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THE AUDIT REPORT FOR AN AGRICULTURAL COOPERATIVE ENTERPRISE

By

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COOPERATIVE RESEARCH AND SERVICE DIVISION

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FOREWORD

Daniel Webster said, "Credit has done more a thousand times to enrich nations than all the monies of the world."

Originally credit was extended largely because the credit seeker had a good reputation. Today credit seekers must bulwark and buttress their reputations with facts - which are best presented in audited reports.

Many papers have been written on all the various phases of credit, except on that extended by financing institutions to farmers' agricultural cooperatives. In this particular field, where material is so scarce as to be almost nonexistent, it is not surprising to find few articles on the credit role of audit reports. It is hoped that this paper, written from the credit viewpoint, will stimulate constructive discussion so that this long neglected subject may receive proper attention and development.

The quality of audit reports of agricultural cooperatives has been improving consistently during the last ten years. This improvement is due mainly to the critical reviews of these reports by the various financial institutions extending agricultural credit - particularly the banks for cooperatives which, since their inception, have been most insistent that their clients engage properly qualified auditors (certified when possible). The criticisms and suggestions, in the main, have been welcomed by professional accountants. It has been recognized by all concerned that there is room for much research to develop standardization and uniformity in this specialized field.

Those people interested in agricultural cooperatives often are at a loss for a guide by which to judge the quality of their audit reports. This article, therefore, is designed primarily for the use of directors and managers, but it also should be of assistance to professional accountants who audit cooperatives.

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By D. G. WHITE, Assistant to the Chief
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CONTENTS

There are three major types of agricultural cooperatives. These are here listed according to the principal services performed and commodities handled.

1. *Marketing*

Citrus fruits	Tobacco
Deciduous fruits	Sugar
Other fruits and vegetables	Nuts
Wine and brandy	Wool
Dairy products	Cotton
Poultry and eggs	Livestock
Grains	Canneries

2. *Purchasing*

   Farm supplies - general
   Petroleum products

3. *Farm Business Services*

Mutual water companies	Warehousing
Mutual insurance companies	Farmers' markets
Bargaining associations	Cotton gins
	Refrigerated food lockers

While some cooperatives perform only one function, others may operate in all three fields and in more than one of the subdivisions shown. As a consequence, no model or uniform style of report can be applied to individual associations. The circumstances relating to the product handled, or the service rendered, necessitate individual specialized treatment. Cooperatives in the same field vary markedly in their internal operations and are affected by particular legal or economic considerations. However, some factors are uniformly applicable under all circumstances and these will be discussed in part I of this report.

In this article there is considerable material which will not be new to the better qualified accountants. Furthermore, much of the data applies equally as well to all forms of business. Some of the material will appear as basic, perhaps even elementary. Parts I and II of this paper are built around a composite of the better features of several recent excellent audit reports. Yet these excellent reports are exceptions. A review of hundreds of reports reveals a level of quality far below the desirable standards indicated in this paper.

NOTE: Mr. White is on leave of absence from his position as Vice President of the Berkeley Bank for Cooperatives, Berkeley, California.

Acknowledgment is made to George J. Waas, Principal Business Analyst, Farm Credit Administration, and C. C. Nemetz, Business Analyst, Berkeley Bank for Cooperatives, for assistance in the preparation of this report.

Each of the main types of cooperatives as well as each of the various commodity groups has its own particular problems and has solved them through specific methodology which is reflected in its accounting and accounting terminology. While these are interesting and the developments are peculiar to themselves, yet it would be impracticable to attempt to cover the special problems of each. Hence this paper is restricted to those which are, in the main, common to farmers' cooperatives.

The purpose in part III is to suggest certain improvements in cooperative audit reports. It is sincerely hoped that these suggestions will stimulate interest and create particular emphasis on this phase of cooperative auditing.

PART I

OUTLINE OF AN ADEQUATE ANNUAL AUDIT REPORT FOR AN AGRICULTURAL MARKETING COOPERATIVE ASSOCIATION

The title page identifies the work. An association operating on a seasonal or noncalendar-year basis has its report dated for the particular period covered, as "1940-41 Season." Its title page usually appears somewhat as follows:

Blank Cooperative Association
Blanktown, Iowa
Annual Audit Report
May 31, 1941

The date shown is the end of the fiscal year and it specifically refers to the balance sheet. The annual audit should always cover a 12-month period. This is necessary primarily that proper comparisons may be made, also because the Bureau of Internal Revenue requires that income-tax filings cover a 12-month period. Although it is undesirable, many so-called annual audit reports are seen which cover less than 12 months. When such reports are issued the auditor should be careful to include accruals for the balance of the year.

SALUTATION

The cooperative association, probably more so than most other types of enterprise, functions as a trustee for its members and patrons. The auditor, therefore, writes his report for all who have an interest in the association, but directs the report particularly to the association's board of directors. Some auditors have addressed their reports to managers. This practice should be discouraged.

INTRODUCTION

Introductory comments state the period audited, the general composition of the report and the character and scope of the audit. They also contain the auditor's certificated opinion that the report correctly sets forth the financial position and the results from operations. Some auditors place the certificate elsewhere in the report. This is usually acceptable provided the certificate is prominently exhibited. The certificate should be expressed as clearly and simply as possible.

Important changes since the last examination in the internal policies, procedures, organization, financial and operating relationships, Federal or State legislation affecting cooperatives, unusual climatic conditions, or the effect of proration or marketing agreements, if of sufficient importance, form part of this introductory material. This is step number one in placing the latest report in its proper relationship to the previously submitted report.

In this section of the report appear explanations of the change in working-capital position through a statement of funds provided and applied. Many auditors entirely omit this statement. This is unfortunate because nowhere else are certain elements so clearly expressed. This is step number two in the continuity of reports. Step number three is a condensed summary of the operations and discussion thereof, usually in comparison with those of previous periods audited.

Sometimes a condensed balance sheet, comparing the year under consideration with the previous year is employed to show the changes in financial position, often in conjunction with the statement of funds provided and applied. The auditor often states his opinion of the adequacy of the association's total capital and working capital.

The matter of income taxes has become increasingly important in the financial affairs of cooperatives. Therefore, today's report includes appropriate comment and the auditor's opinion upon the association's income-tax status. Ordinarily such comments and opinions are found either in the introductory part of the report or at the end of the closing comments.

The content of the introduction to the report varies according to the circumstances and the individual needs developed during the engagement. This introduction is not, of course, uniformly presented for all engagements, but it does mention all matters of first importance. Other information given in the introduction, depending on the individual circumstances and the type of cooperative audited, is as follows:

Comment on the status of open pools and on the pools closed in the period, including a discussion of any over-advances to pool participants.

Comparison of actual operating results with previously prepared budgets or projections.

Summary of operating and volume statistics, and comparison with those of the prior season or seasons.

Comparison of actual returns to patrons with certain standards; for example, the price paid per unit of raw commodity by commercial buyers when these are available.

Presentation of returns to patrons as between cash returns and the various types of capital and reserve retains.

Summary comments on the patrons' equity accounts when they are impaired or have been importantly affected in the audit period.

Frequently this information is presented in complete detail in separate exhibits or schedules. In that event, and especially if there are many exhibits and schedules included in the report, an index appears in the introduction or on a page preceding the salutation.

COMPLIMENTARY CLOSING AND SIGNATURE

The closing and signature may appear at this point in the report, or it may follow the comments relating to the balance sheet and operating statements.

COMMENTS ON THE BALANCE SHEET ACCOUNTS

Accounts are usually commented upon in the order in which they appear on the balance sheet. The name of each item and its amount is stated as a subheading, thus providing a convenient reference to the comment which follows. (See "Several Typical Comments on Balance-Sheet Items," appended.)

Concise comments are made which clearly explain the nature and composition of each account. Any unusual items, or an unusual balancing of any important account, is fully explained. The treatment accorded, or to be accorded, an item subsequent to the date of the balance sheet is stated when known. On the other hand, when any of these are obvious, unnecessary comment is avoided.

There are full statements showing all assignments of receivables, pledges of inventories, and mortgages of properties. The comments state the extent of the verifications. Items set apart from the general assets for specific purposes, or for other reasons, are noted. Accounts receivable are aged as to date of charge and analyzed as to past and future due dates. The collateral security for receivables is described.

The auditor expresses his opinion freely as to the adequacy of valuation reserves. He states that the receivables, the doubtful items particularly, have been discussed with the management. He indicates that he has reviewed the association's depreciation and amortization policies and says whether these are in accord with good accounting practice and consistent with those of prior years.

He further states that all the important irregularities or inefficiencies noted during the course of his engagement were discussed with the management; that he has made the necessary recommendations; and reports what was or will be done to correct these conditions.

Amounts receivable from and payable to the association's patrons, officers, and employees are shown separately from other receivables and payables. Special attention is given any items in these accounts which may indicate a laxity of management or an unauthorized use of funds. Trade creditors' debit balances are separated from the payables and are shown as assets.

Physical verification of inventories, and their testing and checking by the auditor, are noted. Any inventory shortages or overages are fully described and explained. In some instances, the net realization value of the merchandise inventory (sales value, less estimated expense of selling) is shown for comparison with the value at which the inventory is recorded on the association's books. The net realization value of the inventory of canneries and wineries is usually set forth in the audit comments, but is not shown for cooperatives which handle perishable commodities, such as vegetables or fresh fruit. Such value is shown where the market price for the product is comparatively stable over wide areas, but is omitted where the product values (prices) fluctuate daily in the various selling markets. In the latter instances, inventory summaries by kind of products, grades, and quantities is the extent of the information that may be reasonably expected of the auditor.

The portion of the product inventory which is intended to be held for long-term processing, curing, or aging is segregated by some accountants and placed in the noncurrent or deferred-asset section. From a credit viewpoint, however, such inventory may well be classed as current since practically all products, as for example wine and cheese, are salable at a lesser price at any time before completion of the processing and, therefore, are available for hypothecation purposes or for liquidation as a quick asset in case of necessity.

Additions to and disposals of fixed assets, and interim changes in the reserves for depreciation, are set forth in schedule form. Any reappraisal of fixed assets, its purpose or need, is explained fully. If a plant and equipment ledger is not maintained but is needed, the auditor says so. A statement is made of how the assets are valued and how the liabilities are determined. The write-off or write-down of all assets or liabilities should be disclosed and explained. Some expression is made regarding evidence of the association's legal title to any tangible assets.

Turning now to the liabilities, any bank overdraft is explained. The current or noncurrent status of any liability is disclosed. It is made apparent that all proper accruals have been recorded. Interest rates on loans are stated, as are also the repayment terms, security given, and any loan conditions of particular interest.

Credit balances among the receivables are reflected in the liabilities. Current liabilities to members or patrons are described and their type and origin are explained. Unusual obligations are fully commented upon. The details of fixed liabilities are given. Known contingent assets and liabilities are remarked upon. Deferred liabilities, items of deferred income, and other miscellaneous credits are described.

The patrons' equity accounts are detailed by year of origin, and by amount. The bases of their establishment are cited. Equities credited individually to the patrons on the association's records are noted; and the nature of any remaining net worth not so credited is explained. Any deficit items among the capital-equity accounts are pointed out and their ultimate disposition, if known, is indicated.

COMMENTS ON THE OPERATING STATEMENTS

To make his full contribution to the improvement of the association's operating efficiency, and in recognition of the distinct limitations of bare historical costs and statistics devoid of interpretation, the auditor endeavors to separate and point out the influences of labor efficiency, plant utilization, operating policies and routines, and financial strength or purchasing power.

To be specific, pertinent comments on financial ratios, on the excess or lack of cash, the proportion of working capital tied up in receivables and inventories and whether they are turning over fast enough, are of real value. The association's investment in physical plant should occasion comment as to depreciation and capitalization policies and whether the facilities are productive. Whether the margins in departmental operations or in commodities appear normal should be discussed.

Any unusual factors in the particular fiscal period should be referred to. If it is significant, the association's proportion of the total market should be mentioned, particularly if their control approaches a monopoly. The effect or importance of major changes in marketing or marketing connections should be stated.

COMMENTS ON INSURANCE POLICIES AND FIDELITY BONDS

The report includes a detailed schedule of the insurance policies and fidelity bonds in force and the auditor's opinion on the adequacy of the coverage.

A DESIRABLE FORM OF BALANCE SHEET

The balance sheet is neither unduly condensed nor set forth in extreme detail.

Valuation reserves are deducted from the related asset accounts.

Current outlays entirely for the benefit of succeeding fiscal periods, which would otherwise have to be expended in the following period, are shown as prepaid expenses and are included usually among the current assets as the last item in that group, or sometimes in a separate section of the balance sheet. If substantial in amount, they are explained in considerable detail in the report commentary.

A distinction is often made between prepaid expenses, such as insurance and taxes, and other types of deferred charges, such as organization expense. Deferred charges of the latter category are excluded from the current section.

Slow and doubtful receivables, if not offset by a valuation reserve, and other assets that will not be converted into cash within the normal current cycle are also shown outside the current section.

Any financial interest in other businesses (such as in subsidiaries and affiliates) and the cost value of securities are shown in the investments section. However, when the investments are in other concerns which are substantially or wholly owned, their financial transactions usually should come under the audit and be reported therein. In such instances, a separate balance sheet for each subsidiary should be included as well as a consolidated balance sheet. This is a very desirable practice from the lender's viewpoint, enabling a proper consideration of all connected entities. It is also desirable to include in the audit report some information on affiliated corporations where the circumstances indicate a very close working arrangement or, for instance, where the owners or directors are actually or substantially identical with those of the association under audit.

Where there is a definite intention to sell a particular investment within the period of a year, it is usually then placed in the current-asset section. Securities or other investments held in trust for members and patrons (often occurring under specific bylaw provisions) are so identified and reported separately with an appropriate cross-reference to the related trust liability or contra account.

The valuation basis of fixed assets, if other than cost, is clearly stated and proper segregation is made of any reserve (or surplus) arising from any appreciated values entered on the books. The depreciation reserve against these assets is shown and deducted, the net balance being extended.

Seasonal loans, term-loan installments and all other liabilities due and payable within a year after the balance sheet date, are shown among the current liabilities. In like manner, all assets expected or estimated to be liquidated within a year are usually classed as current.

Amounts currently due patrons, such as sales proceeds or patronage refunds, are shown as current liabilities, as well as any portion of capital equities intended to be retired currently. Estimated amounts payable to patrons for pooled product not yet completely disposed of, are shown as deferred liabilities where the product is of the type that is held by the association over a period of years for processing purposes.

All known contingent liabilities or assets are shown in memorandum form within the balance sheet proper, or by a footnote thereon.

Components of the net worth account are shown separately in appropriate detail. A deficit account is separately indicated and never obscured by combination with other capital equities.

A DESIRABLE FORM OF OPERATING STATEMENT

As a matter of choice the balance sheet may be either followed or preceeded by the summary statement of operations. Like the balance sheet, the operating statement is adequately supported by appropriate comments, exhibits, and schedules, and these are departmentalized when the operations of the cooperative are segregated by departments. The nature and form of the exhibits and schedules are designed to fit the particular type of operations, which varies according to the products handled or the kind of services rendered. In years gone by, the balance sheet alone was often used in analyzing credit positions. Today no audit report would be acceptable without comprehensive data on the details of operations. Such data supplement the information portrayed by the balance sheet, thus giving a more complete picture of the financial status.

In his treatment of expenses, these items are shown as operating charges: taxes (except income taxes), depreciation, and charges for uncollectibles. Any income taxes are deducted after the net operating overage (i.e., earnings, savings) is stated. If revenue derived from other than principal sources is net, or if direct costs thereon can be segregated and a net figure thus established, it is stated as an addition below the net operating overage.

PART II

QUESTIONS OF CREDIT EXAMINERS

The following are the principal questions in the mind of the credit grantor when reviewing cooperative audit reports. A knowledge of the credit viewpoint will explain the reasons and emphasize the need for adequate and comprehensive reports.

If the report is voluminous, what is the arrangement of its material? Is it well summarized and does the general presentation indicate that the auditor has grasped the problems presented by the particular engagement?

What is the exact nature of each current asset and each current liability, and is the general financial position in balance? How were the assets and liabilities verified? How are the assets valued, and does the association have anything less than absolute title to any of them?

What are the management's policies on the collection of receivables? Are the operations in accord with the provisions of the association's articles of incorporation, bylaws, membership marketing agreements, and the State cooperative act, if any? Does the report in general (if not specifically under certain circumstances) indicate that the employees with whom the auditor came in contact appear qualified for their positions? Are the accounts and related records well maintained? Is the accounting system adequate, with an effective internal check and control on the flow of cash? Were there any indications or evidence of misplaced trust?

Are there adequate summaries of the operations, both in dollar and physical volume? What were the sales in dollar and unit volume? What products by type, grade, and volume were received or purchased from patrons? What were the net returns to growers in total and per unit of product? What were the rates and total amount of any assessments or product-unit retains for capital or revenue purposes? What savings or overages have been refunded during the season, or are now available for refund? What refunds or dividends have been declared? Was there an analysis and testing of pools, as well as of any distribution of earnings, sufficient to satisfy the auditor that this phase of operations was equitable beyond question and in accordance with the association's bylaws and members' contracts?

What important opinions did the auditor formulate during the course of the audit engagement? Were all the out-of-line conditions indicated by his report discussed with the management, and what was or will be done to correct them?

With specific reference to the more common balance sheet and operating accounts, these questions arise:

Cash. Where is it? Are any funds set aside for special purposes?

Receivables. What brought them into being? Who are they due from? How collectible are they? Were confirmations of account balances obtained from a representative group of debtors? Which are the largest or the unusual items? What had been collected at the close of the auditor's visit? How and when will the remainder be paid? Are any items secured, and if so, what is the nature of the security? Are any accounts pledged or assigned, and if so to whom and for what purpose? Do the charge-offs include any extraordinary items, and if so, what were they? Is the reserve for uncollectibles adequate? If there is no reserve, should one be established? Are advances or other amounts due from patrons, and from officers and employees, set out separately in the report? Were such receivables properly authorized by the directors?

Inventories. Is there a segregation between the product (or merchandise) inventories and the supply inventories? What is their summary by major items, by quantities, and by price? Did the auditor participate in the physical count and, if so, to what extent, or did he merely secure a certificate from the proper officials? Was the count properly reconciled to the date of the audit? Do the inventories contain any obsolete material, and if so has its value been properly discounted? Were any adjustments made? Were there any significant inventory shortages? What caused them? Are they likely to recur? Is there an adequate system for control of the inventory? What merchandise was out on consignment and was its existence verified at source? Are the supply inventories too large in relation to normal seasonal requirements? What is the net realization value of the merchandise inventory on the going-concern basis? On a liquidating basis? If the merchandise inventory (of fruit, for example) is being disposed of by the association on an agency basis, will its probable net realization cover the costs already incurred in carrying it, plus the advances that have been made thereon to the grower? Or, put differently, have advances been made on a safe basis?

Prepaid Expenses. What types of expenses are prepaid? Are they conservatively stated?

Capital Certificates in Central, Parent, or Affiliated Cooperatives. What is their classification by years and by type, and what changes have occurred since the last examination? Have the certificates been examined? How much control is represented? Are these investments proper for a cooperative? What effect do they have on the association's income-tax exemption status?

Fixed Assets. What is the nature and the cost of additions, and were retirements properly extracted? What changes took place in the depreciation reserve analyzed in brief detail, showing rates of depreciation? Does the association maintain an adequate plant and equipment ledger? Is any particular plant or section of a plant idle? Is the plant adequate or obsolete?

Current Liabilities. What did the auditor do to satisfy himself that all liabilities and accruals were recorded? Were liabilities confirmed directly by creditors? How were they incurred? Have important obligations been permitted to run beyond their due dates? Are all tax liabilities recorded. To whom are loans payable and when; what are the interest rates thereon and what is the nature of any security given? Have any loan conditions been violated? Are there unusually large items, and is there any extraordinary indebtedness among the trade accounts payable? Are there any known contingent liabilities? Is there an accrual for Federal income taxes, and if so, on what basis was the liability determined? Are amounts due patrons and officers and employees set forth in their own separate accounts? How did these liabilities arise and were they properly authorized? When and how are these last obligations to be discharged?

Fixed Liabilities. What are their details? What source of funds will be used to retire them? What are the repayment terms? Are installments payable within the next year shown as current liabilities?

Other Liabilities. Are there deferred liabilities to patrons? Why are they classed as deferred? Are patrons' pool-equity accounts detailed? What is the auditor's opinion on the ultimate disposition of any debit pool balances? What pools were closed in the period, how were they closed, and what were the final results? What are the operating statistics relating to the open and closed pools?

Net Worth. How many members does the association have? Does the membership include other cooperatives or other corporate entities? How many members are active? What is the composition of the association's net worth? How and at what rates is capital contributed or retained? Are capital retains from nonmembers credited to them. If so, on what basis and how are they to be treated? What are the purposes for which capital reserves are established? Are reserves adequate? What changes took place in the net worth accounts during the year reviewed? What items in the net worth section are not credited individually to members (or to nonmembers) on the association's records, and why? Have any capital accounts been impaired? Is interest paid to members on their investment and at what rate? Is the payment of such interest mandatory or discretionary? When there are only a few members comprising the association, are their individual interests in the items of its net worth scheduled? If the association has been exempt from income taxes, what effect on that status may be exercised by an increasing amount of unallocated reserve or surplus, or by unusual and perhaps new types of operations in the period audited? Where the association was recently organized, or is proceeding with an expansion program, and has notes receivable from members given for subscriptions to capital, are such notes shown as a deduction from the total capital so as to clearly and conveniently reveal the amount actually paid in? Are the policies and plans respecting fixed capital clearly and completely indicated? Are they sound?

Operating Accounts. Is the operation departmentalized? What was the source of each department's income and what were its costs and net operating result? How do such costs compare with those of similar organizations? Are expenses or unit costs too high, or is product volume too low? If the volume has shown any marked change or trend, what were the influencing factors? Are members satisfied? Is their attitude toward the association and its personnel a favorable one?

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It is, of course, not expected that the audit report will carry specific answers to each and every one of the foregoing questions. Rather, the report should be designed so as to facilitate a credit analysis from the general viewpoint of these queries.

PART III

POSSIBLE IMPROVEMENTS

There is perhaps little new material for the good auditor in the preceding sections of this paper. Auditors and accountants in general may be surprised that those who extend credit are as critically and extensively interested in audit reports. But the interest goes even further and capable credit men always have questions in their minds that are just not covered by the reports. Perhaps our expectations and desires are too great unless audit fees are increased substantially. However, part III is a discussion of additional data which might well be included in most audit reports.

No doubt it is practicable in some cases to omit any reference to some of the things looked for in the audit report. To illustrate, if no mention is made of the past-due items among the association's liabilities, it may be intended to imply there were none. On the other hand, when no mention is made of the currency of receivables or of items of doubtful collectibility among them, it would hardly be proper to assume that all were current and that they will be collected in full. Taking up the lack of any direct reference to certain out-of-line conditions, particularly those that seriously reflect on the quality of the management, perhaps one should be expected to read between the lines and to draw his own inferences, or perhaps the matter might, with propriety, better be made the subject of a separate communication apart from the audit report, provided reference is made in the report to the separate memorandum.

In some cases, however, it is found that highly unsatisfactory conditions have developed over a long period before being disclosed. One association, for example, never operated in accordance with many important provisions of its bylaws and membership marketing agreement. Apparently the auditors never checked this phase. As a result, its financial position is now greatly impaired and the association is liable for suits on the part of members.

In other instances, employees and officers have defrauded associations, or operating capital has been carelessly or unwisely invested in improper receivables or other frozen assets, thus indicating the lack or the nonoperation of a proper internal control and check upon the flow of association funds. Each set of bylaws normally provides for a proper control of funds in general terms, and in the absence of any comment in the audit report that the required control is not being properly exercised, it should be safe to assume that there is nothing irregular in that connection if the auditor stated he examined the association's legal structure.

Most auditors compare the association's system of internal control of its accounting and of its funds with the requirements indicated by their own training and experience, and when they find the existing controls incomplete or inexact, recommend the changes necessary to correct them. The standard form of accountant's report adopted by the council of the American Institute of Accountants includes the statement by the auditor that he has reviewed the system of internal control and the accounting procedures. It is recommended that this statement be included in all reports where the system of internal control and the accounting procedures have been reviewed. Further, it is strongly urged that auditors always include as standard procedure during an audit a review of the internal controls and accounting system.

The operating statements of some cooperatives are incomplete in some respects. Two important figures are often omitted; total returns from sales, and the amount of returns after expenses, which was paid to patrons. The operating statements of many fruit packing and marketing associations are prepared in this incomplete manner.

The terminology of the reports should indicate more clearly that recognition has been given to the association's cooperative nature. For example, after the cooperative has paid its expenses and made the capital retains, any remaining operating credit should be shown as a saving, an overage, or even better perhaps as an expected refund (instead of as a profit). Instead of the term "sales" alone, perhaps it would be well to employ the terms "sales to members and other patrons" in the case of a purchasing association and "sales for members and other patrons" in the case of a marketing association; "gross overage" or "difference" instead of "gross profit"; "net operating overage" instead of "net operating profit"; "other credits" instead of "other income"; and so forth.

The reports of some auditors seem to indicate their need for a more complete knowledge of cooperative law, both State and Federal, and for a better understanding of how cooperatives operate, particularly of the pooling methods and the strong element of trusteeship involved in cooperative operations; and thus for an expanded awareness of the basic differences between accounting for cooperatives and accounting for commercial enterprises.

The auditor is in an excellent position to indicate the probable future of the association. He should avail himself of that opportunity. By virtue of his training and experience, and the insight he gains of the association's affairs as he carries out the audit program, he is placed in a position not only to explain the association's present position, but to outline its future in a general way. This information may be especially valuable where existing conditions are not satisfactory and it appears that important steps must be taken to correct them. For example, trends of high costs or low volume, or both, or other internal conditions, may have become established which, if not changed for the better, might result in the ultimate dissolution of the association. Greater use should be made of devices such as charts and graphs, to more distinctly place emphasis or reveal trends.

The present financial position holds the interest chiefly because it is the basis from which to draw reasonable conclusions of future results of operations and future financial positions. These are the really important things. Auditors already do much, but in some instances they might do more, to help the reader of the audit report reach the right conclusions with regard to an association's probable future, as well as on its present position.

The morale and the ability of the management and employees of an association play a large part in determining its future. The auditor amy have amportant and definite opinions in this connection, but may hesitate to express them. He may conclude that this is not a proper function of his engagement, or he may be reluctant to lay too much stress on internal difficulties. However, the credit grantor believes that anything which the auditor feels is best for the real and long-range interests of the association should be offered as a recommendation or suggestion.

Some of the ideas advanced and the suggestions offered in this Section will possibly not be too well received by the accounting profession. This is recognized, and it is further recognized that long established customs and procedures can only be altered when substantial reasons support the proposals. It is probable that the viewpoints of the professional accountant and the grantor of credit may never be brought into full agreement.

This is fundamentally because the accountant is primarily concerned with what has taken place; whereas, the credit man is more interested in the probabilities of the future. In addition, there are the usual difficulties of accountants in securing satisfactory fees and the problem of meeting extended responsibilities resulting from new court decisions and from regulatory Government bodies which are placing an increased liability to the public on professional accountants.

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SEVERAL TYPICAL COMMENTS ON BALANCE SHEET ITEMS

Cash - $10,000. The office cash fund was verified by actual count and the cash in bank was reconciled to the balances shown by bank statements, and confirmed by direct correspondence with the depository. Comprehensive tests were made of the cash receipts and disbursements, invoices, payrolls, remittances, and other supporting documents. No discrepancies were found in the tests made.

Due From Patrons - $5,000. Accounts receivable from patrons were reviewed in detail with the manager and are all considered collectible in full. These accounts consist, for the most part, of May and June charges for spray material and other growers' supplies.

Revolving Capital - $175,000. This account changed as follows during the 1940-41 season:

Balance June 1, 1940	$167,000
Less: Repayment of 1934-35 Season Deductions	32,000
	$135,000
1940-41 Season Deductions: 800,000 Field Boxes @ 5¢ per box	40,000
Balance May 31, 1941	$175,000

The detail of the credits by seasons is as follows:

Season ended in		Basis	Amount
1936 -	600,000 Field Boxes	@ 5¢	$ 30,000
1937 -	420,000 " "	@ 5¢	21,000
1938 -	480,000 " "	@ 5¢	24,000
1939 -	775,000 " "	@ 4¢	31,000
1940 -	725,000 " "	@ 4¢	29,000
1941 -	1,000,000 " "	@ 4¢	40,000
		Total	$175,000

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