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An investigation of auditing procedures--through a case study

Florence Millicent Rhaney
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AN INVESTIGATION OF AUDITING PROCEDURES--
THROUGH A CASE STUDY

A THESIS
SUBMITTED TO THE FACULTY OF ATLANTA UNIVERSITY IN
PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR
THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION

BY
FLORENCE MILLICENT RHANEY

SCHOOL OF BUSINESS ADMINISTRATION
ATLANTA UNIVERSITY
ATLANTA, GEORGIA
AUGUST 1967
To my family and friends
PREFACE

The Master's Thesis is one of the requirements for the M.B.A. Degree at Atlanta University. While the students are given the opportunity to choose the topic of their choice, it is desirable to choose a topic that relates to one's major area of concentration (accounting, economics, finance, management, or marketing).

With a concentration in accounting, and an interest in case studies, these two interest were combined in the formulation of a case study of auditing procedures encountered in one particular company.

Even though this study was made to satisfy the thesis requirement there are other purposes which will be noted in the introductory chapter.

The writer wishes to thank Dr. Harding B. Young, Dean of the School of Business Administration, Atlanta University, for his consultation in preparing me to make this study. This study has also been carefully read and criticized by Professor Jesse B. Blayton, Sr., C.P.A., my advisor and Accounting Professor at Atlanta University, who has made many helpful suggestions. I feel that the suggestions from such an experienced person in accounting have added materially to the value of this study.

Florence Millicent Rhaney

Atlanta University
August 1967
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CHAPTER I

INTRODUCTORY CHAPTER

Introduction

Today problems face us everywhere, from the factors of going to war with other countries or deciding whether to support one particular country to whether you should attend your classes everyday. In order to reach a decision concerning these problems people usually look at history to see what has happened in the past that will influence their decision today. This method will surely give you some insight as to the past, but what happens if this problem has never occurred before or you do not know where to get information concerning your problem.

A tool that is being used to identify and assimilate various problems in most areas of study, and in business, is the case study method. It is also noted that the case method is becoming popular in all of the disciplines of business.

Case studies can be interesting. The case itself only presents the facts that are pertinent to the business or industry which may be the subject or some of the problems. However, each reader may see a problem in one case entirely different from another person's point of view. The main point that should be remembered is, the ultimate decision that is reached may depend upon the analysis that is presented for the case.
For example, at the top level, an executive does not have any "all-wise" adviser to inform him what problem or problems he should be watching or working on at a particular time. That he must decide himself. And he has no reference book to look into, no infallible aid to give him the solution. He must nevertheless, find some workable solution. This he does by the use of experience, the exercise of his judgment, usually after discussion and consultation with others. And neither before a decision is made, nor after, can he be absolutely sure he has taken the right action. For there is no absolute right in the areas of important business decisions. There are, for the most part, only opinion and judgment.¹

Purpose of Study

Case studies in classroom situations can prove to be interesting in the fact that it gives the student a chance to come to grips with some of the problems that face businesses today. However, in some instances, the student may not have placed as much emphasis on a case to receive the ultimate benefits as he should, as there may not be a personal interest in the company or a feeling of familiarity.

For this reason, it is believed that a case study can be made of any problem pertaining to any particular type of business. Therefore, it has been decided to study a problem that has occurred in the past pertaining to a contemporary company. It is hoped that if this problem should arise again in this company or any similarly situated concerns the outcome may be of some help to management and the workers.

Limitations of Study

In this study, the case that is being presented is an actual situation. Therefore, the writer found it necessary to disguise the name of the company and persons mentioned throughout the case. However, the reader may find that the type of company and its location has not been altered for presentation.

Method and Procedure

As this study begins with an introductory chapter, the purpose of this chapter is to acquaint the reader with the study that is taking place. Included in this chapter is the introduction, purpose of the study, limitations of the study and the method and procedure. In addition, a synopsis of the real estate business and auditing profession has been included in this chapter to acquaint the reader with these two businesses as they will be referred to throughout this study.

Chapter II consists of the case that has been prepared by the writer for further analysis. Throughout this case The J. B. Smith Real Estate Company, Inc. will be referred to as The Smith Company.

Chapter III identifies the problem pertaining to the case study. The problem was not included in the introductory chapter because it is felt that there would be prejudice in defining the specific problem before the case was presented.

The case will be analyzed by the use of a major hypothesis. The major hypothesis will be substantiated or nulled by the use of minor hypotheses. A conclusion will be reached after each minor hypothesis. There will not be an elaborate point system used as a guideline in drawing each conclusion. Instead, conclusions will be drawn from the side that presents the optimum solution. On many occasions it may be noted
that if a rule or law prevails in any situation, this will take precedence over any other prevailing factors.

Reference materials are used in aiding the writer's point of view. It will be gathered from the following sources: conferences with persons in the field of real estate and auditing; books and other reading materials written on the subject and also from careful observation of activities that occur in daily action that may pertain to the solution of the problems in the case.

A summation of the overall conclusions will be presented in the fourth chapter. This chapter will also contain recommendations that will be a guide for future aids and a guide to help solve the existing problems which remain in the business today.

Definitions of terms commonly used throughout this study, that may be misleading or not ordinary terminology have been defined and included in the appendix. Information which appears as reference material is also included in the appendix.

References which are normally included in studies of this nature have been omitted as the persons conferred with may be the actual persons appearing in the case and representing the particular company. However, footnotes and the bibliography which are customary in research papers will be employed by the writer when it is necessary.

To help the reader follow this study much closer is should be noted that in the first chapter the writer is referred to as the writer, as an analyst in Chapter 3, and as an advisor in Chapter 4.

Synopsis

Real Estate Business.—Real Estate plays a vital part in our national economy. More than sixty percent of the total national wealth
is represented by land, land resources, and real estate improvements. The value of all real estate is estimated in excess of 600 billions, or nearly six times the worth of all mechanical and other equipment of factories and utility industries, including the railroads.

The real estate business engages the attention of many people. It concerns the millions who purchase a home, or acquire real estate for business purposes, as well as those who devote their entire time to real estate on their own behalf or on that of others. As a resource and commodity, real estate affects the welfare of all. It is continuously being bought, sold, improved, financed, leased, appraised, and otherwise dealt in by related business and professions.

Although business generally implies transactions in a commodity for profit, many concerned with real estate are not primarily interested in real estate transactions for profit. Each person requires shelter. Everyone is affected, directly or indirectly, by governmental policies involving housing, taxation, assessment, and regulation of real estate.

The importance of real estate as a source of annual business income can readily be judged by the rising volume of residential construction. On the average each new home sets off a chain reaction affecting the ownership or occupancy of ten existing homes. Not all of these transactions are cleared through business channels. Many homes are retained for investment purposes, rented, or exchanged under private and personal agreement without professional or business aid. Nevertheless, the majority of real estate transfers are reflected in the sizable dollar volume which measures real estate business activity.\(^2\)

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Auditing Profession.—The profession of public accountancy has become a social force because of the reliance by stockholders, creditors, management, and employees upon the accountant's representations. Public accountancy is one of the younger professions, and the progress of the profession is at an accelerating rate. Accounting could not develop at a speed in excess of the developments in economic theory, finance, and business conduct in general. Professional standing is the result of public concession and is not the result of the claims of practitioners or their representative spokesmen. The profession of accountancy is on a par with other professions with respect to ethical conduct and on an approximate par in some states with respect to education and experience required for admission to public practice at a certified level. Educational requirements are constantly being raised in the majority of the states of the United States.

Over approximately the last twenty years, the activities of public accounting have emerged from detailed audits to today's modern examination of financial statements and the accompanying expression of opinion of those statements. Paralleling the shift in audit emphasis has been a greatly increased range in the activities of the certified public accountant. Some of these activities include tax services, accounting systems installations, integrated and electronic data-processing services in connection with normal business operations, services in connection with mergers, receivership services, corporate reorganization services, governmental bureau service activities, services related to regulations over securities issuances, general management advisory services, and many others. And the new fields demanding the services of the certified public accountant will be greatly expanded.
with the passage of time and the increased demands of the world of business.\textsuperscript{3}

CHAPTER II

THE J. B. SMITH REAL ESTATE COMPANY, INC. CASE

The J. B. Smith Real Estate Company is a small real estate company located in a large city in Georgia. It was founded in 1927 by John Bynes Smith, a native of that city. He had previously worked as a carpenter with another local carpenter.

In 1927 the J. B. Smith Company's main business was obtained from the rental housing market of minority groups (mainly Negroes). Besides Mr. Smith, the only other employees were a rental agent, and a clerical worker Mrs. Dixon.

With the expansion of the business through the increase of the rental market and the growth in buyers for houses, the company was now handling nearly 2.5 million dollars a year and Mr. Smith found the need for additional funds to finance the expanding growth of the business. Shares of stock were sold to some interested local business and professional men and the business was incorporated in 1954. With the issuance of stock there became a need for a board of directors. This was made up of seven conservative men with different professional backgrounds. With the exception of Mr. Smith, none of these men had a knowledge of the real estate business. Mr. Smith was made president of the board of directors along with his existing responsibility as broker for the firm.

The expansion of the business also brought about a need for additional employees. Mrs. Dixon was made manager of the company and two new employees were hired. Mrs. Adams, as clerk-stenographer and
Mrs. Jackson as clerk.

This being a small office staff the relationship between the employees and the boss was surmountable. As the rental agent was not in the office during most of the day this left the three ladies in the office most of the day by themselves. Along with the fact that they are given the opportunity of learning most of the activities of the business, the ladies became quite familiar with each others personal lives as they had a close relationship with each other outside of the office. Each day Mrs. Dixon, who is a hypochondriac, found great pleasure in having someone to listen to her many illnesses.

The work in the office was often intermingled. Along with their regularly assigned duties each of the ladies accepted rental money and kept her own records. At the end of the day this money was reported to Mrs. Dixon, who also collected money.

The wages that were paid the employees were the minimum wages. Mrs. Adams who was very ambitious found that along with these minimum wages, raises were hard to achieve and there was no room for advancement. Therefore, she decided that the only outlet was to become a real estate salesman, thereby earning commissions to supplement her income. With this achievement she became the only employee to become a salesman.

In the Spring of 1961, Mr. Smith died suddenly from a heart attack, leaving no one to follow him as broker. This left the company in a dilemma as in the State of Georgia it is a law that after the succession of a real estate broker a real estate company is given three months (See Appendix II) to operate before its doors are closed.
Mr. D. J. Archer, a long time friend of Mr. Smith's and Broker of one of Savannah's larger real estate firms consented to serve as broker until the company had its own broker again. Mr. Archer's generosity was incapacitated for three years.

During this time the board of directors asked Mrs. Adams to take the broker's examination (See Appendix II) to become the broker for the company. This request brought about a great deal of animosity among the lady workers. Feeling this strain, Mrs. Adams began to worry about her relationship with the other employees and how this animosity could affect the business if she were to become broker. Therefore, she found it difficult to concentrate on preparing for the examination which she did not pass. After this, one of the directors passed the examination and became the broker.

With the change of brokers it was felt by the members of the board of directors that there was a need for an audit. It was not felt that there was any fault in the operation of the company but it was believed that there was a need to know the financial standing of the company at the time of this change.

Mr. Robert Jordan, who was well known by the employees and the board members was asked to serve as auditor. Mr. Jordan, the cashier at one of the local banks, was a retired insurance examiner and had audited the books of other small companies throughout Georgia. With his duties at the bank, Mr. Jordan found it impossible to perform the audit alone. Knowing that the fee he would receive was not comparable to the fee that most auditors received in this area he could not afford to hire professional help.
Mr. Jordan asked Miss Jane Adams to help him in this audit as he needed someone who was familiar with calculators and who could type to prepare his report. Miss Adams, a senior at one of the local colleges, majoring in Business Administration with a concentration in accounting, had previously worked with Mr. Jordan at the bank doing her laboratory work in order to complete her requirements for graduation. Incidentally, Miss Adams is the daughter of Mrs. Adams who is employed by The Smith Company.

In the Spring of 1965, Miss Adams worked diligently with the financial records of The Smith Company adding the figures from the sample she was given by Mr. Jordan, (she worked during the day and he at night). Mr. Jordan prepared the reports that were to be presented to the board of directors. Included in his reports was the fact that there was a misappropriation of $5,000. However, he also stated that The Smith Company’s records were not in accord with the generally acceptable accounting standards. He also recommended that the duties of collecting money and recording be handled by different persons.

The presenting of this report brought about many resentments among the employers and employees and among the employees themselves. The board of directors immediately sought to fire Mrs. Dixon as the members felt that she was responsible for the $5,000 misappropriation.

Mrs. Dixon became angry with Mrs. Adams as she said that her daughter told her about the findings before the report went to the board of directors and Mrs. Adams could have told her about it. However, Mrs. Adams denied this accusation saying that her daughter did not mention any information relevant to the outcome of the audit to her.
There is still unrest in The Smith Company and one year later Mrs. Dixon decides to take a six-month leave of absence to have an operation on her eyes. During her absence the board of directors again began maneuvering to take away the managerialship of The Smith Company from Mrs. Dixon. No changes have been made in the accounting methods of The Smith Company.
CHAPTER III

ANALYSIS OF THE CASE

Hypothesis

Major Hypothesis.—The audit that was performed for The Smith Company was inefficient, therefore, the board of directors should not rely on the findings 100 percent.

Minor Hypotheses

(1) The audit was not performed by competent persons.
(2) The procedure of the audit was the cause of the misappropriation of funds.
(3) The board of directors was not competent enough to reach a decision concerning the outcome of the audit.

Analysis

The audit was not performed by competent persons.—Before the first hypothesis is analyzed it is necessary to see what the American Institute of Certified Public Accountants (AICPA) considers as the competency of an independent auditor.

(1) Idealism.—Professional success originally is built upon the idealism in which the profession founded; idealism must not be permitted to diminish with the passage of time or by the exertion of pressure.

(2) Culture. The word is used in its broad sense.

(3) Leadership.—Without this quality, professional status is not attainable.
(4) Personality. — The auditor must possess a pleasing personality, tact, judgment, resourcefulness, self-control, and dignity.

(5) Character. — Any person of professional status must be honest, possess high moral standards, be industrious, and possess good work and play habits.

(6) Mental capacity and alertness. — The auditor—through education and professional experience—must develop the mental capacity to analyze every situation which arises in a business. Otherwise, the most important phase of auditing—its analytical aspect—is lost.

(7) Experience and training. — No one can hope to be a leader in his field without experience and rigorous training under proper guidance.

(8) Constructive ability. — As an adviser on the general phase of business operations, the auditor must construct systems, reports, a working system of analyses so that they will be helpful to the client who relies upon them.

(9) A mastery of modern auditing procedures and practices. — Auditing is becoming more exact in its techniques and standards.

(10) An excellent knowledge of accounting theory. — This knowledge is the fundamental basis upon which rests all future development and professional progress of the auditor.

(11) A thorough knowledge of the operation of modern accounting practice. — Without this, the procedures of the auditor will be faulty. Developments in integrated data processing must be studied.

(12) Training in federal, state, and local taxation procedures.

(13) A comprehensive knowledge of cost accounting.

(14) A knowledge of budget preparation and control.

(15) A knowledge of governmental accounting procedure. — This is a field of increasing activity for the public accountant.

(16) The ability to install accounting systems and office operating systems.

(17) Training in commercial law. — The laws of sales, contracts, agency, negotiable instruments, insolvency, and bankruptcy are interwoven with accounting and auditing practice.

(18) A mastery of the English language. — The auditor must be able to speak well and to write clearly, interestingly, and forcefully.

(19) A sound knowledge of business organization and operation. — Advice as to the form of business organization, incorporation procedure, purchasing, and sales procedure requires this knowledge.
(20) A thorough knowledge of finance.—For maximum efficiency, the auditor must be well versed in corporation, partnership, and personal finance.

(21) A good acquaintance with principles of economics.—Broad economic principles govern modern industrial life.¹

Affirmative Views.—Naturally, the auditor must also have common sense. He is a professional person; and his personal attributes, coupled with his ability, education, and experience will determine in great measure the extent of his success.

In analyzing the information that was given in the case it is believed that to a reasonable degree the auditor possessed the qualities that are considered necessary by the AICPA.

It is also questionable as to whether the auditor was independent enough by serving as a consultant to management. In a study taken by the Committee on Professional Ethics of the AICPA supports this question. For their finding was this: The certified public accountant who acts as a management consultant establishes a relationship with his client which might be viewed by a reasonable observer as creating a conflict of interest with his audit independence. That is, does it create a conflict between the certified public accountant's personal interest and the interest of third parties to whom the accountant has a direct fiduciary responsibility in conjunction with an independent audit? The Institute's Committee on Professional Ethics does not believe that the rendering of management advisory services suggests to a reasonable observer a conflict of interest. However, the committee

does not offer any empirical evidence to support its contention.\textsuperscript{2}

The hiring of the Jr. Accountant by the auditor could not have been considered a fallacy for the following reasons: The employer is under the authority to employ a sufficient number of competent employees for the task at hand. If special skill or experience is required, he must hire employees with such qualifications. He must exercise reasonable care in selecting and retaining competent employees, and he is liable for any injuries resulting from a failure to do so.

In determining whether the employer has exercised proper care, it must be remembered that incompetency extends to any kind of unfitness, including careless habits, which makes the employment of the worker dangerous to his fellow employees. On the other hand, infancy, physical incapacity, inexperience, lack of training, or inability to speak English does not necessarily establish incompetency.\textsuperscript{3}

**Negative Views.**—This side of the analysis brings up another point of view. One of the persons engaged in the audit was a relative of one of the employee's. Even though this auditor is not a member of the AICPA, it frowns upon the performing of an audit by a person that is related to a key worker. For it states in its Code of Professional Ethics, Article I, Section 1.01 the following:

\begin{quote}
...A member or associate will be considered not independent, for example, with respect to any enterprise if he, or one of his partners, (a) during the period of his professional engagement or at the time of expressing his opinion, had, or was committed to acquire, any direct financial interest or material
\end{quote}


indirect financial interest in the enterprise, or (b) during the period of his professional engagement, at the time of expressing his opinion or during the period covered by the financial statements, was connected with the enterprise as a promoter, underwriter, voting trustee, director, officer or key employee...

Although neither of the auditors is a key employee of this firm, one is a relative (daughter). A relative is defined as having relationship one to another; mutually related. Therefore, it could be feasible to believe that the interpretation of this code could extend to relatives.

Then too, with the auditor being friendly with the members of the board of directors and the employees could have called for an inadequate audit as the auditor could have basically been trying to please his friends.

Conclusion.—After judging the above facts it is believed that the education, training, and personal traits of the auditors would give them a satisfactorily degree of competency. However, relationship with their client was the one disdainful fact that causes the analyst to support the first minor hypothesis that the audit was not performed by competent persons.

The procedure of the audit was the cause of the misappropriation of funds.—Procedures are acts to be performed during the course of an examination. By applying proper techniques, procedures lead to proof of accuracy of the records and financial statements. Audit procedures constitute the course of action available in determining the validity

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Affirmative Views.--The first argument in support of this hypothesis is that the two persons performing the audit did not work together. This left many instances where, in performing her duties the Jr. Accountant could have added the figures and did not detect any possible errors when she was checking her work.

Then too, when one person has to come and pick up the work that another has started without any explanation as to the outcome there could be many misinterpretations, even though the Jr. Accountant was given instructions as to what duties she was to perform from Mr. Jordan, the auditor.

Negative Views.--The following views are given in contradiction to the aforesaid hypothesis.

The method of bookkeeping for this company was done by persons who were use to keeping the records according to the existing company's policies. Even though the method outlined in The Smith Company Case appeared harsh it could be justifiable for the following reasons. The purpose of accounting is to furnish financial data concerning business enterprise, compiled and presented to meet the needs of management, investors, and the public.

A consistent framework of standards is needed to serve as a basis for judgment in constructing and interpreting financial statements.

Accounting standards should be systematic and coherent, impartial and impersonal, and in harmony with observable, objective conditions.7


However, it may be noted that if two or more persons are handling cash the duties should be separated by giving different ones the job of handling cash receipts and another the related accounting records. As related to The Smith Company the manager should not have been allowed to collect any of the rent money as it was her responsibility to sign for the money collected by the other workers. This was a policy in their system of control.

This audit was performed by sampling. Could this have been a fallacy in the procedure?

Sampling is intended to reveal information about a population of items by examining only a portion of the items in the population. A common assumption is that sampling yields positive information about the population, when in fact it can only yield negative conclusions. Thus a sample will not reveal the exact percentage of defective vouchers in a population consisting of all vouchers prepared during a year's time. (Assume that a defective voucher is being defined as one not containing the initials of a person who is expected to determine that prices on the supporting vendor's invoice agree with those on the related purchase order. A voucher could be defective for other reasons as well). What the sample will do, if the number of defectives disclosed by the sample is equal to or less than the number specified by an acceptance sampling table, is tell the auditor that he can accept the population, with a stated amount of confidence, as not having more than a stated percentage of such defectives.  

If internal control is deficient, the auditor's modification of his examination should not be in the direction of increasing sample size for his tests of transactions to achieve increased reliability for his conclusions about compliance with the system of internal control. The sample of one type of transaction should suffice to indicate that the system such as it is, is operative, and a larger sample that would disclose the extent of compliance helps very little in assessing the fairness of propriety of the account balances produced by the system.\(^9\)

**Conclusion.**—It can be said that the fact that samples only represent the population and cannot be relied upon 100%. As it was pointed out the method of bookkeeping for the company was the most logical cause of the misappropriation of the $5,000 and not the procedure of the audit.

The board of directors was not competent enough to reach a decision concerning the outcome of the audit.—The directors of American business corporations carry a heavy load of responsibility. They hold key positions in the management of many of our business concerns. Their judgment and resourcefulness in selecting operating executives and their wisdom in approving administrative policies will play a major part in the job-making task which business faces in the years ahead.\(^10\)

**Affirmative Views.**—Even though these seven men were not originally businessmen or realtors, their varied backgrounds served as good sources for logical decision making.

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As in the case of Reno v. Bull, 226 N.Y. 546, it was found that—
An opinion, especially an opinion by an expert, may be found to be fraudulent if the grounds supporting it are so flimsy as to lead to the conclusion that there was no genuine belief back of it. Directors of corporations have been acquitted of liability for deceit though they have been lax in investigation and negligent in speech.\textsuperscript{11}

**Negative Views.**—In taking a poll from the public to see how they voiced their sentiments about directors these are the findings of Dr. John C. Baker, Professor at Harvard University in 1945.

Directors are complacent and not deeply concerned over their responsibilities; they lack a profound interest in corporate welfare. "Stuffed shirts."

Directors, irrespective of whether they are executives or non-executives, are not independent; they often fail to have the stockholder's point of view. "Rubber stamps."

The selection and election of directors are not controlled by stockholders but by executive officers. The president may be reelected by men whom he placed in office.

Executive-directors are more interested in "back-scratching" and "logrolling" for individual projects than in the welfare of the company as a whole.

Many directors give too little time to their duties and even fail to attend meetings regularly or to meet their most profunctorial obligations.

Directors do not know what their duties are. "They are mainly facade or window dressing".

Directors often take a narrow view of their responsibilities and neglect completely stockholders whom they are supposed to represent. Directors own no stock, or too few shares to be interested stockholders.

Directors act on problems about which they have too little knowledge.

Directors do not retire when their usefulness is over.

The directorate is just a place to which to "promote superannuated officers."

Directors frequently make decisions in which they are personally interested. This permits self-dealing and creates a conflict of personal interests with their responsibilities to stockholders.

Directors are recruited for the most part from a small group of influential individuals; certain directors are on a large number of directorates. They therefore tend to represent this group of persons and their thinking rather than the stockholders or the public. "members of an exclusive club who conform to a social pattern."

Many directors know well the operations of a specific company, and are motivated by what they can "get out" of their position rather than by a desire to serve all stockholders and society effectively. The motivation of directors has never been clearly explained or understood.

Outside (nonexecutive) directors permit the establishment of groups of interlocking directors.

Directors and officers are insiders and form a self-prepetuating management group. They have great economic power, and stockholders and society have too little control over them.12

Conclusion.--Even though the board of directors is not liable for being negligent in assessing the findings of reports by auditors, it is also felt that they do not possess enough competency to always make prudent and just decisions. Therefore, it can be said that this hypothesis is correct--The board of directors were not competent enough to reach a decision concerning the outcome of the audit.

CHAPTER IV

SUMMARY AND RECOMMENDATIONS

Summary

The minor hypotheses may be concluded and summarized as follows: the audit was not performed by competent persons; the procedure of the audit did not necessarily give rise to the misappropriation of the funds ($5,000), but rather, the system of bookkeeping was the most logical cause and; the board of directors did not necessarily have enough competency to make such a rash decision.

In view of these facts the major hypothesis—The audit that was performed for The Smith Company was inefficient, therefore, the board of directors should not rely on the findings 100 percent—is supported by the preceding findings.

Recommendations

July 24, 1967

To The Board of Directors of The J. B. Smith Company, Inc.:

As consultant to your company I feel that it is my duty to offer the following recommendations that may help to solve your problems. It is felt by my colleagues and me that on some occasions you may not agree with some of the points and may not wish to employ them. However, we ask that you do give them careful consideration and thought as to how we have outlined and analyzed each recommendation.
**Present Operations**

*Change the system of bookkeeping.*—Designate the duties that all of the employees are to perform. It would be best that your clerk collect the rental money at the office only, the clerk-stenographer make the postings in the ledger and the manager may then keep the records of the money that has been collected along with her other duties.

**Future Operations**

*Hire professional auditors to perform the audit of records, preferably a Certified Public Accountant (CPA).*—This will alleviate some of the problems or doubt of any collusion between auditors and the client. Also, this audit will be recognized more favorably by the board of directors, stockholders, creditors and the law.

While this is not being offered as a recommendation it is also felt that Mrs. Dixon, the manager should not be fired. It is believed that for the past 40 years she has been an asset to this company and she must possess some loyalty and a personal feeling towards it. It is further believed that $5,000 is a trivial amount for a person to deliberately misappropriate as she handles approximately 2.5 million dollars a year. It is further believed that Mrs. Dixon's absenteeism from the company is not a commitment of guilt, for she could have actually been sick or this could have been part of her pattern as she is known to be an habitual hypochondriac.

(Signed)
APPENDIX I

Definitions

Independent Auditing.—Independent auditing is the objective examination of financial statements prepared by management. In his examination of the financial statements of a client, an auditor relies upon the examination of internal controls, statements, records, transactions and their underlying evidences for authority and validity, other financial and legal records and documents, and evidence obtained from outside sources. An independent audit is performed in order to ascertain the accuracy, integrity, and authenticity of the financial statements. The financial statements should be prepared on a consistent basis, and in accordance with accepted principles of accounting. ¹

Junior Accountant.—The junior accountant takes care of detailed work on an audit engagement, under the direct supervision of a senior. His initial responsibilities are limited; however, his work is of importance to his superiors, to the firm, and to the client. He need have no prior experience but should have a good formal education at the college level, in schools offering recognized courses in accounting. ²

² Ibid., p. 42.
Real Estate Broker.—Real Estate Broker means any person, firm or corporation, who, for another and for a fee, commission or other valuable consideration, sells, exchanges, buys, rents or offers or attempts to collect rent for the use of real estate; also any person, firm or corporate advertising through signs, newspapers or otherwise, as operating or conducting a real estate office or real estate business. ³

Real Estate Manager.—Manages office concerned with enforcing state or municipal rent-control regulations and negotiating rents: Reviews inspection reports of premises and landlord’s and tenant’s petitions for rent adjustments. Conducts hearings, analyzes field reports, compares rates with those of comparable facilities, and negotiates or sets rents. Classifies and adjusts rents submitted on registration blanks. Investigates complaints from tenants regarding unauthorized rent increases. Furnishes information and interprets regulations to landlords and tenants. Cooperates with zoning authorities and building inspection personnel in legal actions against violators of zoning, safety, and minimum-occupancy ordinances. ⁴

Real Estate Salesman.—Real Estate salesman means a person employed by a licensed real estate broker to sell or offer for sale, to buy or offer to buy to negotiate the purchase, sale or exchange of real estate or the lease, rent, or offer to lease, rent or place for rent any real estate for or on behalf of such real estate broker; also any person, other than bookkeepers and stenographers, employed by any

³Georgia Real Estate Commission, Manual For Georgia Real Estate Brokers and Salesmen, (1966), Sec. 8k-W-02.

Small Business.—A small business is defined as a wholesaler with annual sales of less than $5,000,000; a retailer or dealer in services with a volume of less than $1,000,000; a construction company whose annual receipts for the preceding three years have been less than $5,000,000; a manufacturer with 250 or fewer employees. Manufacturers with between 250 and 1,000 employees may be classed as large or small depending on the type of activity.

This classification is an arbitrary one and therefore has some limitation. The concept varies in different kinds of businesses. Some businesses which would be classified as "small" by the above standards may be "big" in organization, operation and finance. There are some other typical characteristics which assist in making the distinction. For example, the area of small business operation is generally local, ownership is held by comparatively few individuals, capital is supplied by a group that is usually small, and usually there is a close identification between ownership and management.

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5 Georgia Real Estate Commission, loc.cit.

APPENDIX II

Real Estate License Law

The following reference material is taken from The Manual For Georgia Real Estate Brokers and Salesmen, prepared by the Georgia Real Estate Commission.

Examination.—After an application is filed, and examination scheduled no refund of license fee will be made to any applicant in the event of withdrawal. Written examinations for real estate brokers and salesman shall be held at the State Capitol (or other place designated by the Commissioners). All applications for examination must be on file in the Commission office ten days prior to the examination date. A passing grade of seventy-five percent is required of all applicants. If the applicant taking the brokers examination fails on the first examination, he or she, will be permitted to take another examination in six months, however, if applicant fails to pass the second examination, he or she will be required to wait one year before taking the third examination. If the applicant taking the salesman's examination fails on the first examination he or she will be permitted to take another examination, if he or she fails the second examination, he or she will be required to wait one year before taking a third examination. If a salesman applicant fails the examination, and desires to take a subsequent examination, a new application and fee must be submitted.
License Law.—It shall be unlawful for any person, firm partnership association, co-partnership or corporation, whether operating under an assumed name or otherwise, to engage in the business or capacity, either directly or indirectly, of a real estate broker or real estate salesman within any county in the State of Georgia, without first obtaining a license under the provision of this Chapter. Provided, however, that any person who has been actively engaged in the real estate business, either as broker or salesman, and who is actively engaged in such business on April 1, 1956 in the county in which he is a resident if such county has not prior to such date been under the jurisdiction of the Real Estate Commission, and who makes application for license on or before April 1, 1957, shall be entitled to a license either as broker or as salesman upon the payment of the fee required by law for such license, and shall not be required to stand the examination for such license. The provisions of this Act shall not apply to regular licensed practicing attorneys where the transaction involves the relation of attorney and client.

Qualifications of Applicants for License to Act as Real Estate Brokers or Salesmen and the Bond to be Given.—Licenses shall be granted only to persons who are trustworthy and bear a good reputation for honesty and fair dealing and are competent to such a manner as to safeguard the interest of the public and only after satisfactory proof thereof has been presented to the Georgia Real Estate Commission. Before any individual may be granted a broker's license he may have had a salesman's license in the State for at least 12 months and must have been actively engaged in the real estate business for such period of time, and must have passed an examination provided by the Commission;
except that in extraordinary cases the Commission may in its discretion grant a temporary certificate; and except when the applicant has previously held a broker's license in this State he will be eligible for reinstatement of his license upon satisfactory proof being furnished the Commission that he was in good standing with the Georgia Real Estate Commission at the time of his retirement from the real estate business, and conditioned upon his passing an examination to be given by the Commission, and such licensed brokers shall give an indemnity bond, in the amount of $1,000 in a form approved by the Commission, and such shall be an indemnity bond in which the broker and his surety are held and firmly bound to the Governor of the State of Georgia, in his official capacity as such and his successors in office; and the condition of this obligation is that the bond shall be subject to suit by action thereon by any person who shall sustain actionable injuries or loss or damage and it shall be for the purpose of indemnifying any person injured, or damaged, or who may suffer loss due to any wrongful act of any broker, his agents or employees. Said broker shall be bound under said bond to faithfully perform all duties as such broker so far as public citizens are concerned.
BIBLIOGRAPHY

Books


Articles
