

BEFORE THE SECURITIES AND EXCHANGE
COMMISSION

In the Matter of McKESSON & ROBBINS, INC.

OFFICES OF THE SECURITIES AND EXCHANGE COMMISSION,
120 Broadway, New York, N. Y., Friday, February 24, 1939.

Met, pursuant to adjournment, at 10 o'clock a. m.

PROCEEDINGS

The EXAMINER. Mr. Bell, will you be sworn?
Whereupon:

WILLIAM H. BELL

called as a witness for and on behalf of the Commission, being first duly sworn, was examined and testified as follows:

The EXAMINER. Will you give your full name and address to the reporter, Mr. Bell?

The WITNESS. William H. Bell, 67 Broad Street, New York.

The EXAMINER. Mr. Bell, it is customary at the hearings of the Commission to apprise the witnesses of their constitutional privileges. You have the privilege of refusing to answer any question if you believe such answer will tend to degrade you or subject you to fine, imprisonment, or forfeiture. That privilege extends to each and every question that may be propounded to you.

The WITNESS. I so understand.

I. AFFILIATIONS AND BACKGROUND

Q. (By Mr. WERNTZ.) Mr. Bell, will you please state your present firm affiliation and your connection with that firm?

A. I am a member of the firm of Haskins & Sells, certified public accountants. I have been a member for 20 years.

Q. Could you indicate briefly your experience in accounting work prior to becoming a member in the firm?

A. Well, I was on the staff of Haskins & Sells for 9 years before becoming a partner, and I have been with Haskins & Sells 30 years altogether. Before that I had private accounting experience of 7 or 8 years as a clerk and a bookkeeper.

Q. Had you had any educational training in accounting prior to going into private practice?

A. None prior to going into private practice, no. But I am a bachelor of commercial science, New York University, master of commercial science, St. Louis University.

I am a certified public accountant in 12 or 13 States.

Q. Would you indicate one or two of the major ones?

A. New York, New Jersey, Pennsylvania.

Q. Would you indicate in general terms the nature of your firm, its characteristics?

Mr. WERNTZ. Off the record.

(Discussion off the record.)

A. My firm has 28 offices in the United States and 3 in Europe and 2 in the Far East, and as partners in the firm of Deloitte, Plender, Haskins & Sells, we have offices in the principal cities of Canada, Cuba, Mexico, South America, and South Africa. At present the firm of Haskins & Sells has 57 partners. The number of persons on our pay roll from—in the present fiscal year, which begins June 1—has run from a low point of about 960 to a high point of about 1,360. That includes about 240 office employees.

Q. Would you indicate briefly the type of clients which you serve, particularly in specialization?

A. We have quite a diversified clientele; banks, public utilities, railroads, mercantile manufacturing companies, educational, religious, charitable institutions. I think pretty much all that there are.

Q. Are you a member of any of the professional accounting societies?

A. I am a member of the American Institute of Accountants, New York and New Jersey Societies of Certified Public Accountants, American Accounting Association. I am a director of the New York State Society of Certified Public Accountants.

Q. Have you any other offices in those societies at the present time?

A. No.

Q. Have you been active in the professional committee work in those organizations?

A. Well, during the last several years I have from time to time been very active. I am at present a member of some of the important committees, mostly technical committees of the New York State Society. I don't know whether I am a member of any committee of the American Institute at the present time.

Q. Have you engaged in publishing accounting works?

A. I am the author of a book on auditing, published in 1924, of a book on accountants' reports that was published in revised form in 1934, co-author on a book of accountants' working papers, published in 1929.

In the past I have written any number of articles on accounting subjects.

Q. Have you engaged in teaching or other public forms of accounting of that type?

A. Well, several years ago, yes; I did some teaching in accounting subjects in Baltimore and St. Louis. Not in recent years.

II. SCOPE OF EXAMINATION OF FINANCIAL STATEMENTS

Q. Thank you. Could you indicate and distinguish the types of accounting services rendered by public accountants which lead to, or result in, the certification of financial statements?

A. There is only one type of accounting services performed for the purpose of certification of financial statements, but there are varying

degrees of details to which the examination extends, depending upon the size of the organization and the existence and apparent effectiveness of internal check and control.

Q. I take it, then, that it is this type of service to which you refer that you follow in preparing statements for inclusion in 1933 Act and 1934 Act statements for annual reports or for credit purposes?

A. That is so. We undertake to examine the accounts to the extent that we consider necessary and appropriate in view of the system of internal control. Having investigated such a system and all its ramifications in order to determine to what extent the records should be examined.

Q. Thank you. Now, are you familiar with Commission's Exhibit 117, which is the bulletin published and prepared by the American Institute of Accountants entitled "Examination of Financial Statements"?

A. I am.

Q. Did you or members of your firm participate in its preparation?

A. I did not, but one of my partners, Mr. Edward A. Kracke, did as a member of a committee of the American Institute of Accountants.

Q. In your opinion, what was the purpose of publishing such a bulletin, Mr. Bell?

A. No doubt the purpose was to furnish to practicing accountants, regulatory authorities, and credit grantors a concise statement of scope and limitations of the auditing procedure which should be expected to have been carried out as a basis for the opinion expressed by the accountant regarding financial statements in the usual form of certificate or report which is reproduced in the bulletin.

Q. Would you say as to that, that one of the purposes was educational in regard to persons other than accountants?

A. No doubt.

Q. Does this bulletin express, generally, the type of examinations to which you referred in your previous question as to the examination leading up to certification of financial statements?

A. Oh, yes.

Q. And this is the type of examination you had in mind there?

A. Generally, yes.

Q. Now, in examinations of this type, do you feel that the principles of the bulletin are of general application, regardless of size or nature of business of the company involved?

A. Generally speaking, yes. Of course, considerable latitude is necessarily allowed in adapting the general program to different types and sizes of concerns. But it may fairly be said that certainly the principles are of general application.

Q. In your own practice do you follow this as a guide?

A. Well, while we do not specifically require the members of our staff to follow this bulletin, each member of our organization has a set of instructions on specific points in auditing other than the general principles with which our men are supposed to be familiar before they are permitted to perform responsible work by themselves, and which specific instructions are, as a rule, in much greater detail than those given in this bulletin.

Q. Do you expect them to be familiar with this bulletin?

A. We expect all our men in responsible positions to be familiar with all such accounting literature. We do not specifically require them to read this bulletin because we know that we have procedure in their hands which they are required to follow which takes the place of it and is much more detailed and elaborate.

Q. Speaking generally then, do you regard the procedure prescribed by this bulletin as a maximum or minimum in this type of examination?

A. Generally, it is a set of minimum requirements.

Q. Would you say that there are certain parts of this bulletin which may be inapplicable under certain circumstances to particular businesses?

A. I do not know of any business to which it would be entirely inapplicable.

Q. I did not mean the whole bulletin, but particular procedures in it.

A. Oh, yes; it might well be. This bulletin has 41 pages, including some forms at the end—36 pages of instructions. Well, there have been several books of auditing written 20 times or 10 times to 20 times that size, so obviously this is very condensed and therefore it has got to deal with more or less generalizations, and for that reason some of the things in here, here, meaning the bulletin, will not necessarily apply to every situation, and there are a great many things that are encountered in practice which are not specifically covered in the bulletin.

Q. That is what I had in mind, but if you leave out those things which are not applicable because of conditions not present, the remaining procedures you would consider a minimum?

A. I would consider it so. There is one exception to its being a minimum. I said generally minimum.

Q. I am speaking just in general terms here.

A. There is going to be one exception that I am going to bring out later to its being a minimum set of instructions, but as a general thing I would regard it as a set of minimum instructions.

Q. Does the examination performed by your firm generally exceed the procedures outlined in this bulletin or conform to them, or is it less than?

A. Well, I would say that the scope of examination set forth in this bulletin is thoroughly orthodox, therefore it conforms practically to the minimum requirements of our procedure.

Q. Speaking historically, did the publication of this bulletin lead to changes in your own practice, or to audit practice in general?

A. No; the publication of the bulletin did not lead to changes in our practice. When it came out we all checked it up and found that our procedure as to the various accounts and records went at least as far as that prescribed in the bulletin. I do not know what effect the published bulletin had upon audit practice in general.

Q. Now, Mr. Bell, coming to your own work and may I say here that I would like to have you, if you will, distinguish between practices that you followed prior to the beginning of the McKesson hearing, or the McKesson case, and those which may have been developed subsequently to that, if there have been any changes?

A. In other words, you want me to talk about what has been done rather than what may be now.

III. OFFICE METHODS AND STAFF ORGANIZATION AND TRAINING

Q. I would be glad to have you do both, but just distinguish so that we may be sure which it is.

Do you, when a new client comes to you, make any particular investigation of his reputation or credit rating before accepting an engagement or during the course of the first audit?

A. Well, we make whatever investigation we think necessary in particular cases to satisfy ourselves of the reputation of a client before accepting an engagement because we do not wish to be mixed up with any unsavory businesses, or naturally for financial purposes, with any concern which cannot pay our bill.

In the case where anybody comes to us and we don't know anything about them, we make such inquiries as seem to be appropriate in a particular case. If we can't find out anything necessary about his financial standing, it won't take us long after we get on the job to find out something about it.

Q. Now, from your experience in public accounting, Mr. Bell, who would you say exercises the prerogative of appointing auditors to certify the annual reports of corporations whose stock is publicly held and in addition to that, would you indicate to whom you feel your primary responsibility runs?

A. I should say that the president of a corporation or chief financial officer of a large corporation usually has and exercises the authority of engaging auditors. We consider that our responsibility is to the corporation whether we have been engaged specifically by an officer or by the board of directors or by a vote of the stockholders.

Q. When you accept an engagement, Mr. Bell, by what representative of your firm is the scope of the audit determined, and do you reexamine the scope of the audit from time to time?

A. I assume that you are speaking now, of a corporation in which there is a sizable public interest and not of a small concern—

Q. Yes.

A. Where the audit work might be extended beyond the usual procedure in order to meet the peculiar requirements of the specific case. In such situations, the scope of the audit will be determined after extensive investigation of the system of internal control by the accountant in charge of the work and after review by a partner in most cases, or in a few cases by what we call a principal, that is, a person who has demonstrated his fitness as supervisor of work by at least 10 years of experience and is a C. P. A., but has not yet become a partner.

This refers, of course, only to such matters as are dependent upon the system of internal control. There are many matters concerning which the procedure is standard, regardless of the existence or effectiveness of internal control. The scope of the work is thoroughly examined annually in the case of a continuing engagement. That is to say, we do not think it safe to assume that conditions remain the same from year to year.

Of course, there may be certain questions that are determined in discussion by a partner with the client at the time of taking the engagement such as whether or not we are to make any physical tests of inventories, or whether certain small branches or subsidiaries are to be examined or whether we would be permitted to do any preliminary work during the year.

These are questions which may have no bearing whatever on the internal control.

Q. From your experience as an auditor, Mr. Bell, who would you say decides questions as to the scope of the audit on the part of the client?

A. The only questions that would be decided upon the part of the client are those I have just mentioned and, of course, they would be decided by the officer or perhaps the chairman of the auditing committee or directors from whom we take the engagement.

Q. Looking to the future, do you think there should be any change in the method of selecting auditors or in fixing the scope of the audit?

A. It is, of course, desirable that auditors be completely independent of any officers, but I find it exceedingly difficult to formulate any ideas on the subject which would apply to a considerable variety of concerns.

For a large company I am inclined to think it would be a good idea for auditors to be appointed by and confer with a committee of the board of directors, at least the majority of whom are not officers of the corporation.

For smaller businesses it seems quite obvious that the auditor must have his contact largely with the management. I recognize that in theory it is a good thing for auditors to be appointed by the stockholders, but I know from experience that where that is done there is practically no difference between the attitude of the officers toward the auditors or that of the auditors toward the officers than in cases where the auditors are engaged directly by the officers.

As far as the scope of the audit is concerned, it seems quite obvious if auditors are elected by the stockholders, any questions as to the scope will be determined by the officers.

I should like to make my position clear, that in this matter of the scope of the audit there should not be and I believe there seldom is any radical difference of opinion between the management of a large corporation and the auditors as to what constitutes a reasonable examination such as to enable the auditor to express an opinion regarding financial statements.

We used to have such differences of opinion, for example, as to whether there was any necessity of examining subsidiary companies. But it seems to me that those days are now past. In other words, the auditor must be permitted to do whatever he deems necessary and practicable, regardless of the source of his engagement.

In my opinion there never should be any qualification in an accountant's certificate regarding the scope of his work unless, owing to the peculiar circumstances of the particular case, it is impossible or impracticable, the limitations being imposed by conditions and not by

the dictation of his client, to do something that he regards as necessary in order to enable him to form an opinion regarding the financial statement.

I do think that the practice ought to be more generally adopted of engaging auditors at the beginning of the year so that they would be able to do part of their auditing work during the year and not have to wait until the end.

Q. Now, turning to your own firm, Mr. Bell, do you classify your personnel such as between seniors and juniors and the like?

A. We classify our organization as partners, principals that I have already spoken of, what we call in-charge accountants, which is practically the same as what other firms call senior accountants, and senior assistants and junior assistants.

Q. When an engagement is accepted, Mr. Bell, how do you determine which of your staff shall participate in it?

A. There is always a partner, nearly always a partner, and if that is not practicable one of our principals definitely in charge responsible for the engagement. Under him would be a senior accountant and one or more assistants.

The selection as to all of them is made on the basis primarily of aptitude for the particular work in view of its particular characteristics, and secondarily, from the standpoint of the availability of the men at the time.

Q. Are those assignments permanent from year to year in successive engagements?

A. No; such assignments are not permanent.

Q. Would you indicate what your policy is as to that?

A. While there is, of course, a tendency to continue the connection of the partner with the engagement, we recognize that it is even desirable to shift partners from time to time. It is our definite policy to shift the senior accountants notwithstanding the pressure that is brought to bear upon us by clients to continue the same personnel.

This is easily understandable, that is, such pressure is easily understandable, because it takes men some little time to familiarize themselves with the routine and organization of the concern and, of course, the introduction of new men slows up the process. Notwithstanding, it does serve a very good purpose in obtaining a fresh viewpoint.

Q. When you are recruiting juniors for your permanent staff, Mr. Bell, how do you go about that, also for your temporary staff?

A. Well, for some time now all the juniors that we take on our permanent staff are college graduates who specialized or majored in accountancy. Of course, we have to take on other men for our temporary staff owing to the exigencies of the situation at the end of the calendar year.

I may say that every man we take is subjected to the most rigid examination as to his character and attainments.

Q. Do you look for any particular type of experience or training when you are selecting men for these positions as juniors?

A. Well, as to juniors for our permanent staff, as I have just indicated, we seek men—young men who have majored at accounting in college. We go out and look for them. As temporary staff

juniors we try to get, and generally succeed, men of education in accountancy and experience, judgment, personality, and responsibility.

Q. When you have taken these juniors on, do you have any further course or further requirements as to self-education? Do you require them to be certified public accountants?

A. Yes. We have to give very particular attention to development of our younger men because of a desire to develop our own successors. We put them through a course of training involving group discussions, some of which are participated in by the partners. The C. P. A. certificate is definitely a requisite for advancement, and therefore the young men have to continue their accounting education until they have received such a certificate and then we hope they won't stop learning.

Q. What type of duties do you assign to these juniors as a rule?

A. The juniors are required to assist the seniors.

First, of course, their work is what may be called mechanical, checking records of one kind or another, under the direction of the senior.

Gradually, as they develop, they are given more important work.

Q. Would you say that this work they do requires a knowledge of accounting; that is, the juniors?

A. Oh, yes; some knowledge of accounting.

Q. Now, speaking generally, from what source do you obtain your seniors? What qualifications do you look for in them?

A. Our seniors are almost invariably obtained from the ranks of the juniors and from promotion in our own organization. The qualifications we look for are technical accounting skill, personality, character, industry, proficiency in the use of English, and general adaptability to the work.

Q. Can you describe briefly the duties or types of duties which you assign to seniors?

A. Well, the seniors work directly under a partner or principal who has charge of the engagement. He is in charge, whereas the partner or principal has supervision over a great many jobs; the seniors work most of the time on only one job and naturally get into details much more than their supervisors.

Q. You mean one job at a time?

A. At a time; yes.

Q. And do you consider it a part of a senior's duties to train the men under him, or perhaps you would want to include there assistant seniors.

A. Oh, very definitely. That's about the only way a junior can progress. Such training is exercised by direction and supervision of individual tasks and discussion of reasons for doing things.

Q. Do you expect a senior to sample the work that his juniors have done to determine whether they are in fact performing a satisfactory job on the original documents?

A. Oh, of course they must. Well, it is just unthinkable that they shouldn't.

Q. Is that the manner in which you satisfy yourselves that the juniors are doing their work? That is, that sampling plus a review of the working papers they prepare?

A. Constant familiarity with, on the part of the seniors, with the work that is being done by the juniors, reports made to our offices by the seniors on their impressions of the work of the juniors, that is the way we keep track of the development of these young fellows.

Q. Now, as to the partners in your firm. Do they participate in the field work of the audit program as distinguished from the review?

A. They do.

Q. Could you indicate there to what extent?

A. We have enough partners so that with comparatively few exceptions they can keep closely in touch with the work being done by our men in the field by periodic visits, and, of course, they attend any conferences with the client on any important points.

There may or may not be occasion to visit the client at other times during the year, but perhaps it may be stated as a general rule that we are not engaged until late in the year so that in relatively few cases is there any occasion for us to visit our clients during the year. When such visits are made, of course, we would see the appropriate financial or operating executives.

Q. You say that the partners visit the client during the course of the audit. Do they see in that case just the officers of the client or do they make any contact with their own men there?

A. Oh, well, primarily, of course, to supervise and keep in touch with the work of our men; primarily. Otherwise, any supervision isn't worthy of the name.

Q. Now, on a new engagement, Mr. Bell, do you expect the staff assigned to that engagement to become generally familiar with the trade or industry, either before they go down to the work or before they complete the initial audit?

A. We expect the staff to become familiar with the particular business which is under examination. The extent of that familiarity, of course, depends upon the intricacies and complexities of the business. In other words, we expect the men to have a good idea of the nature of the business but not necessarily of all of its technical refinements.

Q. Now, do you expect your juniors to be sufficiently familiar with the type of records and documents with which they will come in contact so as to be able to recognize what we may call significant irregularities?

For example, the lack of a date on a check.

A. Oh, yes. We expect them to be able to recognize irregularities. The juniors—a junior must be advised by his superior of the nature and form of any irregularities which are undertaken to discover at first and gradually he must learn for himself.

Q. Do you expect him to be alert to detect such irregularities and report them?

A. We certainly do.

Q. What instructions do you give your staff as to the course to follow when an irregularity is discovered? Do you take it up immediately with the client?

A. Any irregularities that are discovered by the staff must be reported to the supervising partner or principal.

It is very difficult to generalize as to how such matters would be taken up with the client and what position we would take on the premises. The partner or principal would discuss the matter with as high an official as necessary in an appropriate case, or the chairman of the board of directors.

Q. Would you make any examination before you took the matter up with the client? That is, how far would you go before you saw someone representing the client?

A. It all depends upon what it is. Oh, let's say we discover a \$100 shortage in the cashier's fund. We would be sure that there was a shortage and not go off half cocked, and accuse somebody wrongfully and then in that case we take it up with the treasurer or the comptroller, as the case might be. It is very hard to generalize on that subject as to what we would do in particular cases.

Q. You would attempt to be as sure as possible of your ground before you took it up with the client, I take it?

A. Well, naturally.

Q. But in contradistinction to that, the members of your staff would take up anything with their senior that they thought was irregular?

A. All up the line from juniors to seniors to partners.

IV. CONDUCT OF THE EXAMINATION

A. INTERNAL CHECK AND CONTROL

Q. I see. Now, coming to the system of internal check and control. To what extent do you require the members of the staff assigned to a particular audit to become familiar with the business which they are auditing? That is, the plant layout of a manufacturing company, the operating methods, the nature of products, character of personnel and so forth?

A. We require the members of the staff to know something about the business, its operations, the nature of the products and the like. As to the character of the personnel, it is quite obvious they can't make an audit without having a pretty good idea of the people in the accounting department, but beyond that I would not necessarily expect them to go. As far as the plant layout is concerned, we do not expect them to be specialists in manufacturing processes but we do expect they will get a pretty good idea as to the location of merchandise of various kinds. Otherwise, they are not in position to determine whether or not there is any physical control of the merchandise.

We urge our men to use their legs and go on exploring expeditions.

Q. When you referred to accounting personnel, do you mean by that those who are engaged in actively making entries in the books or those who are engaged in various steps of the flow of transactions? For example, the shipping clerk who may not make any entries exactly, would he be one of the accounting personnel in your opinion?

A. Yes. Of course, that all depends upon the size of the organization and just how the activities of the shipping department work into the inventory, say. I wouldn't want to say that in every case I would

expect our men to know about the receiving room and the shipping room, although they ought to for some purposes, especially if it is all one place, together. But I don't mean that accounting department to be restricted necessarily to the general ledger bookkeeper or the cashier. I mean the whole works in the accounting and clerical organization.

Q. Thank you. And now, in an engagement do you obtain or prepare an organization chart or its equivalent which would indicate the duties of the various people working on the financial and accounting matters?

A. Yes; we regard an outline of the duties and lines of control of such persons as absolutely essential.

Q. What do you understand this term "internal control and check" to mean? Could you indicate some of the principal features of such a system?

A. A system of internal check and control would include a system of internal audit that might be thus described: A system of internal check and control means essentially that organization and routine are so divided that there is such a division of duties that no one person can profit by falsifications of records and that any considerable error or fraud perpetrated by one person will be discovered by another. That is about as far as the system can go, although there are cases in very large offices where the system is so refined that collusive fraud of two or more persons may be discovered by other employees in the ordinary course of their work. A system of internal auditing literally means that one person goes over and checks the work of another, substantially as though he were doing it independently. Of course, there can be no system of internal control unless the business is large enough to permit the employment of a sufficient number of persons to accomplish these purposes.

Q. Now, at page 7 of the bulletin, Mr. Bell, it is stated that the nature and extent of the examination depends upon the purpose of the examination, the amount of detail to be included in the statements covered by the report, the type of business the accounts of which are being examined, and the system of internal check and control. Could you indicate there the effect of each of these factors on the scope of examination?

A. The comments in the bulletin to which you have referred are stated to apply to the examination of small- or moderate-sized companies. Of course, an examination of a small company where there cannot be expected to be any system of internal control must necessarily extend in considerable detail the verification of cash transactions which verification may safely be dispensed with, to some extent, if the organization's set-up safeguards against fraud or serious error.

That same principle applies in varying degree according to the size of the business and the extent and apparent effectiveness of the internal control. As to the amount of detail included in the statements, I am inclined to think that that makes very little difference except as it may be necessary to analyze accounts in order to report details of operations.

It is quite understandable that the extent of the examination would be different, say, in the case of a business with one only or two customers than one with 10,000 customers.

Q. Would you say that the nature of the business in which the concern is engaged may alter the scope of the examination? For example, comparing an investment trust with a manufacturing business, would the scope of the examination be related to that also?

A. The scope of the examination as applied to particular accounts and procedures would, of course, vary.

Q. How would that vary? What would be the principle upon which it would vary?

A. Well, you said an investment trust with a manufacturing company. An investment trust, you have no receivables. You have no inventories, you have securities, you have definitely provable sources of income, all of which tends to make the examination of an investment trust much simpler than that of a manufacturing company.

Q. Would you say that in that respect the scope of the examination depends upon what factors in the business are particularly important? That is, in the investment trust it would be the account of the securities, for example; in a manufacturing concern it might be the inventories and receivables and plant, if those are the principal things in the scope of the examination would it be altered to verify those things?

A. Not only that but the transactions, the cash transactions are more easily provable in the case of the investment trust than a manufacturing company and the authority for transactions is definite and limited in the case of an investment trust, you see.

Q. And now, at several places in the bulletin, I think you have just indicated that it states that section 2 is for small- or moderate-sized businesses and that for large businesses the modifications of section 3 should be observed. What is it that distinguishes between a small and large business in this respect? Is it the aggregate assets, the number of branches, or what; size of transactions?

A. This purpose of criterion of size would be the volume or number of transactions. It is just as easy, for example, to audit the cash expenditure of a million dollars as one of \$50.

Q. So that you would take the number of transactions rather than the dollar volume?

A. Rather than the aggregate dollar volume.

Q. Would it make any difference if the business was engaged in several different lines of activities as opposed to a business that is engaged in only one?

A. It may very well, but that would depend upon how the organization was set up, whether there were separate departments for it involving separate records or whether it all went through one department, although there were several products there. In the latter case, it wouldn't be particularly different from where there is one product except, possibly—well, except for, very definitely, the question of inventories.

Q. I see. Now, at page 9 in the bulletin it is indicated that the extent of the examination is to be determined in part from the accountant's knowledge of the individual situation.

What is your understanding as to the extent of such knowledge of the situation which the accountants should have before rendering a certificate, let's say? How much should he know about it?

A. Well, manifestly, an accountant must become sufficiently familiar with the individual situation as to the ramifications of the business and the accounting system of routine during his first examination to determine how far he should go in verification of the respective accounts. I think that's the best way I can answer that.

Q. What method do you employ, Mr. Bell, for developing this information about clients' accounting procedure and system of internal control?

A. Well, we have forms which are required to be filled out by the partner, principal and senior accountant, which shows the various accounting procedures and the duties of each person engaged in carrying out such accounting procedures, in sufficient detail so that we can get a good idea as to whether there is any opportunity for fraud or error of any considerable amount. These forms are filled out only after we have satisfied ourselves by inquiry and as far as possible by actual observation of the procedure, by consideration of handwriting and so on as to the routine actually employed. We consider all the possibilities of the perpetration and concealment of irregularities before deciding upon the audit procedure to be followed.

Q. Could you indicate briefly the scope of the various reports that you utilized? That is, just for example what are they; to what extent do you rely on them; do you keep them up to date?

A. Well, we rely on them a great deal, as I have indicated, as a basis for the determination of the scope of our examination as applied to particular records and processes. We require that any such analysis of the situation be made anew at the time of each audit and not be continued from year to year because we don't think it is safe to assume the conditions are the same now as they were a year ago.

Mr. WERTZ. Off the record.

(Discussion off the record.)

Q. (By Mr. WERTZ.) Mr. Bell, will you indicate roughly the various topics which you consider by means of these questionnaires?

A. Well, we have what we call a cash questionnaire that goes rather outside the scope of strictly a cash questionnaire that we inquire into and set down for the functions of every person that has to do with the handling and reporting of cash and whether or not he has to do with any other procedure in accounting and indicate there whether that respect is a good or bad situation or somewhere in between and we have a questionnaire as to their inventory procedure in respect to accounting control and physical control as well and another one on top of these that we require the partner to make out to be sure that he himself has satisfied himself that the things are as they are represented to be.

Q. I think you indicated in one of your previous answers that you make inquiry to determine that the purported system of internal check and control is actually being followed and that you examine documents for handwriting and so on. Do you follow any other procedures in seeing whether the system actually is in operation as described?

A. The best we can—yes, we obtain our information by direct inquiry and observation of the particular individuals in their performance of their various duties. We don't get our information from inquiry from their immediate supervisor or administrative officials.

Of course, it is a little bit hard to generalize there as to just how, but we have to take one thing at a time. In other words, we are not willing to accept somebody's information that even he does so and so without seeing him do it or seeing his handwriting or observing him do it. Of course, we have got to get a general chart, if you like, to start with, in a large organization, large office, and then test it out to see whether it is actually being followed.

Q. Now, if your study of the system of internal control discloses what you feel to be weaknesses in their accounting procedure, do these, in your opinion, require additional steps in the audit program? Could you give any illustrations of that if the condition exists?

A. Yes, it should be understood that the only reason for dispensing with certain auditing procedures is that the internal accounting control sets up such safeguards as to obviate the necessity for such procedures.

Manifestly, in the absence of internal accounting control there is no excuse for not carrying out the auditing procedure. The disbursement of pay rolls might be taken as an example. If the same person prepares the pay rolls and disburses the money and currency, he has the opportunity for manipulation of the pay rolls to his advantage, in which case the auditor should test the make-up and footings of the pay rolls. Whereas, if the preparation and disbursing of the pay rolls are separate functions, thus removing the opportunity for fraud, the auditing of pay rolls by the independent accountant may be reduced to the minimum. In any such case the additional work would not be discussed with the company. I don't know that you asked that last question but I put it in anyway.

(Discussion off the record.)

Q. (By Mr. WERNITZ.) I believe you stated that the additional work would not be discussed with the company. If they found out that you were doing it since you were there and made objection to your doing that work, what would your position be?

A. Well, in our experience there are a few cases where clients object to our doing any work that we consider necessary. About the only question there that involves difference of opinion of any kind is with respect to inventories and it is my understanding that such will be discussed later.

Q. Would you say that when you have compared your study of the system of internal check and control, the auditor should have a real knowledge of the accounting system followed by the client including a knowledge of the various types of documents which the company prepares to evidence various transactions?

A. Yes; I would, as to any documents which we really considered important.

Q. That does not mean that you would in each audit see every document that had been prepared during the course of the year.

A. Oh, not at all.

Q. But that you would be familiar with every general type of document?

A. Yes.

Q. Is it your understanding that an examination such as is contemplated by this bulletin would disclose fraud? And in that connection, I would like to have you look at page 10, paragraph 2, the second sentence?

A. It is in the second full paragraph, I take it.

Q. That is correct.

A. Meaning the procedure will not necessarily disclose defalcations nor every understatement of assets concealed in the records of operating transactions or by manipulation of the accounts?

Q. That is right.

A. Now, your question is, Should this examination disclose fraud? That is right?

Q. That is right.

A. An examination made in accordance with the bulletin ought in my opinion to disclose any fraud of relatively large amount except perhaps where there has been widespread collusion or forgery of records. The quotation means to me that the procedure will not necessarily disclose every defalcation. The reason for this is obvious since the procedure is limited at the most to test checks and it is quite possible that some irregularities will not be detected even when quite comprehensive tests of the record are made for the purpose of detecting fraud; the periods covered by the tests are scattered through the period on the general theory that if a person perpetrates fraud once, he will do it again and that he will be caught somewhere. There have, however, been numerous instances where a person committed one fraud and stopped there. Also in the interest of economy, frequently small items are accepted on their face, and, therefore, some petty irregularities may not have been discovered. Certainly, I think that the auditor should satisfy himself as to the general accuracy and integrity of the record.

Q. Would you say, however, that within the scope of the examination, that is, within the test checking and sampling that you do, that the auditor should be alert to discover fraud or other irregularities?

A. Very definitely; yes.

Q. Now, speaking generally again, I believe you have indicated that the process of examination contemplated is largely a question of sampling. Do you feel that sampling such items as sales, plant additions, cash disbursements, et cetera, if the references are satisfactory adequately verify the records as a whole, and if so, do they conclusively verify the records not examined? If they don't conclusively verify those records, do you think the tests are still adequate for the purposes in mind?

A. Speaking generally, I should say, yes. Of course, sales might very well be subjected to tests whereas plant additions would be completely verified. Any such tests as may be made could be said to adequately verify the records as a whole in the sense that they indicate reasonably that the records as a whole can be considered as reliable. One would not say that the testing procedure would conclusively verify the records not examined but the testing procedure should indicate that there is nothing radically wrong with the records for the periods covered by the tests.

I don't like the word "verify" very well, but I haven't been able myself to get a good substitute for it.

Q. Perhaps we can say, "established to your own satisfaction."

A. Reasonably.

(Whereupon a short recess was taken.)

AFTER RECESS

Q. (By Mr. WERTZ.) Mr. Bell, there is one point I would like to have you clear up for me. In the classification of members on your own staff, am I correct in understanding that you have the following gradations roughly: Junior assistants, then senior assistants, then seniors in charge of particular audit work, and then principals who supervise the seniors and the partners at the top?

A. Yes; the only reason we have this group of principals is that we can't have enough partners. It is our practice to have all our work supervised closely by partners but we can't have enough of them.

Q. So that the ordinary audit staff would consist of seniors, senior assistants, and junior assistants and then either a principal or a partner in charge of that whole thing?

A. That is right.

Q. Or would there be both a principal and partner?

A. There might very well be several principals and several partners on a very large job.

Q. With one of the partners heading it up?

A. With one partner naturally having the deciding voice.

Q. But would there be many cases where you would have simply a partner? And then skip over the principal down to the senior?

A. Very many.

Q. And would there be many in which there was no partner but a principal?

A. Necessarily some, because we haven't enough partners to go around.

Q. That is what I wanted you to clear up, whether there was always a principal in between the partner and the senior?

A. No; it is the exception rather than the rule.

B. CASH

Q. Now, turning to the details of the audit program and taking first cash. Do you consider the cash program outlined on pages 11 and 12 as a minimum or maximum procedure, and would you indicate briefly any steps therein that you ordinarily omit and any steps that you ordinarily add?

A. In some respects it is a maximum procedure and in some, minimum. Generally, maximum, in my opinion. Where it says in paragraph 8 that in certain instances comparison of deposits with cash book entries may be extended to include a check of the original deposit slips or authenticated copies thereof, that, in my opinion, indicates minimum procedure.

In my opinion, that should be done in practically every case and when it is not done because of the great number of items involved, usually there should be a second verification of the bank balances in order to discover whether deposits have been made to cover up a shortage for which there is no corresponding entry in the records of cash receipts.

Q. Now, at page 33 in the bulletin, reference is made to the reconciliation of bank accounts by employees who are independent of

the cashier's department. How important do you consider this matter?

A. Well, this speaks of relatively smaller working funds which are reconciled periodically independent of the cashier's department. I should say that it is important to have reconciliation of such small balances by internal auditors but that no independent auditor would dispense with reconciliation of any important bank account by himself, if I have understood your question.

Q. In the case of large funds as a question of the system of internal check and control, would you consider it important that there be an internal reconciliation by a person not connected with the cashier's department.

A. I consider it highly desirable but it is almost ideal procedure that you can't count upon having.

Q. But that would not affect your reconciliation independently?

A. Not at all.

Q. Would you make such a reconciliation only as at the balance sheet date, or would you go back and check any of the monthly dates?

A. Ordinarily only at the balance sheet date or the date where we go in there, if it is later, unless the cash on hand consists of relatively minor imprest working funds, but as a general rule it is necessary to verify all the cash at once, the cash on hand and cash in bank and also simultaneously with marketable securities, negotiable securities and sometimes notes receivable, and things of that sort which can't be done promptly at the end of the year and must be done, let us say, on February 24. Then it would be necessary in most cases to make another verification of the bank balances on February 24 as well as that at December 31.

Q. Would you make those two verifications if you followed the procedure outlined in that sentence to which you refer, namely comparison with deposit slips?

A. Two verifications of bank balances?

Q. Yes.

A. The idea of the second verification of the bank balance which, of course, may not be a complete verification because your audit may not have been taken up to the 10th or 20th of January, say, is to find what has come back from the bank, largely, now, what has come back from the bank in the way of checks which are outstanding at the end of the year and might not have been shown up as checks outstanding at the end of the year and thereby a shortage may have been concealed at the end of the year.

Q. I believe you indicated as to that last sentence of item 8 on page 12, where it suggests extension of the comparison of deposits to include a check of original deposit slips, that you ordinarily felt that that was a minimum procedure. What is the purpose of such a check?

A. We think it is highly important and we do it in almost every case to either go to the bank and see original deposit tickets or get banks to furnish us with copies of deposit tickets and check the composition of deposits for the last few days of the year, about 3 or 4 days of the year; when I say 3 or 4 days, that depends upon the

situation with regard to the number of bank accounts that are carried by the concern. A concern might have a bank account in New York and one in San Francisco, for example. A cashier might draw a check on a San Francisco bank and deposit it in a New York bank on the afternoon of December 31 and not show it as a deduction from the account in the San Francisco bank. Thereby he would be padding his aggregate bank balance. Now, then, it is going to take a check on a San Francisco bank maybe 8 or 10 days to get to San Francisco and back again, so, therefore, in that case you have got to extend your period of examination over, not necessarily examination of deposit tickets, but of any subsequent verification.

In this case I have cited, if you see the deposit ticket for December 31 of your New York bank, the jig is up. You are going to discover that he has deposited that check in there which is not entered in the record as a transfer from the other bank.

What I have been saying applies to transfers between banks. There are also questions of kiting receipts from customers. A man may be short in his cash \$500, and he wants to cover that up at the end of the year. He has received a \$500 check from a customer today. He puts that in the bank to cover up his shortage, but does not enter it in the cashbook, thereby creating a shortage in the accounts receivable, you see. That is the sort of thing that we look for in the checking of entries in the cash receipts record with deposit tickets.

Q. Now, again in item 8 in the third line, Mr. Bell, the term bona fide receipts appears. What is your understanding of the meaning of that term, and how do you establish that the receipts are in fact bona fide?

A. By bona fide receipts I assume it meant receipts in the regular course of business which are entered in the record and not some items that the cashier has deposited to make good a shortage, without entry in the records.

Q. Now, turning to the general composition of the cash in bank, would you say that it is customary and proper to include in cash amounts due from foreign banks and from private bankers and do you have in mind any conditions under which it is not customary, and also how do you determine the existence of any such conditions?

A. I can see no objection to including in cash demand deposits with foreign banks. Of course, converted at proper rates of exchange and assuming that the cash is in fact available, that is to say that the currencies are not blocked. Likewise, there should be no objection to including demand deposits with a private banker, that is, one who is authorized by law to receive deposits.

Q. How would you establish that there are no restrictions on the transfer of funds, for example?

A. That there were no restrictions to the transfer of funds from a foreign country?

Q. Yes, that they are free.

A. In our own case, we undertake to keep our people advised from our office in New York about such situations, but we would expect anyone on a job that had a considerable amount of foreign bank balances to be familiar with that.

Q. Would your cash procedure include checking up in such a case to see actually whether there were any such restrictions or not? For example, if a client had a large bank deposit in some European country, would you expect the senior or someone else on the staff to look into that particular country if he did not already know?

A. Oh, very definitely.

Q. How would you determine that a particular person is in fact a bank. Do you have any procedure for that?

A. Well, the way we would determine whether a particular depository is in fact a bank or banker is from its name or from information that we obtain that it is in fact such. If we run across a name which is said to be that of a bank, but which fact is not evident in the name, John Smith and Co., for example, we would have to ascertain from an official list of bankers that they were, in fact, bankers.

We should also, in such a case, take particular pains to find out whether the deposit was in fact a demand deposit.

Q. Do you rely to any extent upon the appearance of transactions with the bank in customary form, that is, canceled checks, bank statements, et cetera? You have indicated that you rely on the name, such as the First National?

A. I think that would be a fair indication, yes. If ordinary checks were being drawn on a concern that was purported to be a private banker. Of course, most banks in this country have the word "bank" or "trust company" in their name, and they are not permitted to have the word "bank" or "trust company" in their name unless they have fulfilled certain legal requirements.

Q. Do you follow any procedure to determine in fact that there is such a bank as the X National Bank?

A. No.

C. ACCOUNTS AND NOTES RECEIVABLE

Q. Now, turning to accounts and notes receivable, Mr. Bell, in the bulletin in items 3, 5, and 6, for example, there are instructions as to making inquiries. What persons do you make inquiries of in that connection? Where do you get the information?

A. Well, it is very difficult to generalize on this subject. The accountant would discuss some things with the credit manager and other things with the sales department, perhaps with other persons, depending upon conditions in the particular case. Of course, he gets clues to different matters from his examination of the other records. That is about as definite as I can be.

Q. You would say ordinarily it would be inquiries of employees of the company directly concerned with the particular problem?

A. In most cases; yes.

Q. Now, in item 3, the first sentence reads:

Examine the composition of outstanding balances.

What is meant by that instruction?

A. By examining the composition of outstanding balances, I believe it means the determination of what particular charges the balance consists of, that is to say, there may be many charges and many credits to the account, and the balance may consist, let us say, of the last two or three items of charges or perhaps the last item, and one dated several months prior.

Q. How do you go about determining that composition of the balance?

A. Just pick them out. Footing the account in the first place, footing both sides of the account and arriving at the balance and naturally if it was \$1,210 we can start backward and see what items made up the \$1,210.

Q. In connection with that procedure, do you attempt to age the accounts?

A. Oh, yes; to some extent, depending upon the conditions. Sometimes they are aged very elaborately and sometimes we just pick out the old accounts and subject them to scrutiny and inquiry and perhaps specific confirmation.

Q. How far back into the account would you go to determine the composition of the balance as far as is necessary?

A. As far as is necessary to determine the balance. In other words, we wouldn't necessarily audit every debit and credit to an account receivable to see whether the balance is correctly stated.

Q. Now, in such examination do you expect the general condition of the individual account to be noted, such as, for example, a concentration of charges at the year end or usual write-offs or allowances of various types?

A. I don't think that concentration of charges at the end of the year would be noted from an examination of the individual accounts receivable. It would, however, be observed from examination of the sales accounts, so, similarly, the presence or absence of special credits for returns, allowances, write-offs, and the like would be indicated respectively through an examination of the income account rather than the individual accounts receivable. All these things will be considered in any proper examination of the accounts, having in mind the character of the particular business.

Q. Now, turning to the top of page 15, you will find there a sentence reading as follows:

While such confirmation is frequently considered unnecessary in the case of companies having an adequate system of internal check, it is one of the most effective means of disclosing irregularities.

Is it your understanding that this sentence implies that receivables ordinarily should be confirmed, or, if it doesn't, are there any circumstances under which you feel it is particularly desirable to confirm receivables?

A. It is my understanding that the sentence quoted means at least that it would be highly desirable to obtain confirmation of accounts receivable. I believe that in any case it is desirable to obtain at least some test confirmations of large amounts and in most, if not all, cases it is necessary to do so as an additional check on the effectiveness of internal control.

Manifestly, if there cannot be said to be any internal control, confirmation of the accounts, at least to the extent of comprehensive tests, is absolutely necessary.

Q. Now, in making up your determination as to whether in a particular case receivables should be confirmed, does the past credit and adjustment record of the individual accounts affect your judgment in any way?

A. What I have just said about the desirability of obtaining confirmations applies regardless of the credit and adjustment records

of the individual accounts. However, the bulletin indicates the confirmation might not be considered necessary if there appears to be an excellent system of internal control and the individual accounts and the business generally have a good record as to collections without claims. With respect to collections prior to completion of the audit, such collections cannot be relied upon unless they are traced into the bank. Many a fraud has been concealed in this fashion.

Q. Now, there are a number of ways of confirming accounts receivable, Mr. Bell. There is the method of positive confirmation of as many as you can reasonably obtain, negative confirmation of all of them, and positive confirmation of perhaps the larger ones with a sample perhaps of the balance. How do you feel as to the relative value, considering the expense, of these methods?

A. As a practical matter in most cases I think that positive confirmation of larger accounts and a selection of other accounts, especially those accounts which are old or apparently in dispute is the best procedure.

Of course, there are some situations where in order to obtain any reasonable assurance of the correctness of the account, practically all of them have to be confirmed.

Negative confirmations, in my opinion, are useful but, of course, they are not as conclusive as positive confirmations.

Q. Are they as conclusive in your mind as a positive confirmation of a sample, for example?

A. No.

Q. Of course, if the sample got too small, you might have a difference of opinion there?

A. I think it probably would be better to send out a 100 percent negative confirmation form, than a short positive confirmation form.

Q. What would you say as to the relative cost of these various methods, Mr. Bell, which have been mentioned, would you just grade the three of them?

A. Well, what sized business? And furthermore, Mr. Werntz, when you say positive confirmations of as many accounts as is reasonably possible, reasonably possible—

Q. Let us press that as far as it will go. You exert every effort to get them in?

A. You send out all. There may be 100 accounts receivable, or 40,000.

Q. Yes.

A. You send them all out in any event which is a pretty expensive process.

Q. Perhaps there has been a misunderstanding. I just wanted you to indicate as a method which of these would be the more expensive method rather than the actual cost?

A. Obviously, the positive confirmation of as many accounts as is reasonably possible and that is generally pretty expensive.

Q. And the less expensive would be which?

A. The positive confirmation of a fair sample or of all large accounts and a sample of all others. That would be the less expensive. Although sending out negative confirmations of all the accounts may not be very expensive if the work is properly planned which would mean that the accountant would take the statements as they are prepared, check them to the ledger balances, put a rubber

stamp on there, or something would be imprinted on a statement or something attached to it, "If this is not correct notify Haskins & Sells," and he could combine that more or less with the taking off of trial balances of accounts receivable and it wouldn't be so much more work unless there were a very great many accounts which under some situations he might test anyway. That is to say, where there are a very great many accounts, all of which are relatively small, and we have situations of that kind.

Q. You might say then that the positive confirmation of as many as you can would be considerably more expensive than either of the other two methods and as to those it would be hard to say except in individual cases which would be the most expensive.

A. Yes, and I don't think in the usual situation of, say, a fair-sized business, just a fair-sized business, that it is necessary or economically advisable to send out positive requests for all accounts, in the usual situation. There are cases, as I said, where the records are in such bad shape, and you have no confidence at all in the accounting processes, where, in order to get any reasonable satisfaction you have to confirm all or practically all the accounts.

Q. Would you explain why it wouldn't be economically desirable business-wise in some cases?

A. Because on the same principle that we adopt tests through all our auditing procedure, we think it is economically wasteful to go in and make what would be called a detailed audit which is practically 100 percent check of records in order to accomplish our objective. The same principle would apply to 100 percent confirmation of accounts receivable in the majority of cases.

Q. If your sampling process, Mr. Bell, indicated a significant amount of errors, would you extend the sampling to include the others?

A. Oh, very definitely yes. All this testing procedure is based upon, or is subject to extending the test even to the point of complete verification if your test developed something wrong.

Q. Now, looking at page 8 and again at page 34 under "Accounts receivable" there is reference to safeguards surrounding the handling of incoming mail and remittances and to the mailing of statements to customers.

What inquiries do you make, or what tests would you make in this connection? Do you take steps to assure yourself that statements are actually mailed, for example, and if you do, would you consider that actual mailing was partial assurance of the authenticity of the accounts?

A. There is very little that the accountant can do with respect to the system of handling incoming mail and the mailing of monthly statements to customers except to ascertain what the usual procedure is.

Obviously if in the ordinary course a person who is in a position to abstract or intercept cash has anything to do with the keeping of accounts receivable records or sending out statements to customers, it is necessary to devote considerable attention to the cash records and the accounts receivable. As a rule it is impracticable for us to assure ourselves that in the ordinary routine, statements are actually mailed to customers. If that were done, it would be pretty good assurance that the accounts were authentic.

Q. Providing they didn't come back or anything?

A. Yes, sir.

Q. I mean just the mailing wouldn't assure it, but it would be the mailing and no objection to the accounts. I assume you have that in mind.

A. I have that in mind, but I think that if we could find out that they all went out, then, if it were a situation where we could rely we would equally find out what happened subsequently, fairly well, anyway.

Q. That's what I had in mind.

A. Yes.

Q. Now, on page 34 under "Accounts receivable," again, Mr. Bell, there is a suggestion that a relatively limited test of individual customer's accounts may suffice under certain circumstances. What kind of an examination do you feel is contemplated by that expression, "relatively limited test"?

A. I understand this to mean that where there are a great many individual customers' accounts, none of which is relatively large in amount and there is a good system with respect to the division of the duties between the ledger keepers, the cashier, and the mailing department, and so on, it may be safe to dispense with detailed examinations of some of the individual accounts.

Q. Would you indicate any percentage, or otherwise there, or is it too indefinite for that?

A. Oh, I could give you the approximation, perhaps. If there were 50,000 accounts receivable in number, a good system, well organized office, I'd be satisfied to examine 5,000 of them.

Q. That's what I had in mind. You would consider that to be within the "relatively limited test"?

A. Yes.

Q. I see. Now, if you have in a particular situation determined that it was unnecessary to make confirmation of open accounts, would that decision control your decision in respect to confirming notes receivable arising from open accounts?

A. In my opinion it should be unnecessary to obtain confirmation of notes receivable from customers which are not yet due.

Q. How about overdue ones?

A. They are in the class of doubtful accounts and very likely I should want to confirm them if they are sizeable and taking all things into consideration.

Q. Would you say that you ordinarily would look at notes receivable; that is, look at the individual notes?

A. Oh, very definitely. The fact that there is a piece of paper that evidences a debt that is not yet due, to my mind is a confirmation of the indebtedness.

Q. I see. Now, on page 33 there is a particular situation relating to notes receivable. For example, large installment companies may have thousands of notes receivable which are controlled by satisfactory internal check. I take it you would not feel that confirmation was necessary in such a situation.

A. It is a little hard to state. I would think that—well, let me say this: It is stated that these are controlled by a satisfactory internal check. Any such situation would require detailed study of

the particular conditions, but in all probability the satisfactory internal check would be found to include satisfactory or occasional test confirmations by an internal auditing staff.

Q. And you would accept that type?

A. Which procedure, in most cases, would be at least highly desirable as part of the system of internal control. Assuming this satisfactory internal check, the existence of it, I should not consider it necessary for the public accountant to confirm the notes receivable.

D. INVENTORIES

Q. I see. Now, turning to inventories, Mr. Bell. In your opinion, is an accountant responsible for the pricing of inventory in accordance with generally accepted accounting principles?

A. Yes.

Q. And one of the quite frequent bases is cost or market, whichever is lower. What is meant by "market price" in that connection? What procedure do you employ to satisfy yourselves that such a market price is, in fact, applicable as to quantities, grades, conditions, and so forth?

A. Market price means, in my opinion, the cost of reproduction or replacement or the sales value less selling expense, if that is lower. This definition applies in nearly all cases. There are some instances, such as mineral products, where sales value is the only measure of market price.

In determining the market prices, recourse is had in some cases to published quotations, and in others for recent purchase invoices.

As to manufactured goods, the reproduction cost would be measured by the present replacement cost of the principal ingredient and of labor and other elements.

As to identifying the market price with grade and quantity, the public accountant cannot, of course, be expected to be familiar with all the fine technical aspects of the client's affairs. All he can do is use his common sense.

As to quantity, I do not see that the public accountant can differentiate between the market for, say, a few hundred pounds of merchandise and 10,000 pounds any more than he can differentiate between the quoted market value of securities which may be based upon the sale of a few hundred shares of stock and the price which may be obtainable for, say, 10,000 shares of stock.

Q. You would distinguish, would you, between, let's say a retail selling price and a wholesale selling price?

A. Oh, yes. Now, which is this, a retail establishment, or what?

Q. Well, I am speaking in either case. Let's take it as a retailing establishment. The price to it from its wholesaler might very well be different from the market price to the wholesaler. Will you distinguish that price?

A. Oh, yes. As I have said, the market value of the inventory in the hands of retailers is what it would cost to replace that unless the goods are obsolete or out of fashion or something or other, and they are going to get rid of them for what they can, in which case the selling price would be the criterion.