatively few special points to be covered in any one case and these are covered quite thoroughly with only general reference to other accounting and auditing principles. The present problem, therefore, involves not only a presentation of the principles actually dealt with in a particular case or cases, but in order to be fairly complete and comprehensive must include illustrations of important auditing principles not dealt with in the particular cases cited in this thesis.

During the survey of the many cases available constant attention was given to the requirements that a particular case must fill and every effort was made to select a case that would illustrate the greatest number of important everyday principles. It is believed that the case selected as the basis for this work is a very substantial one in this respect.

Certain features not illustrated by the cases selected have been included for the reason noted above. Among the more important of these is the inclusion of certain exhibits and schedules in Part IV. These were included for the purpose of presenting more of the various forms of reports made to clients. So many audit reports are incomplete in this feature that particular stress has been put upon this part of

the presentation. Most auditors are very familiar with the cases they have worked upon but may fail to point out to the client a proper presentation of the information gathered. The client engages the auditor to survey the situation and report his findings, not by a brief statement that everything is right or that certain features have been handled wrongly, but to submit a comprehensive and understandable report concerning all features bearing upon the situation. A review of numerous audit reports from all parts of the country reveals the fact that a large percentage are either incomplete or so technical that the average business man would be unable to understand them. Therefore, wherever it was thought advisable to include additional information this was done by using illustrations from other actual cases.

During the course of an audit complete notes are kept of the work done and features noted by the auditor. In the report to the client much of the information so gathered is made a part thereof in much the same form as it appears in the working notes. In the present work, certain details have been outlined for the working notes, (Part III) in order that a duplication would not be effected when the report to the client (Part IV) was compiled. Such omissions do not materially affect the proper presentations of the necessary complete and correct form of working notes.

The concern whose records form the basis of the case hereinafter presented is a Corporation engaged primarily in the selling of truck tires. They handle the product of a large Eastern manufacturer whose goods are nationally advertised and have a wide distribution. The concern buys direct from the factory branch which is located in

Los Angeles. The bulk of the sales are made to various trucking and automobile transportation companies as well as to individual truck owners. The concern emphasizes the rendering of genuine service as its officers believe that through service alone success in a large measure will result.

In addition to the sale of truck tires the concern maintains an electrical department where the batteries of electrically propelled trucks are re-charged and repaired. This department was installed primarily for the purpose of building up the sales of tires and incidentally to reduce overhead expenses of the concern as a whole.

Throughout the remainder of this presentation the concern will be spoken of as the "Tire Service Corporation". It is obvious why it is necessary to use a fictitious name when the exact figures and other data are as found in the files. Wherever a name or account title was found that would identify the firm, changes were made. Little change, however, was made in the method of procedure or calculations as shown by the files.

## Chapter II

### SURVEY OF WORK TO BE DONE AND OUTLINE OF AUDIT

#### INFORMATION DESIRED BY CLIENT.

During the first conference with the manager and the accountant it was determined that the audit to be made should be confined to a Balance Sheet audit with such checkings, verifications and analyses of the detail contained in the records as would permit the compilation of a correct Balance Sheet and Income Statement as of the close of the fiscal year, October 31, 1924. Also the compilation of adjusting and closing Journal Entries in such form as would enable the bookkeeper to bring the books into conformity with the report submitted.

In a general way it was decided that what ever revisions in the accounting system were deemed to be necessary should be taken up and submitted in written form.

The information to be compiled was to be used in making up the Income Tax Return for the fiscal year ended October 31, 1924.

#### OUTLINE OF AUDIT

The general books used by the firm are:

1. Combination Cash Book and Journal
2. General Ledger
3. Subsidiary Accounts Receivable Ledger
4. Stock Ledger

No uniform classification of accounts is used.



The general procedure followed was:

- a. Take-off Trial Balance on columnar working paper
- b. Reconciliation of Bank balances and verification of footings and postings of monthly Cash receipts and disbursements; in other words, a proper verification of Cash transactions must be made.
- c. Check the Trial Balance of Accounts Receivable to the individual accounts and determine the total of Accounts Receivable that are over ninety days old. Check postings from books of original entry for one month. Examine all Journal Entries affecting the control account.
- d. Obtain a copy of merchandise inventory signed by an officer of the corporation. Determine whether the items on the inventory were priced at cost, market or cost, or market, which ever was lower. Make test checkings as to pricing and reasonableness of quantities.
- e. Verify personal account balances by checking postings to same and direct communication with persons named.
- f. Examine actual securities as shown by the books.
- g. Analyze Fixed Asset Accounts and determine correctness of entries therein.
- h. Make a complete and careful analysis of merchandise account, distinguishing between Purchases, Sales, Purchase Returns and Allowances, Sales Returns and Allowances and any other entries thereto.
- i. Analyze Interest and Discount account in such a manner as will furnish necessary information for Income Tax Return.

- j. Determine nature of Suspense Account and treat same in correct manner.
- k. Analyze Salaries account, distinguishing between Officers' Salaries and others.
- l. Check monthly postings to all expense accounts and prove footings of same. Examine as to reasonableness.
- m. Check trial Balance of Accounts Payable to individual accounts and verify by otherwise made test checkings at different periods throughout the year. Examine thoroughly, all Journal Entries affecting this account.
- n. Analyze Capital Stock account. Trace any entries affecting same during year and verify balance as shown by reference to Capital Stock Ledger.
- o. Make an analysis of Surplus and Undivided Profits account in the manner most suitable for compilation of Income Tax Return.
- p. Determine nature of Electric Shop Account and make such analysis as will be necessary.
- q. Verify balance in Lease Account.

## Chapter III

## WORKING NOTES

Trial Balance per Books  
October 31, 1924  
As Submitted by the Bookkeeper

Accounts Receivable	31 486 96	
Accounts Payable		16 243 48
Capital Stock Issued		13 602 00
John Smith	220 90	
Henry James	1 060 43	
Electric Shop	1 974 77	
H. H. Wilson	50 00	
Stocks and Bonds	2 300 00	
Auto Account	1 170 70	
Furniture and Fixtures	5 032 16	
Merchandise Account		35 872 07
Interest and Discount		451 01
Auto Expense	1 487 61	
Office Expense	607 97	
General Expense	9 231 69	
Lease	618 50	
Rent	2 500 00	
Suspense Account	1 662 92	
Telephone and Telegraph	553 41	
Traveling	512 40	
Salaries	19 984 97	
Surplus and Undivided Profits		16 734 13
Cash	2 447 30	
	<u>82 902 69</u>	<u>82 902 69</u>

## CASH RECONCILIATION

October 31, 1924

Cash on Hand November 6, 1924:

Checks drawn by:		
J. J. Schnider	58 69	
R. E. Watson & Co.	26 40	
Rapid Transportation Co.	314 11	
Reliable Truck Co.	168 50	
McCarthy Transfer Co.	78 23	
	<hr/>	645 93
Cash for Deposit:		
2 ten dollar bills	20 00	
4 five dollar bills	20 00	
	<hr/>	40 00
Petty Cash on Hand		7 90
Petty Cash Vouchers not entered on books		12 64
		<hr/>
		706 47
Cash Receipts per Cash Books and Deposit Slips		4 697 32
		<hr/>
Total Cash November 1 to November 6 accounted for		5 403 79
Cash Disbursements per Check Record 11/1 to 11/6		4 550 67
		<hr/>
Cash on Hand November 1, 1924		853 12
Los Angeles National Bank (see Bank Reconciliation)		614 40
Southern California National Bank (see Bank Reconciliation)		979 78
		<hr/>
		2 447 30
		<hr/> <hr/>

BANK RECONCILIATION  
as at October 31, 1924

Los Angeles National Bank

Balance per Bank Statement	622 00	
Deduct: outstanding cheques as follows:		
Cheque Number 1000	2 50	
" " 1001	1 85	
" " 1012	1 25	
" " 1026	2 00	
	<u>7 60</u>	
		614 40
		<u><u>614 40</u></u>
Balance per Books	691 40	
Deduct: cheques returned by bank which have not been credited on books, same awaiting re-deposit		
	77 00	
	<u>77 00</u>	
Balance as above		614 40
		<u><u>614 40</u></u>

Southern California National Bank

Balance per Bank Statement	1 995 23	
Deduct: outstanding cheques as follows:		
Cheque Number 744	8 37	
" " 746	158 33	
" " 750	100 00	
" " 754	100 00	
" " 756	87 50	

Cheque number	760	87 50
" "	761	87 50
" "	762	43 75
" "	763	75 00
" "	764	60 00
" "	765	75 00
" "	766	45 00
" "	767	87 50

1 015 45

979 78

Balance per Books

1 006 73

Deduct: cheques returned by bank which  
 have not been credited on books,  
 same awaiting re-deposit

26 98

979 75

Add: difference in amount for cheque  
 number 725 (salaries)

03

Balance as above

979 78

## NOTES ON CASH BOOK CHECKINGS

Cash Receipts record monthly totals for the months of November, 1923, January, 1924, May, 1924 and October, 1924, were verified and found to be correct. It was also found that all Cash Receipts were either deposited in Bank or represented by Petty Cash vouchers. Journal Entries placing Petty Cash disbursements on the books were verified by checking same to Petty Cash Vouchers. All deposits as shown by the books were checked to duplicate deposit slips. The total deposits for the year plus the amounts expended as Petty Cash agreed with total of Cash Receipts.

Canceled cheques were checked to the cheque record for the entire year and said record was found to be correct. Cheques outstanding at October 31, 1924, are as indicated in the bank reconciliations.

## NOTES ON ACCOUNTS RECEIVABLE

The bookkeeper submitted a list of Accounts Receivable as of October 31, 1924. This list was checked to the accounts Receivable ledger and found to be in agreement with same. The total of the balances as shown by the Accounts Receivable ledger was found to be identical with the balance as shown by the control account. There were no accounts over ninety days old.

An examination of the control account disclosed the fact that a journal entry had been posted thereto in the amount of \$1277.38 crediting Accounts Receivable and debiting the Suspense Account. Said Journal Entry was dated October 31, 1924. Upon further examination it was found that \$1,277.38 of the Accounts Receivable had been considered as doubtful

and this amount had been taken out of the accounts Receivable and set up in the Suspense Account. After a conference with the bookkeeper and the officer of the Corporation who had charge of collections, it was agreed that the above amount should be set up as a Reserve for Bad Debts (see adjustment 1 and 2 on working sheet).

Letters of verification were mailed to each customer from whom there was a balance due requesting a verification of the amounts as shown by the company's records. A sufficient number of answers were received to assume that the balance as shown by the books is correct.

#### NOTES ON MERCHANDISE INVENTORY

A copy of Merchandise Inventory as of October 31, 1924, was furnished, same being signed by the persons taking the inventory and certified to by the Secretary and Treasurer of the Corporation. Said inventory was priced at cost or market, whichever is lower. Test checkings were made to the invoices in order to establish the accuracy of the pricing as shown.

A signed copy of the Merchandise Inventory as of October 31, 1923, was cited and the total as shown was checked to the record of same.

The Merchandise Inventory as of October 31, 1924, was \$15,691.35. The beginning inventory was \$16,106.90, see Adjustment No. 28 on the working sheet.

#### NOTES ON PERSONAL ACCOUNTS RECEIVABLE

An analysis of the three personal accounts as shown by the general ledger disclosed the fact that all entries to same were in regular order. The balances due the corporation from these individuals are less than one



month old and a conference with the individuals named, verified the correctness of the balances due.

John Smith and Henry Jones are officers of the Corporation and H. B. Wilson is office manager.

#### NOTES ON STOCKS AND BONDS

The balance in the Stocks and Bonds Account of \$2,300.00 is made up of \$500.00 in stock of the Rapid Transportation Company, Certificate No. 83 for five shares of Common Stock par value \$100.00 was cited. The balance of \$1800.00 is represented by a receipt signed by the Fiscal Agent of the Tupman Sand and Gravel Company. This receipt is evidence of payment by the Tire Service Company of \$1800.00 for eighteen shares of stock of the Tupman Sand and Gravel Company. According to a statement by the Secretary and Treasurer of the company the certificate of stock would be received within a few days.

#### NOTES RE FURNITURE AND FIXTURES ACCOUNT

The footings of the Furniture and Fixtures Account as shown by the general ledger was checked and found to be correct. On analyzing the account it was found to contain \$5,128.69 which represented payments on Tools and General Shop Equipment. Also it was discovered that prepaid rent amounting to \$150.00 had been charged to this account (see adjustments 3 and 4 on working sheet). It was further discovered that depreciations amounting to \$1254.28 for the year 1923 had been written off the asset account (see adjustment No. 5 on working sheet). Upon investigation it was found that of the depreciation written off, approximately

\$1200.00 applied to Tool and General Shop Equipment and \$54.28 to Furniture and Fixture proper.

Depreciation for the year ended October 31, 1924, was calculated on the balance of \$1007.75 remaining in this account at ten per cent. (see adjustment No. 6 on working sheet).

Depreciation on Tools and General Shop Equipment was calculated at twenty per cent. for the year ended October 31, 1924. (See adjustment No. 7 on working sheet.)

Request was made for a list of the items included in this account. This list was compiled by the bookkeeper and checked by the auditor to the individual items. Pricings were checked to the invoices and found to be correct.

#### NOTES RE MERCHANDISE ACCOUNT

Footings and postings to this account were checked and found to be correct. A further scrutiny of the account disclosed the fact that it contained all merchandise transactions for the year. On analyzing the account it was found that sales for the year totaled \$162,659.71 (see adjustment No. 8 on working sheet); purchases totaled \$115,717.86 (see adjustment No. 9 on the working sheet); sales returns and allowances amounted to \$2,234.97 (see adjustment No. 10 on the working sheet); purchases returns and allowances totaled \$7,272.09 (see adjustment No. 11 on the working sheet). The totals of the above figures are equal to the totals as shown by the merchandise account, exclusive of the beginning inventory (see adjustment No. 12 on the working sheet).

## NOTES RE INTEREST AND DISCOUNT ACCOUNT

This account was analyzed and found to contain discounts received, discounts allowed and interest paid. The totals of these items were as follows: discounts received, \$1,919.31; discounts allowed, \$1,128.93, and interest paid, \$339.37 (see adjustments numbered 13, 14, and 15 on the working sheet). Postings to this account were checked from the books of original entry and found to be as indicated above. Test checkings were made to determine if the entries in the books of original entry were substantially correct. The result indicated that all entries were regular.

## NOTES RE SUSPENSE ACCOUNT

Checking the footings and postings to this account revealed the fact that it contained, besides the accounts receivable written off in 1924 (see adjustment No. 2), the accounts receivable written off during the fiscal year 1923 (see adjustment No. 16 on the working sheet). Also, cash received in 1924 on accounts written off in 1923 was contained in this account (see adjustment No. 17 on the working sheet). The balance of the accounts written off during 1923 were uncollectible and as profit and loss had already been charged with the full amount and the current year's profit and loss credited with the income on these accounts, so as to conform to the proper Income Tax practice, no further adjustments need be made.

## NOTES RE ELECTRIC SHOP ACCOUNT

On making an analysis of this account it was found that, because the officers had desired to keep the revenues of the electric shop

separate from the revenue from merchandise sales and the expenses of this department also separate, this account contained all transactions affecting the electric shop. Page twenty-one of the working notes gives the results of the analysis made. Adjustments numbered 18, 19 and 20 on the working sheet, gives the summary analysis required to close this account and set up the proper accounts. It is to be noted that the balance at the beginning of the year of \$604.72 is closed out of this account and charged to profit and loss of prior years. Upon further analysis it was discovered that the account contained machinery payments amounting to \$2,250.00 made during 1923 (see adjustment No. 21 on the working sheet). No depreciation has been calculated on the electric shop equipment. After due consideration it was decided to calculate depreciation on this equipment at twenty per cent. on cost. It appears that this rate is the most equitable and one that will be allowed by the Internal Revenue Department for Income Tax purposes (see adjustment No. 22 on the working sheet). The list of items compiled by the bookkeeper was checked to the physical objects and found to be correct. Installation charges were verified by statements and cancelled checks. Invoices covering the larger amounts were checked to the inventory prices of same.

## ANALYSIS OF ELECTRIC SHOP ACCOUNT

AS OF OCTOBER 31, 1924

Salaries	Equipment	Power and Water	Rent	Miscell- aneous	Repairs	Interest
37 45	950 00	167 62	100 00	1 30	18 00	18 52
4 00	175 00	10 60	100 00	5 51	106 15	19 70
84 00	158 37	199 15	100 00	7 22	129 98	21 94
4 00	175 00	8 58	100 00	3 00	99 36	5 30
84 00	175 00	166 41	100 00	7 50	44 38	22 26
4 00	158 38	6 75	100 00	4 62	7 65	20 14
8 00	635 65	142 79	100 00	1 44	35 81	
87 50	158 33	8 85	100 00	3 16	46 10	
4 00	175 00	104 76	100 00	3 14	26 30	
8 00	158 33	3 80	100 00	25	25 24	
96 50	185 00	112 75	100 00		7 04	
4 00	158 33	7 50	100 00		12 35	
12 10	158 33	122 37			5 70	
77 50	158 33	3 75			32 74	
4 00	158 33	133 13			10 56	
87 50	158 33	7 45			54 21	
4 00	16 94	103 94			7 35	
4 00	158 33	3 50			15 04	
4 00	158 33	125 41				
4 00	158 33	9 66				
4 00		124 40				
87 50		4 16				
87 50		146 13				

Salaries	Equipment	Power and Water	Rent	Miscellaneous	Repairs	Interest
8 00		8 00				
87 50						
8 00						
87 50						
4 00						
8 00						
87 50						
87 50						
8 00						
87 50						
4 00						
87 50						
12 00						
87 50						
12 00						
8 00						
87 50						
87 50						
8 00						
87 50						
4 00						
4 00						
87 50						
4 00						
87 50						

Salaries	Equipment	Power and Water	Rent	Miscellaneous	Repairs	Interest
8 00						
4 00						
87 50						
4 00						
4 00						
4 00						
87 50						
8 00						
87 50						
87 50						
6 00						
<b>2 331 45</b>	<b>4 387 64</b>	<b>1 731 46</b>	<b>1 200 00</b>	<b>37 14</b>	<b>683 96</b>	<b>107 86</b>

## NOTES ON GENERAL SALARIES ACCOUNT

All salaries with the exception of those paid to employees working in the electric shop were charged to this account. The clerical accuracy of the account was verified and all monthly postings from books of original entry checked and found to be correct. Test checkings of payments on payrolls were made to determine the sufficiency of same. No payments were found to have been made that were not in regular order. An analysis of the account showed that of the total salaries paid, \$4,800.00 was to officers. John Smith and Henry Jones each received \$2400.00 during the year as salaries for their services (see adjustment No. 23). Any further analysis of this account would require more time than it was considered justifiable to use. Sufficient verifications were made, as stated above, to give reasonable assurance that the total amount paid as salaries is correctly stated by the account. Ordinarily it is desirable to have a greater analysis of salaries but the time required to make such an analysis did not seem to justify the result to be obtained.



ANALYSIS OF GENERAL EXPENSE ACCOUNT  
 FISCAL YEAR FOR  
 FISCAL YEAR ENDED OCTOBER 31, 1924

Insurance	Taxes	Heat, Light Water	Advertis- ing	Donations	Travel- ing	Income Tax	Office Expense	Gen. Shop Equipment	Interest
96 36	15 75	17 26	306 60	8 57	14 20	770 47	16 05	243 15	9 53
43 13	20 00	11 26	12 00	25 00		770 47			
14 31	27 00	22 66	71 64	30 00		770 47			
16 31	818 31	28 55	62 00	50 00					
10 50	104 00	28 20	22 36						
13 31	35 00	23 88	8 29						
131 26		21 38	124 00						
14 31		24 27	60 81						
14 31		1 20	3 20						
6 29		23 32	8 90						
14 31		19 49	56 00						
93 10		13 02	126 26						
7 13		12 68	40 00						
47 74		14 28	12 00						
14 31			45 00						
10 06			14 00						
22 60			12 00						
60 00			4 65						
14 31			40 25						
			15 40						
			20 00						
			69 30						
			7 50						
			8 15						
			108 78						
			748 44						
			29 68						
			168 00						
			6 00						
			10 20						
			55 21						
			12 00						
			40 00						
			7 50						
			53 00						
			20 00						
			6 00						
<b>332 54</b>	<b>820 06</b>	<b>261 41</b>	<b>2 415 11</b>	<b>113 57</b>	<b>14 20</b>	<b>2 311 41</b>	<b>16 05</b>	<b>243 15</b>	<b>9 53</b>

## NOTES ON EXPENSE ACCOUNTS

Auto Expense. Monthly postings to this account were checked and the balance verified. Test checkings of the larger payments made for auto expense were made. In each case the cancelled check was examined together with the detailed statement for which it was made as payment. No irregular entries were found to have been made to this account.

Office Expense. Treatment similar to that made for the auto expense account as above was made for this account. All entries were apparently made in regular order.

General Expense. It was found that all expenses except those found under other classifications on the trial balance were charged to this account. It was, therefore, necessary to make a detailed analysis of this account. The results of this analysis are given on page twenty-one of the working notes. Payments of income tax for year 1923 had been charged to this account and as this is an unallowable deduction, same was charged to surplus. Monthly postings to this account were checked and the clerical accuracy of the balance shown verified. In making the analysis shown on page twenty-one of the working notes, test checkings were also made to cancelled checks and invoices in order to determine whether amounts charged were regular. It was found that all entries were regular and properly chargeable. Adjustment No. 24, on working sheet, sets up the proper charges and credits as shown by the analysis of this account.

Rent. The balance in this account is the total rent paid less the rent charged to the Electric Shop. Monthly entries were verified and the various leases examined to determine if all entries were regular.

Telephone and Telegraph. Monthly entries were checked and the balance verified. Test checkings were made to paid bills and cancelled checks and the amounts examined were found to be regular.

Traveling. Same verification as for above (Telephone and Telegraph).

#### NOTES ON LEASE ACCOUNT

The examination of the leases re Rent account, disclosed the fact that prepaid rent had been charged to the Lease account. As none of the leases had expired, it was found that the balance as shown was in regular order. Prepaid rent on buildings occupied in Los Angeles amounted to \$618.50 and on building occupied in Pomona, \$150.00, had been paid in advance for rent.

#### NOTES ON ACCOUNTS PAYABLE

The trial balance of accounts payable submitted by the bookkeeper was checked to the accounts payable ledger and found to be in agreement. The total of the ledger balances agreed with the balance as shown by the control account. Correspondence files were examined as well as the minutes and the unpaid bill files but no information was found that indicated that the accounts payable ledger was incomplete. Letters of verification were mailed direct to all names shown on the ledger and answers to over seventy-five per cent. were received. In each instance the ledger account balances were confirmed. An analysis of the accounts payable gave the following information:

TRADE	\$14,633.73
MISCELLANEOUS	1,609.75

Accounts payable are all paid by the tenth of each month and discounts taken in all cases where allowed.

#### NOTES ON CAPITAL STOCK ISSUED

There were no entries to this account during the year. The stock certificate book and stock ledger were examined and found to agree with the items and balance in this account. All stock issued is held by the officers of the corporation as follows: John Smith, eighty-one shares; Henry Jones, fifty-four shares; Joe Doe, two shares; all shares being of a par value of \$100.00 each.

#### NOTES ON SURPLUS ACCOUNT

No entries had been made to surplus account during the year except for dividends paid. The balance in this account at the beginning of the year was accepted, adjustments being made thereto as noted elsewhere in the working notes. Dividends paid during the year amounted to \$5440.80. This amount was verified by reference to the minutes and cancelled checks.

#### NOTES ON AUTO ACCOUNT

Footings and postings were verified. Depreciation for the year 1923 had been credited to the account instead of setting up a reserve account (see adjustment No. 25). The balance after adjustment represents the cost price of two autos and trailers. The actual assets were cited and ownership of same verified. Depreciation for the year ended October 31, 1924, was computed at twenty-five per cent. on the average

balance in the account during the year and amounted to \$362.13 (see adjustment No. 26).

#### GENERAL NOTES ON ADJUSTMENTS

It was found that of the total amount paid for insurance, \$158.13 was unexpired (see adjustment No. 27). Insurance policies were examined and found to be in regular order.

It was later discovered that \$245.00 of the balance of \$2250. credited to Profit and Loss should not have been made. Adjustment No. 30 brings these accounts to their true balances.

Only three-fourths of the income tax payable for 1923 had been paid, viz. \$2311.41, leaving \$770.47 yet to be paid. The books did not include this liability, therefore, adjustment No. 31. Adjustment No. 37 sets up the estimated tax liability for the year 1924 as computed from the net profit shown on the working sheet.

An examination of the previous year's income tax return disclosed the fact that no depreciation had been taken on Electric shop equipment. Calculation of this was made and set up as per adjustment No. 33.

THE SERVICE CORPORATION - WORKING SHEET  
OCTOBER 31, 1924

Name of Account	Trial Balance October 31, 1924		Adjustments		Trial Balance After Adjustments		Profit and Loss Electric Shop		Profit and Loss General		Assets and Liabilities	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	2 447 20				2 447 20				2 447 20		2 447 20	
Accounts Receivable	31 485 96	(2)	1 877 38		32 794 34				32 794 34			
John Smith	220 90				220 90				220 90			
Henry James	1 060 43				1 060 43				1 060 43			
E. H. Wilson	80 00				80 00				80 00			
Stocks and Bonds	2 800 00				2 800 00				2 800 00			
Auto Account	1 170 70	(25)	328 81		1 499 51				1 499 51			
Furniture and Fixtures	6 032 14	(5)	1 254 28	(4)	1 007 75	(4)	150 00		1 007 75			
				(3)	8 128 69	(3)	8 128 69					
Electric Shop	1 274 77	(14)	9 109 46	(20)	9 604 72	(20)	9 604 72					
				(19)	10 479 51	(19)	10 479 51					
Lease	618 80	(4)	180 00		768 80				768 80			
Suspense Account	1 642 92	(17)	335 80	(15)	819 34	(15)	819 34					
Accounts Payable		16 243 56				16 243 56					16 243 56	
Capital Stock		13 602 00				13 602 00					13 602 00	
Surplus and Undivided Profits		16 734 13				16 734 13					16 734 13	
		(23)	847 44		847 44							
		(21)	770 47		770 47							
		(24)	2 311 41		2 311 41							
		(32)	2 113 36		2 113 36							
Merchandise Account		38 872 07	(11)	7 222 09	(10)	2 654 97	(10)	2 654 97				
		(6)	145 689 71	(9)	15 717 84	(9)	15 717 84					
				(12)	16 106 90	(12)	16 106 90					
Interest and Discount		451 01	(13)	1 919 31	(14)	1 129 95	(14)	1 129 95				
				(15)	329 27	(15)	329 27					
Auto Expense	1 487 61				1 487 61				1 487 61			
Office Expense	607 97				607 97				607 97			
General Expense	9 231 69				9 231 69				9 231 69			
Sent	2 500 00				2 500 00				2 500 00			
Telephone and Telegraph	553 41				553 41				553 41			
Traveling	812 40				812 40				812 40			
Salaries	<u>13 096 37</u>		34 20		34 20				34 20			
	82 902 69	82 902 69			82 902 69				82 902 69			

TIRE SERVICE CORPORATION -- WORKING SHEET  
OCTOBER 31, 1924

Name of Account	Trial Balance October 31, 1924		Adjustments		Trial Balance After Adjustments		Profit and Loss Electric Shop		Profit and Loss General		Assets and Liabilities	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Loss on Bad Debts	(1)	1 277 38			1 277 38				1 277 38			
Reserve for Bad Debts			(1)	1 277 38		1 277 38						1 277 38
Tools and General Shop Equipment	(24)	242 16										
	(3)	5 128 69			5 371 84						5 371 84	
Reserve for Depreciation on Tools and General Shop Equipment			(7)	1 026 73								1 026 73
			(8)	1 200 00		2 226 73						2 226 73
Reserve for Depreciation on Furniture and Fixtures			(9)	100 78								100 78
			(5)	84 28		185 06						185 06
Depreciation on Furniture and Fixtures	(6)	100 78			100 78				100 78			
Depreciation on Tools and General Shop Equipment	(7)	1 026 73			1 026 73				1 026 73			
Merchandise Sales			(8)	162 659 71		162 659 71				162 659 71		
Merchandise Purchases	(8)	116 717 66			116 717 66				116 717 66			
Sales Returns and Allowances	(10)	2 234 97			2 234 97				2 234 97			
Purchases, Returns and Allowances			(11)	7 272 09		7 272 09				7 272 09		
Merchandise Inventory	(26)	16 691 36									16 691 36	
	(12)	16 106 90	(26)	16 106 90	16 691 36							
Discounts Received			(13)	1 919 31		1 919 31				1 919 31		
Discounts Allowed	(14)	1 128 93			1 128 93				1 128 93			
Interest Paid	(24)	9 63										
	(15)	399 37			348 90				348 90			
Profit and Loss Prior Years	(20)	804 72										804 72
	(16)	516 34	(21)	2 260 00		860 94						860 94
	(30)	245 00										
Income from Accounts Previously charged off			(17)	133 80		133 80				133 80		
Income from Electric Shop			(30)	245 00								
			(18)	8 103 46		8 364 46			8 254 46			
Repairs Electric Shop	(19)	683 66			683 66			683 66				
Power, Light and Water, Electric Shop	(18)	1 731 46			1 731 46			1 731 46				
Salaries, " "	(16)	2 331 46			2 331 46			2 331 46				
Miscellaneous Expense, " "	(18)	37 14			37 14			37 14				
Rent, " "	(18)	1 200 00			1 200 00			1 200 00				
Equipment, " "	(19)	4 387 64									4 387 64	
	(21)	2 260 00			6 637 64							6 637 64
Interest, " "	(19)	107 66			107 66			107 66				
Depreciation on Equipment, " "	(22)	1 327 53			1 327 53			1 327 53				
Reserve for Depreciation on Equipment, Electric Shop	(22)		(22)	1 227 53								1 227 53
			(33)	847 44		2 174 67						2 174 67

TIME SERVICE CORPORATION - WORKING SHEET  
OCTOBER 31, 1954

	Trial Balance October 31, 1954		Adjustments		Trial Balance After Adjustments		Profit and Loss Electric Shop		Profit and Loss General		Assets and Liabilities	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Office Salaries	(23)	4 800 00			4 800 00				4 800 00			
Insurance	(24)	632 54	(27)	156 13	474 41			474 41				
Taxes	(24)	820 04			820 04			820 04				
Heat, Light and Water	(24)	261 41			261 41			261 41				
Advertising	(24)	2 415 11			2 415 11			2 415 11				
Donations	(24)	113 87			113 87			113 87				
Reserve for Depreciation on Automobiles	(26)		(25)	562 13		562 13					562 13	
Depreciation on Automobiles	(26)		(25)	328 81		328 81					328 81	
Prepaid Insurance	(27)	156 13			156 13			156 13			156 13	
Profit and Loss Current Year	(28)	16 106 90	(29)	15 631 35		415 55			415 55			
Income Tax Payable			(31)	770 47		770 47					770 47	
Income Tax Payable			(32)	2 113 35		2 113 35					2 113 35	
		<u>200 278 36</u>		<u>200 278 36</u>		<u>202 168 15</u>			<u>1 808 06</u>		<u>1 808 06</u>	
Profit on Electric Shop to Surplus									9 354 45		9 354 45	
General Ret Profit to Surplus									17 216 85		17 216 85	
									<u>171 954 91</u>		<u>171 954 91</u>	
											<u>28 977 59</u>	
											<u>28 977 59</u>	



Chapter IV  
REPORT TO THE CLIENT

REPORT  
on  
BALANCE SHEET AUDIT  
of  
BOOKS AND ACCOUNTS  
of  
THE TIRE SERVICE CORPORATION  
LOS ANGELES, CALIFORNIA  
As of October 31, 1924

Case No. 0000  
Report No. 1  
Pages 29 - 66  
November 20, 1924

REPORT  
on  
BOOKS AND ACCOUNTS  
of  
THE TIRE SERVICE CORPORATION  
LOS ANGELES, CALIFORNIA  
As of October 31, 1924

Board of Directors,  
Tire Service Corporation,  
Los Angeles, California.

Gentlemen:

Pursuant to arrangements made with the Auditing Committee of your Board, we have completed a Balance Sheet Audit of the books and Accounts of your Company.

PERIOD COVERED

The period covered in this examination is the fiscal year beginning November 1, 1923, and ending October 31, 1924, all statements submitted herewith, unless otherwise definitely specified, refer to the transactions of this fiscal year.

SCOPE OF AUDIT

In compliance with your request this was a Balance Sheet Audit wherein the Assets and Liabilities were substantiated as of date of October 31, 1924, and other such checkings and verifications made as

were deemed necessary in order that the "Balance Sheet" herewith submitted could be certified. The Expense and Revenue Accounts were examined in order that the changes in condition from the beginning to the end of the year might be traced. Full details as to the extent of the audit are given in Exhibit "F" annexed.

### FINDINGS

Summary of the financial condition at the end of the year in comparison with that at the beginning of the year, and the general manner in which this was brought about is set forth in the following:

#### ASSETS AND LIABILITIES

Account	October 31, 1924	October 31, 1923	Increase
Assets, Total	\$63,453.61	\$50,279.72	\$13,173.89
Liabilities	<u>19,127.31</u>	<u>14,224.29</u>	<u>4,903.02</u>
Capital Worth	\$44,326.30	\$36,055.43	\$ 8,270.87

The above increase in Capital Worth of \$8,270.87 occurred as follows:

Net Profit for 12 months	\$19,151.91	
Less: Income and Profits Tax	<u>2,113.36</u>	
		17,038.55
Less: Dividends Paid	5,440.80	
Income Tax Liability for 1923	3,081.88	
Adjustment of Profit and Loss prior year	<u>245.00</u>	<u>8,767.68</u>
Net Increase in Capital as above		\$ 8,270.87

The operations for the year 1924 resulted in a net profit of \$19,151.91 before deducting Income and Profits Tax. A summary of

these operations compared with 1923 is as follows:

PROFIT AND LOSS

Account	Year Ended Oct. 31, 1924	Year Ended Oct. 31, 1923	Increase Decrease
Net Sales	\$160,424.74	\$122,355.95	\$38,068.79
Cost of Goods Sold	<u>108,861.32</u>	<u>78,401.26</u>	<u>30,460.06</u>
Gross Profit on Sales	51,563.42	43,954.69	7,608.73
Operating Expenses	<u>35,270.75</u>	<u>26,035.89</u>	<u>9,234.86</u>
Operating Profits	16,292.67	17,918.80	1,626.13
Other Income	<u>3,988.17</u>	<u>5,341.19</u>	<u>1,353.02</u>
Totals	20,280.84	23,259.99	2,979.15
Other Deductions	<u>1,128.93</u>	<u>806.56</u>	<u>322.37</u>
Net Profit for Year	\$ 19,151.91	22,453.43	3,301.52

The percentage of cost of goods sold to net sales for the twelve months ended October 31, 1924, was 67.86%, while for the previous twelve months it was 64.08%, thus showing an increase in the percentage of cost of goods sold to sales of 3.78%. This increase may be attributed almost entirely to a slight increase in prices paid for merchandise purchased.

The percentage of Operating Profit to Net Sales for the year ended October 31, 1924, was 10.16% and for the year ended October 31, 1923, it was 14.64% or a decrease in the percentage of operating profit to sales of 4.48%.

STATEMENTS SUBMITTED

In order to summarize the transactions for the period under review, and for the purpose of presenting our findings in tabulated

form, there have been prepared certain statements designated as "Exhibits", viz:

Exhibit	Description
"A"	Certified Balance Sheet
"B"	Detailed Balance Sheet
"C"	Comparative Condensed Balance Sheet October 31, 1924, with October 31, 1923
"D"	Analysis of Surplus Account for year 1924
"E"	Comparative Profit and Loss Statement fiscal year 1924 with fiscal year 1923
"F"	Extent of Audit and comments on Findings

Information supplemental to that set forth in the Exhibits will be found in certain other statements designated as "Schedules" and are as follows:

Schedules	Description
"1"	Analysis of Cash in Bank October 31, 1924
"2"	Investments
"3"	Accounts Receivable Personal
"4"	Analysis of Reserve for Depreciation
"5"	Revenues and Expenses - Electric Shop
"6"	Adjusting and Closing Journal Entries

#### CONCLUSION

In conclusion we wish to express our appreciation for courtesies extended by your office force during the course of our examination and to state that the books and accounts in use were well kept.

Respectfully submitted,

BLANK AUDIT COMPANY.

**EXHIBITS**

## CERTIFIED BALANCE SHEET

As of October 31, 1924

After giving effect to adjustments

ASSETS		LIABILITIES	
CURRENT ASSETS		CURRENT LIABILITIES	
Cash on hand and in bank	2 447 30	Accounts Payable	16 243 48
Accounts Receivable (Less Reserve for Doubtful Accts)	31 486 96	Accrued Income Tax Payable	<u>2 883 83</u>
Personal Accounts Receivable	1 331 33	Total Current Liabilities	19 127 31
Inventory	<u>15 691 35</u>		
Total Current Assets	50 966 94	CAPITAL ACCOUNTS	
FIXED ASSETS		Capital Stock Issued	13 602 00
Autos	1 499 51	Surplus	<u>30 724 30</u>
Furniture and Fixtures	1 007 75	Total Capital	<u>44 326 30</u>
Tools and General Shop Equipment	6 371 84		
Electric Shop Equipment	6 637 64		
	14 516 74		
Less: Reserve for Depreciation	<u>5 246 70</u>		
Total Fixed Assets less depreciation	9 270 04		
PREPAID VALUES			
Unexpired Insurance	158 13		
Prepaid Rent	<u>768 60</u>		
Total Prepaid Values	926 63		
OUTSIDE INVESTMENTS			
Corporation Stocks	<u>2 300 00</u>		
TOTAL ASSETS	63 453 61	TOTAL LIABILITIES	63 453 61

## CERTIFICATION

We certify that the above Balance Sheet showing a total Net Capital and Surplus of \$44,326.30 is in accordance with the books and believe that same fairly sets forth the financial condition of the Tire Service Corporation at October 31, 1924.

SIGNED.....

Los Angeles, California,  
November 20, 1924.

## BALANCE SHEET

AS OF DATE OF OCTOBER 31, 1924

ASSETS	DETAILS	ITEMS	TOTALS
<u>Current Assets</u>			
Cash on Hand and in Bank		2 447 30	
Accounts Receivable	32 764 34		
Less: Reserve for Bad Debts	<u>1 277 38</u>		
		31 486 96	
Personal Accounts Receivable		1 331 33	
Merchandise Inventory		15 691 35	
Total Current Assets		<hr/>	50 956 94
<u>Prepaid Values</u>			
Unexpired Insurance		158 13	
Prepaid Rent		768 50	
Total Prepaid Values		<hr/>	926 63
<u>Outside Investments</u>			
Autos	1 499 51		
Less: Reserve for Depreciation	<u>690 94</u>	808 57	
Furniture and Fixtures	1 007 75		
Less: Reserve for Depreciation	<u>155 06</u>	852 69	
Tools and General Equipment	5 371 84		
Less: Reserve for Depreciation	<u>2 275 73</u>	3 146 11	
Electric Shop Equipment	5 371 84		
Less: Reserve for Depreciation	<u>2 174 97</u>	4 462 67	
Total Fixed Assets		<hr/>	9 270 04
Total Assets			<hr/> <hr/> 63 453 61



## BALANCE SHEET (continued)

LIABILITIES AND CAPITAL	DETAILS	ITEMS	TOTALS
<u>Current Liabilities</u>			
Accounts Payable		16 243 48	
Income Tax Payable-Year 1923	770 47		
Income Tax Payable-Year 1924	<u>2 113 36</u>	<u>2 883 83</u>	
Total Current Liabilities			19 127 31
<u>Capital Accounts</u>			
Capital Stock Issued		13 602 00	
Surplus		30 724 30	
Total Capital Accounts		<u>44 326 30</u>	
Total Liabilities and Capital			<u><u>63 453 61</u></u>

COMPARATIVE CONDENSED BALANCE SHEET  
October 31, 1924 with October 31, 1923

ASSETS	Oct. 31, 1924	Oct. 31, 1923	Increase Decrease
<b>CURRENT ASSETS</b>			
Cash	2 447 30	5 490 70	3 043 40
Accounts Receivable	31 486 96	18 241 56	13 245 40
Personal Accounts Receivable	1 331 33	1 009 73	321 60
Merchandise Inventory	<u>15 691 35</u>	<u>16 106 90</u>	<u>415 55</u>
Total Current Assets	50 956 94	40 848 89	10 108 05
<b>OTHER ASSETS</b>			
Unexpired Insurance	158 13		158 13
Prepaid Rent	768 50	500 00	268 50
Corperation Stocks	2 300 00	500 00	1 800 00
Autos	808 57	1 119 70	311 13
Furniture and Fixtures	852 69	2 508 57	
Tools and General Equipment	3 146 11		1 490 23
Electric Shop Equipment	<u>4 462 67</u>	<u>4 802 56</u>	<u>339 89</u>
Total Assets	63 453 61	50 279 72	
Net Increase in Assets			<u>13 173 89</u>
<b>LIABILITIES</b>			
<b>CURRENT LIABILITIES</b>			
Accounts Payable	16 243 48	5 824 29	10 419 19
Income Tax Payable	2 883 83		2 883 83
Notes Payable		5 000 00	5 000 00
Contracts Payable	<u>          </u>	<u>3 400 00</u>	<u>3 400 00</u>
Total Current Liabilities	19 127 31	14 224 29	4 903 02
<b>CAPITAL ACCOUNTS</b>			
Capital Stock Issued	13 602 00	13 602 00	none
Surplus	<u>30 724 30</u>	<u>22 453 43</u>	<u>8 270 87</u>
Total Liabilities	33 453 61	37 279 72	
Net Increase in Liabilities and Capital			<u>13 173 89</u>

NOTE: The figures used for year 1923 as above were accepted by us without verification.

## ANALYSIS OF SURPLUS ACCOUNT

For 12 Months Ended October 31, 1924

Surplus at October 31, 1923 22 453 43

Additions

1. Net Profit for Year 1924	19 151 91	
Less: Income Tax	<u>2 113 36</u>	
		17 038 55
2. Adjustment of Profit of prior years		<u>808 94</u>
Total Additions		<u>17 847 49</u>
Total Credits		40 300 92

Deductions

1. Dividends Paid 1923-24	5 647 30	
2. Income Tax	3 081 88	
3. Depreciation not taken in 1923	<u>847 44</u>	
Total Deductions		<u>9 576 62</u>
Surplus October 31, 1924		<u><u>30 724 30</u></u>

## COMPARATIVE PROFIT AND LOSS STATEMENT

Year 1924 with Year 1923

	For Twelve Months ended October 31, 1924				For Twelve Months Ended October 31, 1923			
	Detail	Items	Totals	% to Sls.	Detail	Items	Totals	% to Sales
Sales	162 659 71				128 755 20			
Less: Returns and Allowances	<u>2 234 97</u>				<u>6 399 26</u>			
Net Sales		160 424 74		100.00		122 355 95		100.00
Cost of Sales:								
Inventory Merchandise at beginning of year	16 106 90				- - - - -			
Purchases during year (net)	<u>108 445 77</u>				<u>94 508 16</u>			
Total	124 552 67				94 508 16			
Less Merchandise at end of year	15 691 35				<u>16 106 90</u>			
Cost of Goods Sold		<u>108 861 32</u>		67.86		<u>78 401 26</u>		64.08
Gross Profit on Sales			51 563 42	32.14			43 954 69	35.92
Expenses:								
Auto Expense	1 487 61			.93	916 40			.75
Office Expense	624 02			.39	652 73			.70
General Expense	2 394 66			1.49	3 634 92			2.89
Rent	2 500 00			1.56	1 575 00			1.29
Telephone and Telegraph	553 41			.34	214 08			.17
Traveling	526 60			.33	317 05			.26
Salaries	15 184 97			9.47	11 320 60			9.26
Depreciation on Furniture and Fixtures	100 76			.06	54 28			.05
Depreciation on Tools and General Equipment	1 025 73			.64	1 200 00			.98
Interest Paid	348 90			.22	302 68			.25
Office Salaries	4 800 00			2.99	4 900 00			4.00
Insurance	474 41			.30				
Taxes	820 06			.51				
Heat Light and Water	261 41			.16				
Advertising	2 416 11			1.50				
Donations	113 57			.07				
Depreciation on Autos	362 13			.22	328 81			.27
Bad and Doubtful Accounts	<u>1 277 38</u>			.80	<u>519 34</u>			.42
Total Expenses			35 370 75	21.98			25 035 69	21.28
Operating Profit			16 292 67	10.16			17 918 60	14.64

COMPARATIVE PROFIT AND LOSS STATEMENT

Year 1924 with Year 1923

For Twelve Months ended October 31, 1924

For Twelve Months Ended October 31, 1923

	Detail	Items	Totals	% to Sls.	Detail	Items	Totals	% to Sales
Operating Profit (Forward)			16 292 67	<u>10.16</u>			17 918 80	<u>14.64</u>
Additions to Operating Profit								
Discount on Purchases	1 919 31			1.20	4 543 35			3.71
Income from Collection of Bad Accounts	133 80			.08				
Income from Charging and Repairing Trucks	<u>1 935 06</u>			<u>1.20</u>	<u>797 84</u>			<u>.66</u>
Total Additions			<u>3 988 17</u>	<u>2.50</u>			<u>5 341 19</u>	<u>4.37</u>
			20 280 84				23 259 99	
Deductions from Operating Profit								
Discounts Allowed	<u>1 128 93</u>			<u>.70</u>	<u>806 56</u>			<u>.66</u>
Total Deductions			<u>1 128 93</u>	<u>.70</u>			<u>806 56</u>	<u>.66</u>
Net Profit for Year			19 151 91	11.94			22 453 43	18.35
Less: Accrued Income Tax			<u>2 113 36</u>	<u>1.32</u>			<u>3 081 88</u>	<u>2.52</u>
Net Increase to Surplus			<u>17 038 55</u>	<u>10.62</u>			<u>19 371 55</u>	<u>15.83</u>

NOTE: 1923 figures accepted without verification.

## EXTENT OF AUDIT AND COMMENTS ON FINDINGS

As a matter of information and as setting forth the extent to which each of the several accounts were checked or verified during this Balance Sheet Audit, there is set forth in the following paragraphs, under the name of the account, a description of the work done, the accounts dealt with in the order in which they appear on the balance sheet.

In those instances where it was felt that an expression of our opinion as to methods or policy might be welcomed, we have included same herein.

CASH 2,447.30

The cash consisted of two items: cash on hand awaiting deposit of \$853 12, and net bank balances of \$1,594.18.

Cash on hand awaiting deposit was verified on November 6, 1924. It amounted to 706,47 and was reconciled with the amount called for by the records as having been on hand at October 31, 1924, namely, 853,12, this latter amount having been subsequently deposited in the banks.

The bank accounts were reconciled with the regular bank statements and in addition thereto the balances, as called for by the said statements, were verified by direct correspondence with the respective banks.

All monies received were traced from the records of receipts to the respective bank accounts or to the record of cash disbursements. The cancelled bank vouchers were checked against the record of disbursements and the signatures and endorsements thereon were carefully scrutinized.

We believe that it would be advisable to require that all cash received be deposited in one of the several bank accounts not later than the day following the receipt. All necessary disbursements of petty cash should be made through the petty cash fund and should be limited to items of not more than five dollars for any single disbursement.

Monthly statements should be obtained regularly from each bank rather than at varying indefinite dates. A communication addressed to the bank will provide these statements being prepared at regular intervals, which should be at the close of each month. These statements should be reconciled with the books and filed as a permanent record.

The use of a standard form of voucher cheque numbered consecutively, irrespective of the bank on which it is drawn, would be advisable. These cheques should be made in duplicate and on the typewriter. At the time they are drawn, the name of the bank upon which they are drawn is to be entered in the space provided for that purpose.

A desirable modification of the present form of cash disbursements record could be secured by separating the record of petty cash disbursements from the disbursements made by cheque. The disbursements made by cheque should be recorded in a loose leaf book to be designed as a "Cheque Register", a separate column being provided for each bank and the total of the cheques on all banks for any given day extended to the "Total" column. These columns should be at the left hand side of the sheet, the center portion providing for cheque number, payee's name and memo. The right hand portion should be reserved for distribution columns.

A petty cash fund should be established and all disbursements less than five dollars be made therefrom. A fund of fifty dollars should be

sufficient. As this fund is depleted a bank cheque should be drawn in whatever amount is sufficient to restore the fund to the original amount. The distribution of this amount to the various accounts should be made according to the petty cash vouchers. A properly authorized petty cash voucher should be on file for every petty cash disbursement.

ACCOUNTS RECEIVABLE

32,764.34

The trial balance from the Customer's Ledger was checked and the totals proved against the control account. Statements of each customer's account was mailed by us with a request that it be verified and returned to our office. A sufficient number complied with the requests to satisfy us that the accounts as stated on your records were correct.

An analysis of the accounts as to their age was made and appears as follows:

Age	Amount	% of total
Less than 30 days	21,062.20	64.29
30 to 60 days	8,244.70	25.16
60 to 90 days	3,457.44	10.55
	<u>32,764.34</u>	<u>100.00</u>

The sum of the balances of the accounts that are over thirty days old is 11,702.14 or 35.71 % of the total. The credit period is usually 60 days, therefore the accounts are in good condition. The Reserve for Doubtfull accounts amounts to 1,277.38 and has been built up by the process of charging to the expense of operations an estimated



amount monthly. The present remaining balance is that resulting after charging off against the Reserve all accounts determined to be absolutely worthless. We believe, therefore, that the present balance is sufficient to insure reasonable safety.

PERSONAL ACCOUNTS RECEIVABLE 1,331.33

The items composing the balance of this account were verified by direct communication with the individuals. We feel that it is important that the balance in this account be collected at an early date and suggest that arrangements be made whereby this will be affected.

MERCHANDISE INVENTORY 15,691.35

The inventory appears on the Balance Sheet at the quantities and values taken by your management. Our verification consisted in the checking of prices at random points of approximately 50% of the items. Further, we satisfied ourselves that the method of pricing was at cost or market whichever was lower. Quantities were verified by checking about 40% of the items on hand at the inventory date. We obtained a statement from a responsible officer of the company certifying in writing to the quantities and pricing.

The present system of handling the inventory appears to be satisfactory. We are of the opinion, however, that, in case it becomes needful to make any changes in the present personnel, difficulties might easily arise. We would, therefore, suggest that careful consideration be given to the subject of the installation of a system of stock control under the direction of one responsible storeman, who should be under the

direct supervision of the purchasing agent. The system should provide for a perpetual inventory with continuous checking of quantities in rotation. In our opinion, minor rearrangements at the store room should be made and all goods except those used for display placed under lock and key.

PREPAID VALUES

926.63

(a) Insurance \$158.13. All insurance policies were examined and carefully checked. The unexpired insurance premiums on policies of all kinds aggregated \$158.13. The accounts were adjusted in accordance therewith.

(b) Prepaid Rent \$768.50. This amount consists of two items, viz., \$618.50 rent prepaid in advance on the buildings occupied in Los Angeles and \$150.00 prepaid rent on buildings occupied in Pomona. Our verification consisted of a careful scrutiny of the two leases.

CORPORATION STOCKS

2300.00

The balance in this account consists of two items, (1) 5 shares of stock in the Rapid Transportation Company and (2) a receipt for \$1800.00 paid to the fiscal agent of the Tupman Sand and Gravel Company for which there is to be received 18 shares of stock of said company.

The five shares of stock in the Rapid Transportation Company were examined by us and found to be in proper form. In answer to a communication from us the fiscal agent of the Tupman Sand and Gravel Company acknowledged the receipt of \$1800.00 paid him and further stated that the actual stock certificates would be forthcoming within a very few days.

We did not see any statements of either of the companies whose stock is owned, nor any memoranda as to their real worth.

AUTOS

This account represents the cost of two light automobile trucks with certain other accessory equipment. It was found that depreciation for the year ended October 31, 1923 had been credited to the asset account instead of the proper Reserve account. Adjustment of this amount was made and the account now stands at the original cost value.

Ownership by the company of these assets was verified. The reserve for depreciation amounting to \$690.94 up to the close of the fiscal year under consideration is considered adequate and fair and leaves the net book value of the asset at what is considered a proper amount.

FURNITURE AND FIXTURES

1007.75

Considerable confusion was found in the method of handling this account. It contained besides amounts properly chargeable thereto, \$150.00 prepaid rent at Pomona and \$5,128.69 representing payments on tools and general shop equipment. After the proper analysis of the account was made the remaining balance as representing furniture and fixtures was verified by checking a list of the individual items to the actual assets and checking the pricings by reference to the original invoices.

Further, our analysis disclosed the fact that depreciation amounting to \$1,254.28 for the fiscal year ended October 31, 1923, had been credited to the asset account. Proper treatment was accorded this item in a similar manner as outlined in the comments on autos accounts next above.

TOOLS AND GENERAL SHOP EQUIPMENT

5,371.84

The balance in this account represents the cost of miscellaneous tools and general equipment not included elsewhere in the accounts. As noted above most of this amount had been charged to Furniture and Fixtures account. The General Expense account had also been charged with \$243.15 which is properly included in this account. The balance in this account as shown on the balance sheet is the total properly included therein. We verified this amount by checking a list of the items compiled by your office, to the various items making up same. All invoices of the larger amounts were examined and we are satisfied that the prices as shown by the verified detailed list is correct.

It is suggested that greater care be taken in the future to see that the cost of equipment purchased is charged to the proper asset account. A good working rule to follow is the one laid down by the Internal Revenue Department which states that where the life of equipment is longer than one year, the cost is to be set up in an asset account and depreciated at the proper percentage annually. If this is not done, confusion exists in compiling the Income Tax Returns and the Profit and Loss Statement will not reflect true conditions.

ELECTRIC SHOP EQUIPMENT

6,637.64

This account was set up by us to represent the cost of equipment purchased for use in the Electric Shop. The Electric Shop account as shown by the books contained besides the cost of equipment purchased, all revenues and expenses attributable to this department. It was necessary, therefore, to make a complete analysis of this account and set up the

proper accounts. During this analysis we verified all major items charged to equipment by reference to the invoices. A list of the electric shop equipment on hand was checked by us to the various items composing same.

It is suggested that all items in the Furniture and Fixtures account and Equipment accounts be numbered either by attaching to each a metal tag bearing a number, or by stamping on the individual pieces of equipment a number. Tags placed on the various pieces of furniture and fixtures should bear the letters, F-F, while those on the general equipment should be, G-E, and those on the electric shop equipment E-E. By doing this each item can be readily identified and confusion at the time of a check-up and reconciliation with the books of account largely eliminated.

ACCOUNTS PAYABLE

16,243.48

The accounts payable were found to be composed of the following:

Trade	14,633.73
Miscellaneous	1,609.75

A complete check was made of the balances of the accounts payable ledger with the control account. Over seventy-five per cent. of the accounts due was verified by statements received directly by us from creditors. All the accounts payable were aged and found to be well within the discount dates.

We are of the opinion that the present method of handling the accounts payable, although accurate, is involving a considerable amount of unnecessary work. There are several methods by which this work could

be reduced. It will be remembered that practically all bills are being discounted and therefore it does not become necessary to keep a ledger account with each vendor. A system of vouchering, whereby the invoices are filed in an unpaid folder under the name of the vendor and then transferred to the paid file when paid, would answer for a ledger account. This would require that as the invoices are grouped for payment, entry should immediately be made on the Invoice Register and Distribution Record, and that as soon as paid the entry of the cheque number should be made on said Invoice Register. All items not having a cheque number at the end of a given month would constitute the accounts payable as of that date.

INCOME TAX PAYABLE

2,883.83

As the income tax for 1923 was reported on the calendar year basis and payments thereon made quarterly, there remains 770.47 still due. An amended return for 1923 based on the fiscal year has been filed but not as yet granted by the Internal Revenue Department. The computed liability for the fiscal year ended October 31, 1924, is 2,113.36, the first quarter of which is due on or before January 15, 1925.

The amount as shown is, of course, subject to whatever revision the Internal Revenue Department may make. However, we believe there will be no further liability above the amount as shown.

CAPITAL STOCK ISSUED

13,602.00

The amount as shown represents the par value of 13,602 shares of stock issued at the time of the commencement of business. The stock ledger was carefully examined by us and found to be in proper order.

SURPLUS

30,724.30

This amount represents the excess of net earnings remaining after all dividends declared have been paid.

We believe that the policy pursued by the management of retaining in the business, a considerable portion of the earnings, is a very commendable and fundamentally sound one.

ACCOUNTING SYSTEM

There are certain features of the system of accounts now in use and the methods of handling same which we feel could be greatly improved on and for your information and consideration we suggest the following:

1. Uniform classification of accounts together with a manual of accounting procedure. This would make possible the proper segregation of all transactions and provide your office with a permanent record of uniform procedure, a record required particularly when there is a change in bookkeepers or when two or more persons are working on the books.

2. New general accounting forms. A general revision in the general forms now in use should be made to conform with and for the best operation of the account classification mentioned above.

**SCHEDULES**



## ANALYSIS OF CASH IN BANK

Los Angeles National Bank

Balance per Bank Certificate		622 00	
Less: outstanding cheques as follows:			
Cheque number	1000	2 50	
"	"	1001	1 85
"	"	1012	1 25
"	"	1026	2 00
			<hr/>
			7 60
			<hr/>
Balance per books			614 40
			<hr/> <hr/>

Southern California National Bank

Balance per Bank Certificate		1 995 23	
Less: outstanding cheques as follows:			
Cheque number	744	8 37	
"	"	746	158 33
"	"	750	100 00
"	"	754	100 00
"	"	756	87 50
"	"	760	87 50
"	"	761	87 50
"	"	762	43 75
"	"	763	75 00
"	"	764	60 00
"	"	765	75 00
"	"	766	45 00
"	"	767	87 50
			<hr/>
			1 015 45
			<hr/>
Balance per books			979 78
			<hr/> <hr/>
Total cash on deposit			1 594 18
			<hr/> <hr/>

INVESTMENTS

	Par Value	Amount
Five shares stock - Rapid Transportation Co.	100.00	500 00
Eighteen shares stock - Tupman Sand & Gravel Co.	100.00	<u>1 800 00</u>
Total Investments		2 300 00

NOTE: The stock certificates representing ownership of the eighteen shares of stock in the Tupman Sand and Gravel Company have not been received.

## ACCOUNTS RECEIVABLE - PERSONAL

As of October 31, 1924

John Smith, President	220 90	
Henry Jones, Secretary and Treasurer	1 060 43	
H. A. Wilson, Office Manager	<u>50 00</u>	
Total		1 331 33

## ANALYSIS OF RESERVE FOR DEPRECIATION

As of October 31, 1924

	For previous period	Depreciation For 12 mos. ended Oct. 31, 1924	Total
Electric Shop Equipment	847 44	1 327 53	2 174 97
Tools and General Shop Equipment	1 200 00	1 025 73	2 225 73
Furniture and Fixtures	54 28	100 78	155 06
Auto Trucks and Trailers	<u>328 81</u>	<u>362 13</u>	<u>690 94</u>
Totals	2 430 53	2 816 17	5 246 70

## ELECTRIC SHOP REVENUES AND EXPENSES

Year Ended October 31, 1924

Electric Shop Revenue		9 354 46
Electric Shop Expenses		
Repair	683 96	
Power, Light and Water	1 731 46	
Salaries	2 331 45	
Miscellaneous Expense	37 14	
Rent	1 200 00	
Interest	107 86	
Depreciation on Equipment	<u>1 327 53</u>	
	Total Expenses	<u>7 419 40</u>
	Net Income	<u><u>1 935 06</u></u>

## ADJUSTING AND CLOSING JOURNAL ENTRIES

AS OF OCTOBER 31, 1924

1.

Loss on Bad Debts	1 277 38	
Reserve for Bad Debts		1 277 38

Estimated loss on accounts receivable as of October 31, 1924

2.

Accounts Receivable	1 277 38	
Suspense Account		1 277 38

To charge back into accounts receivable, accounts deducted and held in suspense.

3.

Tools and General Shop Equipment	5 128 69	
Furniture and Fixtures		5 128 69

To take out of the furniture and fixtures account the cost of tools and general equipment and set up same in the proper account.

4.

Lease	150 00	
Furniture and Fixtures		150 00

To charge lease account with rent paid in advance at Pomona, same being previously charged to furniture and fixtures in error.

5.

Furniture and Fixtures	245 28	
Reserve for Depreciation on Tools and Shop Equipment		1 200 00
Reserve for Depreciation on Furniture and Fixtures		54 28

To correct entry previously made and set up proper reserve accounts.

## 6.

Depreciation on Furniture and Fixtures	100 78	
Reserve for Depreciation on Furniture and Fixtures		100 78

To set up depreciation for year 1924 at 10%.

## 7.

Depreciation on Tools and General Shop Equipment	1 025 73	
Reserve for Depreciation on Tools and General Shop Equipment		1 025 73

To set up depreciation on the above at 20% per year, the above being for the year 1924.

## 8.

Merchandise Account	162 659 71	
Sales		162 659 71

To set up sales for year 1924 in the proper account.

## 9.

Purchases	115 717 86	
Merchandise Account		115 717 86

To set up purchases for year 1924 in the proper account.

## 10.

Sales Returns and Allowances	2 234 97	
Merchandise Account		2 234 97

To set up sales returns and allowances for the year 1924 in the proper account.

## 11.

Merchandise Account	7 272 09	
Purchases Returns and Allowances		7 272 09

To set up in the proper account purchases returns and allowances for the year 1924.

## 12.

Merchandise Inventory	16 106 90	
Merchandise Account		16 106 90

To remove the inventory of October 31, 1923, from the merchandise account and set up same in the proper account.

## 13.

Interest and Discount	1 919 31	
Discounts Received		1 919 31

To set up discounts received during the fiscal year 1924.

## 14.

Discounts Allowed	1 128 93	
Interest and Discount		1 128 93

To set up discounts allowed customers during the fiscal year 1924.

## 15.

Interest Paid	339 37	
Interest and Discount		339 37

To set up interest paid during the year 1924.

## 16.

Profit and Loss - Prior Years	519 34	
Suspense Account		519 34

To take out of the suspense account bad debts of the fiscal year 1923.

## 17.

Suspense Account	133 80	
Income from Accounts Previously charged off		133 80

To take out of the suspense account income received on accounts charged off in the fiscal year 1923.



## 18.

Electric Shop	9 109 46
Income from Electric Shop	9 109 46

To set up the income from the electric shop in the proper account.

## 19.

Repairs	Electric Shop	683 96
Power, Light and Water	" "	1 731 46
Salaries	" "	2 331 45
Miscellaneous Expense	" "	37 14
Rent	" "	1 200 00
Equipment	" "	4 387 64
Interest		107 86
Electric Shop		10 479 51

To analyze the electric shop account and set up the proper accounts.

## 20.

Profit and Loss - Prior Years	604 72
Electric Shop	604 72

To complete the analysis of the electric shop account and charge the remaining balance therein from the year 1923 to profit and loss of that year.

## 21.

Electric Shop Equipment	2 250 00
Profit and Loss - Prior Years	2 250 00

To set up the equipment paid for in 1923 that had been charged to this account.

## 22.

Depreciation on Electric Shop Equipment	1 327 53
Reserve for Depreciation Electric Shop Equipment	1 327 53

To set up depreciation on this equipment at 20% for the year 1924.

## 23.

Officers' Salaries	4 800 00	
Salaries		4 800 00

To take out of general salaries account the amount paid to officers during 1924.

## 24.

Surplus and Undivided Profits	2 311 41	
Office Expense	16 05	
Traveling Expense	14 20	
Tools and General Shop Equipment	243 15	
Interest Paid	9 53	
Insurance	632 54	
Taxes	820 06	
Heat, Light and Water	261 41	
Advertising	2 415 11	
Donations	113 57	
General Expense		6 837 03

To analyze general expense accounts and set up proper accounts.

## 25.

Auto Account	328 81	
Reserve for Depreciation on Auto		328 81

To charge back into the Asset account depreciation deducted in error and set up same in proper account.

## 26.

Depreciation on auto	362 13	
Reserve for Depreciation on Autos		362 13

To set up depreciation for year 1924 at 25%

## 27.

Prepaid Insurance	158 13	
Insurance		158 13

To set up unexpired portion of insurance premium at October 31, 1924.

## 28.

Profit and Loss - Current Year	16 106 90	
Merchandise Inventory		16 106 90

To close out the beginning inventory

## 29.

Merchandise Inventory	15 691 35	
Profit and Loss		15 691 35

To set up inventory of merchandise as of October 31, 1924.

## 30.

Profit and Loss - Prior Years	245 00	
Income from Electric Shop		245 00

To set up in Income Account of current year amount credited to Profit and Loss of 1923.

## 31.

Surplus and Undivided Profits	770 47	
Income Tax Payable		770 47

To set up last quarter of 1923 income tax payable.

## 32.

Surplus and Undivided Profits	2 311 41	
Income Tax Payable		2 311 41

To set up estimated liability due the Government as income tax for year 1924.

## 33.

Profit and Loss - Electric Shop		7 419 40	
Repairs	Electric Shop		683 96
Power, Light and Water	" "		1 731 46
Salaries	" "		2 331 45
Miscellaneous Expense	" "		37 14
Rent	" "		1 200 00
Interest	" "		107 86
Depreciation on Equipment	" "		1 327 53

To close into Electric Shop profit and loss account expenses for year.

## 34.

Income from Electric Shop	9 354 46	
Profit and Loss Electric Shop		9 354 46

To close electric shop income to Profit and Loss.

## 35.

Profit and Loss - Electric Shop	1 935 06	
Profit and Loss - Current Year		1 935 06

To close electric shop profit and loss into general account.

## 36.

Sales	2 234 97	
Sales Returns and Allowances		2 234 97

To close into sales, returns and allowances for year.

## 37.

Sales	160 424 74	
Discounts Received	1 919 31	
Income from Accounts Previously charged off	133 80	
Profit and Loss Current Year		162 477 85

To close Income Account into Profit and Loss.

38.

Purchases Returns and Allowances	7 272 09
Purchases	7 272 09

To close into purchases - returns and allowances for year.

39.

Profit and Loss - Current Year	144 845 45
Auto Expense	1 487 61
Office Expense	624 02
General Expense	2 394 06
Rent	2 500 00
Telephone and Telegraph	553 41
Traveling	526 60
Salaries	15 184 97
Loss on Bad Debts	1 277 38
Depreciation on Furniture and Fixtures	100 78
Depreciation on Tools and General Shop Equipment	1 025 73
Purchases	108 445 77
Discounts Given	1 128 93
Interest Paid	348 90
Officers' Salaries	4 800 00
Insurance	474 41
Taxes	820 06
Heat, Light and Water	261 41
Advertising	2 415 11
Donations	113 57
Depreciation on Autos	362 13

To close expense accounts into Profit and Loss for year.

40.

Profit and Loss - Current Year	19 151 91	
Surplus and Undivided Profits		19 151 91
To close net profit for year into Surplus.		

41.

Profit and Loss - Prior Years	880 94	
Surplus and Undivided Profits		880 94
To close into Surplus.		

42.

Surplus and Undivided Profits	2 883 83	
Income Tax Payable		2 883 83
To set up last installment of 1923 income tax and 1924 tax.		

## Chapter V

## CONCLUSIONS

For the purpose of summarizing the procedure in the forgoing chapters and in order that a general view of the complete audit may be had, the following conclusions are written.

The first step in beginning the audit is to determine what work is to be done in order that the information desired by the client may be most readily obtained. An examination of the trial balance submitted by the bookkeeper<sup>1</sup> and a general survey of the books of account revealed the general procedure to be followed. At the time of verifying the balance as shown by the trial balance, notes similar to those shown in chapter two were made.<sup>2</sup> This expedites the work later on by furnishing a definite outline to be followed.

As each account was analyzed, written notes on the findings were made so that the auditor might have complete information for reference at the time the report was compiled. These notes can in most instances take the form shown in chapter three.<sup>3</sup> Each individual case, however, will determine to a considerable extent in what form the notes should be compiled. These notes also served as an explanation for the adjustments shown on the Working Sheet. When the report was reviewed by the supervisory accountant before it was submitted to the client, these notes furnished him with the necessary information.

In order that the adjustments found necessary by the analysis of the various accounts could be incorporated with the account balances

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<sup>1</sup> Thesis, p. 7

<sup>2</sup> Ibid, pp. 4, 5  
and 6

<sup>3</sup> Ibid, p. 11.

as shown by the books, the Working Sheet<sup>1</sup> was prepared. The working sheet summarizes all transactions in columnar form and is the basis from which the report to the client is made. By adding to the beginning trial balance the adjustments found necessary, the complete final trial balance was arrived at. From this trial balance the profit and loss accounts were carried to their respective columns and after the proper calculations were made the net profit was determined. The accounts not treated as profit and loss accounts were carried to the columns representing the trial balance after closing, or the asset and liability columns. The net profit, as determined, was added to the surplus account. With this information at hand the report to the client was compiled.

The balance sheets<sup>2</sup> were compiled from the figures shown in the trial balance after closing on the working sheet. The profit and loss statement<sup>3</sup> was compiled from the figures shown in the profit and loss columns on the working sheets. The other exhibits and schedules were, in a similar manner, prepared from the data shown on the work sheet supported in greater detail by the notes on the various accounts analyzed.

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<sup>1</sup>Thesis, p. 26

<sup>2</sup>Ibid, pp. 45, 46  
and 47

<sup>3</sup>Ibid, p. 39



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