"CASH—WORK PROGRAM

"(1) Prepare and mail requests for confirmations, enclosing self-addressed return envelope.

"(2) Obtain and foot company's bank reconciliation as at November 30th. Check company's balance to the books and check bank balance to the opening balance shown on the December bank statement.

"(3) Obtain the December bank statement and the checks paid by the bank during December. Compare these checks dated in December with the December entries in the cash disbursements book as to date, payee and amount. Compare checks dated prior to December 1st with the company's reconciliation at November 30th. In connection with this work, examine the checks as to signatures, endorsements, and date of the bank's paid perforation and list for approval checks bearing the second endorsements of employees. List for further inquiry any checks for substantial amounts drawn to 'Cash' and any checks representing large and unusual payments to officers or employees.

"(4) Compare checks left open in the company's November 30th reconciliation and in the December cash disbursements book with the outstanding checks shown on the December 31st reconciliation prepared for us by the company.

"(5) Trace all receipts shown in the December cash receipts book and receipts shown on the company's November 30th reconciliation to the credits shown on the December bank statement and to the December 31st reconciliation. Note whether there were any unreasonable delays in depositing cash receipts as indicated by the cash-book dates and the bank statement dates. Check the details of the last three deposits in December and first three deposits in January from the cash receipts book to company's duplicate deposit tickets. The company has requested us not to confirm deposit tickets with the banks. If receipts are not deposited intact, this fact should be mentioned in your memorandum.

"(6) Foot the December 31st reconciliation and make sure that there are no open items thereon.

"(7) Foot the cash receipts and disbursement books for December and trace the totals to the general ledger.

"(8) Reconcile the total disbursements per the cash-book for December with the total charges per the December bank statement.

"(9) Reconcile total receipts per the cash-book for December with total credits per the bank statement for December.

"(10) Reconcile total disbursements and receipts per the cash-book with the total charges and credits per the bank statement for the month of July and check company's reconciliation at July 31st as outlined in the foregoing items (2), (3) and (4). Foot the cash receipts and disbursements books for July and trace the totals to the general ledger.

"(11) Prepare schedules of interbranch, intercompany, and inter-bank cash transfers for the period from December 20th to January 10th.

"(12) Examine checks outstanding at the time of our previous examination which were not examined by us at that time.

"(13) At a convenient date in January, obtain directly from the bank the bank statement and checks paid to date. If this statement is not obtained from the bank unopened, compare the checks with the bank statement to see that none is missing. Trace all paid checks dated December 31st or prior to the checks shown outstanding on the December 31st reconciliation and, in addition, scrutinize very carefully the dates of endorsements and paid perforations to determine that checks dated in January had not been actually issued in December. This phase of the work is of the utmost importance. Trace deposits in transit per the December 31st reconciliation to the January bank statement.

"(14) With reference to the petty cash fund, this fund should be counted and the notes receivable examined at the close of business on December 31st, if this work can be done without incurring traveling expenses; otherwise, these assets may be examined at the beginning of the examination without concurrently reconciling the bank accounts.

"(15) The foregoing is a general program outlining the minimum work to be done on cash. This program should of course, be modified and added to in order to meet the requirements of each particular examination. The additional work done should be described below."

It will be noted that this specific work program varied in at least one respect from the foregoing general memorandum. Where internal control is weak, the memorandum required that original deposit slips or copies obtained from the bank be compared with the cash book for 10 days before and 10 days after the closing date. The specific work program, however, required a comparison for 3 days before and 3 days after closing date with the Company's duplicate deposit slips as the client requested that the deposit slips not be confirmed at the banks.

In our hearings, this specific work program was compared item by item by Rowbotham with the suggested program laid down in the American Institute of Accountants' bulletin "Examination of Financial Statement by Independent Public Accountants." The comparison showed that the programs were substantially the same except for inapplicable items and the omission of the optional procedure as to checking receipts with deposit slips obtained from the bank [679] which was covered in the Bulletin by this sentence: "In certain instances such comparison may be extended to include a check of original deposit slips or authenticated copies thereof." [680]

The procedure laid down by Thorn in the specific cash work program reproduced above was changed in two significant respects on the work at Bridgeport. The first of these was that part of item five which required the comparison of duplicate deposit slips for the last 3 days of December and the first 3 days of January with the cash book entries. Ritts testified that no duplicate deposit tickets were available at Bridgeport as the Company never followed the practice of keeping them in that office. He could not recall whether he had ever suggested a change in this system although he personally preferred having duplicates of all deposit slips. Instead of checking with duplicate deposit slips, the deposits as shown on the bank statement were compared with the detail in the cash books.[681] The comparison with the Company's duplicate deposit slips was made in the wholesale houses but originals or copies authenticated by the banks were not obtained anywhere because in arranging for the work Coster requested

[679] R. 1858-1860. "* * * that was omitted because the problem there seemed to be one of catching minor defalcations of cashiers around those 48 houses * * *." Testimony of Rowbotham, R. 1860.

[680] Ex. 117 (p. 12).

[681] R. 437-443.

that this step be omitted,[682] and Price, Waterhouse & Co., although recommending it, did not consider this step necessary as part of their balance sheet examinations in this case.[683]

In connection with this variation of the audit program to adjust it to conditions found at Bridgeport and to comply with Coster's request not to ask the banks for original or authenticated copies of deposit slips, it should be recalled that at the time this audit step was recommended by Price, Waterhouse & Co. and rejected by Coster, there was no Manning & Company and receipts purportedly from the foreign crude drug customers were deposited separately from the other receipts. The deposit slips on the latter were prepared by Miss Bakos, a cashier in George Dietrich's office. However, she never saw the remittances from the foreign crude drug customers but for her records was advised of them and the bank in which they were deposited by George Dietrich.[684] McKesson deposit slips covering these transactions, secured from the bank for the hearings, disclosed single items of deposit covering credits to more than one account and were identified as having been written by George Dietrich. It will also be recalled that Seal of S. D. Leidesdorf & Co., in explaining the manner in which the fraudulent transactions were handled at this time, testified that single checks from accounts controlled by Coster and his brothers were deposited (deposits not made by Miss Bakos) and recorded on the books of the McKesson Companies at Bridgeport as receipts frequently from two or more foreign crude drug customers located in different cities. [685]

The other requirement omitted at Bridgeport (with Thorn's approval) was the reconciliation of the bank accounts at July 31. It was stated that this work was done in the wholesale houses as an extra precaution to catch minor defalcations of cashiers where all the cash records were handled by one person.[686] In lieu of this procedure at Bridgeport, Ritts required the vouching of all items returned with the January bank statements.[687]

At this point a somewhat detailed consideration of the cash work done at Bridgeport is especially necessary because Price, Waterhouse & Co.'s representatives testified that they relied heavily on apparent

[682] "I also said that we would like to have Mr. Coster consider whether we should examine a few days' original bank deposit slips in connection with our cash verification and that, unless he instructed us to the contrary, we would in future check original bank deposit slips for a few days in December and January, to the cash receipts book. After considering the point for a few days, Mr. Coster instructed us not to do this. This is referred to in a subsequent letter we later wrote to Mr. Coster confirming our understanding of the matter." Ex. 83, Memorandum regarding 1930 accounts of the Connecticut Company, signed by A. Jaureguy.

[683] R. 439.

[684] R. 2643–2658; pages 113–115 *supra*.

[685] R. 4562–4567; pages 116–117 *supra*.

[686] R. 442. Wyman understood that the step was added to satisfy officials at Bridgeport as to the handling of cash at the branches. R. 328.

[687] R. 442.

collection as the best evidence of the authenticity of the foreign crude business.[688] If suspicion had pointed to Manning & Company, through whom all of the collections were supposedly effected in later years, as being fraudulent, it is probable that the entire scheme would have been uncovered.

All of the staff who took part in the work on this cash program on the 1937 audit at Bridgeport were questioned at the hearings concerning the manner of its execution. Thorn in that year counted the cash there and mailed the requests for confirmation of bank balances on December 31.[689] Wyman [690] completed the program for the Canadian Company and two juniors,[691, 692] under Ritts' or Wyman's supervision completed the work on the Connecticut Division.

The bank accounts examined for the Canadian Company included two in the same bank in Bridgeport, two in Montreal banks, one in a branch of a New York bank, and Manning & Company of Montreal. For the Connecticut Division four accounts were carried in Bridgeport, three in New York, one in Paris, France, and Manning & Company in Montreal.[693] The head office of the Maryland Company at Bridgeport and other units of the Company throughout the country carried bank accounts in various cities in the United States and in foreign countries.

Wyman, who had progressed from junior to senior status in 6 years work with Price, Waterhouse & Co. was in charge at Bridgeport in 1937 during the time the cash work was in progress, as Ritts was in New York assisting Thorn much of the time. Wyman testified that he received no oral instructions from Ritts but merely followed the

[688] See testimony of Rowbotham at R. 2008:

"Now, as for accounts receivable, it has always seemed to me that the best verification you could get on the accounts receivable is the fact of the collection of it and that seemed to me proof of the existence of these accounts, but as to whether Robert Dietrich had a warehouse full of crude drugs ultimately some time or other we had to rely on the officials of the company as to that quantity and quality and condition. I mean, I could go out there and look at those crude drugs and then be none the wiser."

See also testimony of Thorn at footnote 641 *supra*.

[689] R. 878-879.

[690] *George F. Wyman* (Harvard AB, 1927), Ritts' understudy in 1937, was employed by Price, Waterhouse & Co. through the placement bureau of the American Institute of Accountants, December 1, 1931, after 2 years with a newspaper concern and a year and a half as a clerk in the mortgage department of the Guardian Life Insurance Company of America. He first worked on the McKesson engagement as a junior in the 1932 and 1933 examinations at Jacksonville, in charge at Chattanooga for 1934 and 1935, and Birmingham in 1936. He secured his certificate as a certified public accountant in New York in April 1938. (R. 305-307, 386; Ex. 212.)

[691] One of these, who graduated from a prominent eastern university in 1924 and attended a metropolitan university for 1 year, was employed by Price, Waterhouse & Co. from January 4 to February 18, 1932, and again from January 17 to 29, 1938. He hoped the first employment would be permanent but took the second on a temporary basis and resigned on the date stated. He had done investment analysis work for 5 years and was a special investigator for 2 years for one concern and an accountant for 2 years for another. He was not a C. P. A. (R. 1323-1324, 1340; Ex. 212.)

[692] The other, who took about 2½ years' work in a metropolitan university, was employed by Price, Waterhouse & Co. on December 27, 1937, on his own application. He had had a varied experience as bookkeeper and accountant with several business firms over a period of 5 years before deciding to apply for a position in public accounting work. He had passed the New York C. P. A. examination and was entitled to his certificate on completion of the experience requirement (R. 386-387, 402; Ex. 212).

[693] Ex. 21, 29, 29A.

typed work program by comparing it with what had been done the previous year as shown by that year's work papers for the Canadian Company.[694] One junior carried out most of the cash work on the Connecticut Company in one of the two weeks he was employed by Price, Waterhouse & Co. On his resignation another junior completed the work. The junior who began the work testified that Ritts was not in Bridgeport during the week while he was at Bridgeport and presumed that he received instructions from Wyman although he could not recall any special instructions.[695]

This junior remembered very little about his week's work and had difficulty in explaining why some of the steps in the program were required. When he took up the work the bank statements and canceled checks were handed to him in a box. He did his work in the directors' room, and put the papers away in a safe at night, but he could not remember where the safe was. The Manning & Company account did not then appear unusual to him,[696] nor did he recollect having asked any questions about the account but presumed that he did ask Wyman if Manning & Company was a bank. He never asked any employee of McKesson & Robbins about it. Counsel for Price, Waterhouse & Co. asked him if the papers from Manning & Company appeared "* * * to be such papers as would come from a bank." His answer was: "Not a bank, but a banking firm, possibly."

"Mr. STEWART. A private bank?
The WITNESS. Yes."[697]

He could not recall seeing any Manning & Company canceled checks or debit and credit advices such as were used by Manning & Company. He remembered nothing but the statements and one item.[698] He did not recall comparing entries in the cash book or looking for signatures, endorsements, or perforations. He "frankly" did not remember any positive step he took in connection with Manning & Company. He did not know whether duplicate deposit slips were kept at Bridgeport. When asked what purpose would be served by comparing them with the cash book entries he replied:

"A. I can say that it is just added, just an added check on the mechanism of the system of depositing receipts in the bank.
Q. [By Mr. GALPEER.] Specifically, what would that check, if you know?
A. It is a little vague. I find it a little hard to say exactly what it imports."[699]

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694 R. 314.
695 All ref erences to this testimony are included in R. 1326–1344.
696 "Q. [By Mr. GALPEER.] Did the fact that there were no open items on those dates strike you in any way unusual with an active bank account?
A. Without a knowledge of Manning & Company's bank account I would say no." R. 1329.
697 R. 1330.
698 R. 1330–1331.
699 R. 1334–1335.

It appears from the following answer to a question as to why he should look at bank perforations that he also was not sure on that point.

"A. I would say that that was to show that there was no substitution in any way of checks that went through the bank, also the proper date; in other words, the amount being checked.

Q. Why would that be significant?

A. The substitution, you mean, or the checking?

Q. The substitution.

A. Well, it just assures that everything is going through in a proper flow, I would say.

Q. Do you know of any other reason for watching perforations on bank checks?

A. I don't think of one at the moment." [700]

The same junior testified that he supposed he learned who had custody of the canceled checks and bank statements, but that he could not remember whether it was the comptroller's office or assistant treasurer's office. Neither did he know who made the regular monthly reconciliation.[701]

In response to further questions this junior said that he felt quite free at all times to ask questions of the senior in charge, Wyman.

"Q. [By Mr. STEWART.] Did you, from the work that you did on cash, see any occasion to ask any more questions about the Manning & Company account than any of the other banking accounts you examined?

A. Except that it was a different form and it was a private banking firm, not a national bank or trust company.

Q. But beyond that difference in form, did you see any more occasion to question the fact as to whether it was, in fact, a bank?

A. No." [702]

The foregoing quotation suggests that a description of the Manning & Company statement may be helpful here. The Manning & Company statements were printed in black on white paper, ruled in blue ink and measured 12½ inches in width by 17½ inches deep. Aside from its size, the Manning statement also differed from those of ordinary commercial banks [703] in its columnar headings and in other details. The Manning & Company December 1937 statement for the Canadian Company reproduced in section III is typical of these statements except that the entries occupy only one-half the sheet whereas the statements for the Connecticut Company and Division usually filled one sheet and part of another.[704] Except for Manning & Company, the eight banks represented in the accounts of the Canadian Company and the Connecticut Division were well known commercial banks, the form of whose statements and documents would be familiar to any junior.

[700] R. 1335–1336. Cf. Item (13) page 195 *supra*.

[701] R. 1338.

[702] R. 1341–1342.

[703] E. g. Ex. 198, 199, 239.

[704] Ex. 30; page 100 *supra*.

The erroneous acceptance of Manning & Company by Price, Waterhouse & Co. as a real bank goes back to its pretended inception in 1931. Thorn was in charge of the work in Bridgeport for this year.

Price, Waterhouse & Co.'s permanent file contained a memorandum regarding accounts receivable arising from crude drug exports prepared the year before during the 1930 audit in which Thorn described a sales contract with "Manning & Co., Ltd.," of Montreal in which Manning was referred to as a purchasing agent for several hundred retailers and jobbers throughout the British Empire.[705] The Charles Manning & Company, Limited contract with the Connecticut and Canadian (McKesson) Companies to which the foregoing referred was dated March 12, 1930 and had a 1-year term from that date. An abstract of this contract was included by Thorn in the Price, Waterhouse & Co. working papers.[706] An alleged balance sheet of Charles Manning & Company, Limited, which Thorn examined showed that Company's net worth at December 31, 1929, to be approximately $600,000.00.[707]

Jaureguy's memorandum to Rowbotham on the 1931 accounts devoted one page to an explanation of a new sales contract with "W. W. Smith & Co." replacing the previous year's arrangement with "Manning & Co." and related that "* * * Manning & Co., Montreal * * * during the year * * * went into the private banking business exclusively and sold its export business to W. W. Smith & Co. whose main office is in Liverpool and who are said to have 600 or so representatives all over the world * * *." [708] This new contract dated August 1, 1931, was between the Connecticut and Canadian (McKesson) Companies and W. W. Smith & Company, Inc., of New York (referred to therein as the New York Company) and was represented in the working papers by a two-page abstract.[709]

The second paragraph is the part of this abstract of interest in connection with Manning & Company's identity:

"Since the Connecticut Company on March 12, 1930 entered into a contract with Charles Manning & Co. Limited, a Canadian Corporation, for the latter to render certain services in promoting foreign trade of the McKesson Companies and contract has been renewed since to March 12, 1932. Also since Charles Manning and Co. Limited, have been acquired by Manning and Co. a co-partnership of Montreal, and which has caused all domestic and foreign buying and selling offices formerly owned by Charles Manning and Co. Limited to be transferred to the New York Company, which it has caused to be organized, and the said Manning and Co. have requested the Connecticut and Canadian Companys to

[705] Ex. 83, R. 811-12. Quoted in part at page 55 *supra*.

[706] Ex. 89, R. 956. Quoted at page 55 *supra*.

[707] Ex. 83, 89.

[708] Ex. 82.

[709] Ex. 55, R. 958-959. Price, Waterhouse & Co. reported through their counsel that this abstract was prepared by an assistant,—a temporary employee when on this engagement but previously employed for two periods of 2½ years each interrupted by resignations to enter private accounting work. Thorn when asked at the hearings to read the second paragraph said he could not read it.

execute a new agreement with the New York Company in lieu of contract of March 12, 1930."

The actual contract between the McKesson Companies and the New York Company (W. W. Smith & Company, Inc.),[710] referred to the formation of W. W. Smith & Company, Inc. by Manning & Company in the following words: "* * * which it caused to be organized * * * (one hundred per cent (100%) of the stock of which it owns) * * *." As appears, the assistant to whom Thorn delegated this important work did not abstract the reference to the 100% ownership of W. W. Smith & Company, Inc. by Manning & Company and thus either overlooked or did not know that according to other documents equally relied upon, the ownership of W. W. Smith & Company, Inc. was supposed to be in W. W. Smith & Co. of Liverpool.[711]

The new arrangement as made at August 1, 1931, was approved by the directors of the Connecticut and Canadian Companies at meetings recorded as having been held on September 3, 1931, the former at 3 o'clock in the afternoon and the latter at 3:45 p. m. Coster presided over both meetings and George E. Dietrich acted as secretary.[712]

According to the minutes [713] Coster explained the need for making the contracts which he exhibited to the meeting and "* * * explained that the amount to be paid Manning & Co. was somewhat higher than that formerly paid but that in his opinion the charge was entirely reasonable and proper." Then

"On motion duly made and seconded and by the affirmative vote of all present the following resolution was adopted:

"*Resolved*, That the system of foreign representation as explained to the meeting by the President has the entire approval of this Board of Directors and that the action of the President and of the other executive officers of this Company in negotiating, executing and delivering, in the name of this Company, a contract with Manning & Co., a co-partnership of Montreal, Canada, and of a subsidiary contract with W. W. Smith, Inc., a New York corporation, dated as of the first day of August, 1931 and in the form submitted to this meeting be, and the same hereby is approved, ratified and confirmed." [714]

Similar procedure was reported in identical language in the Canadian Company meeting.[715]

Thorn included abstracts of these minutes in his working papers and was questioned at some length about them. He insisted that he knew of only one contract—the signed one with W. W. Smith &

[710] Ex. 206. Quoted in part at pages 57–59 *supra*.

[711] Ex. 207. See also Ex. 82, 215.

[712] The minutes of the Connecticut Company meeting recite that F. Donald Coster, C. Barnum Seeley, Horace B. Merwin, Rowley W. Phillips, and George E. Dietrich (being the entire board except Herbert D. Robbins) were present. The minutes of the Canadian Company meeting recite that "All of the directors were present" (being those present at the Connecticut Company meeting plus Jonathan Grout). Ex. 179, 180 and pages 119–120 *supra*.

[713] Quoted at page 60 *supra*.

[714] Ex. 180.

[715] Ex. 179.

Company, Inc., and none with Manning & Company although the abstract opened with the phrase, "Re contract with Manning & Company and subsidiary contract with W. W. Smith, Inc."

"Q. [By Mr. GALPEER.] So that it is your idea that the present abstract covers both contracts referred to in the Board of Directors' minutes?

A. [By THORN.] My idea really is that there is really only one contract referred to in the minutes.

Mr. STEWART. Is it your inference, then, Mr. Thorn, that the reference to subsidiary contract with W. W. Smith & Company refers to the fact that the Smith Contract was a successor contract to the Manning contract, of the preceding year which is mentioned in that abstract?

The WITNESS. Yes." [716]

Although Price, Waterhouse & Co. was thus apparently unaware of its existence, there was introduced at the hearings a nine page agreement between Manning & Company and the McKesson Companies, dated August 1, 1931,[717] taken from the contract files of McKesson & Robbins [718] to which was attached a copy of the W. W. Smith & Company, Inc. contract previously referred to. Although the copy introduced was unsigned it appears to be the one referred to in the minutes.

The Manning & Company agreement recited that the assets and business of Charles Manning & Company, Limited had been acquired by said Manning & Company which had caused all the foreign and domestic buying and selling offices and agencies formerly owned and conducted by said Charles Manning & Company, Limited to be transferred to W. W. Smith & Company, Inc., a New York corporation which it had caused to be organized for that purpose, and 100% of the stock of which it owned. It also stated that Manning & Company had requested the McKesson Companies to execute a new agreement with said W. W. Smith & Company, Inc. in lieu of the contract of March 12, 1930 with Charles Manning & Company, Limited, as renewed and extended and that Manning & Company which as above stated owned 100% of the stock of W. W. Smith & Company, Inc. unconditionally guaranteed complete and prompt performance of said new agreement between W. W. Smith & Company, Inc. and the McKesson Companies, a copy of which was annexed to the Manning contract.

Paragraph three of the contract stated:

"Manning & Company expressly represent that it has acquired all of the foreign exchange and banking business formerly conducted by said Charles Manning & Company, Limited, and that hereafter such business will be conducted by it under its own name."

Paragraph six of the contract covered the banking service contracted for between the co-partnership of Manning & Company and

[716] R. 960. See also R. 957-960.

[717] EX. 216. Quoted in part at pages 56-57 *supra*.

[718] R. 4460.

the McKesson Companies. Briefly, the partnership was prepared to handle letters of credit to finance shipments of merchandise up to one million dollars at any one time, at varying rates of commission, depending on the length of the credit.[719]

Here then was the origin of Manning & Company as a bank which opened with two letters of credit, one with the Connecticut Company for $250,000, and the other for $150,000 with the Canadian Company, both dated August 5, 1931, and expiring August 5, 1932 after which this method of apparently doing business was abandoned supposedly in favor of individual letters of authority covering each sight draft.[720]

In addition to the W. W. Smith & Company, Inc. contract and the Manning & Company contract, both dated August 1, 1931, which referred to the 100% ownership of W. W. Smith & Company, Inc. by Manning & Company, there was also a guaranty of the W. W. Smith & Company, Inc. contract by a co-partnership, W. W. Smith & Co. of Liverpool, England. This third contract, also dated August 1, 1931, is represented in evidence by a digest taken from the files of McKesson & Robbins, Incorporated [721] and by a note added to the Price, Waterhouse & Co. abstract of the W. W. Smith & Company, Inc., contract.[722] The Liverpool partnership's interest in guaranteeing performance by a corporation stated to be 100% owned by the Montreal partnership of Manning & Company is not apparent.

Had Thorn been familiar with both the W. W. Smith & Company, Inc. and Manning & Company contracts of August 1, 1931, it would appear that he might have questioned not only the guaranty by the Liverpool partnership also dated August 1, 1931 but the purported Bradstreet's report dated October 14, 1931, which described W. W. Smith & Co. as the parent of "W. W. Smith & Co. Inc." W. W. Smith & Co. was described by this report as being Commission Merchants, purchasing, forwarding, and steamship agents with offices at 191 Montague Street, Brooklyn, New York, also Montreal, Hamburg, Genoa, Liverpool, Marseilles, Melbourne, Ceylon, Bombay, Hongkong. The report stated that the firm was established at London in 1857 and that the partnership W. W. Smith & Co. in July 1931, as a convenience in handling United States business, organized a corporation, "W. W. Smith & Co., Inc." in the State of New York, with a nominal capital of $10,000. It also was reported to have acquired in August 1931, the business of "Chas. Manning Ltd." of Montreal engaged in a general merchandise brokerage business.[723]

An important factor in the conflicting interests of Manning & Company and W. W. Smith & Co. in W. W. Smith & Company, Inc.

[719] Ex. 216. Quoted in part at pages 56–57 *supra*.
[720] Ex. O, P; and pages 117 ff. *infra*.
[721] Ex. 215. Quoted at pages 59–60 *supra*.
[722] Ex. 55.
[723] Ex. 207 reproduced at page. 62 *supra*.

is that in one version the New York Corporation acquired a worldwide organization of buying and selling offices from Manning & Company, whereas under another interpretation the New York Corporation was merely the United States office for the old established partnership of W. W. Smith & Co. which had 600 representatives throughout the world.[724] Further inconsistency develops when the practice of Manning & Company in its purported banking business is examined to see in what manner the business might have yielded a profit to Manning & Company. Article 6 of the Manning & Company agreement provided a schedule of rates of commission to be charged for the granting of credits and further provided that the rates were to be subject to change from time to time to conform to the lowest prevailing market rates established by recognized commercial banks and bankers. But, as we have seen, letters of credit were only issued thereunder covering the first year's operations of the McKesson Companies under this arrangement and thereafter no credit was extended. The Manning & Company bank statements and samples of debit and credit advices from which such statements were prepared do not indicate that any charge was made by the bank for service in connection with either collections or payments.[725] In addition, since it was the opinion of Thorn that because the McKesson balance with Manning & Company was carried in United States dollars and that Manning & Company would have to carry this with New York banks,[726] and, since the year end balances indicated that the deposit carried with Manning & Company was comparatively small in any event, it is hard to conceive that a bank profit ordinarily available from deposits would have been available to Manning & Company at least in an amount to compensate for the purported services rendered.

The 1933 extensions of the W. W. Smith & Company, Inc. contract and W. W. Smith & Co. contract of guaranty as abstracted by Price, Waterhouse & Co. [727] made no mention of Manning & Company. The new W. W. Smith & Company, Inc. contract and W. W. Smith & Co. contract of guaranty of August 1, 1935 made no reference to Manning & Company either, but stated that W. W. Smith & Co. had a substantial financial interest in W. W. Smith & Company, Inc. and would derive some share of the profits accruing to W. W. Smith & Company, Inc. from the McKesson agreements.[728]

The foregoing paragraphs cover the pretended establishment of Manning & Company as a bank. Some aspects of its purported operations must be examined. For example, at our hearings a question was raised with Thorn, who had been cashier of a country bank

[724] Ex. 207.
[725] Ex. 30, 33, 34.
[726] R. 951, quoted in part at page 206 *infra*.
[727] Ex. 56. Quoted in part at page 63 *supra*.
[728] Ex. 50. Quoted in part at pages 63-65 *supra*.

and had worked in a New York bank, as to the practice of Manning & Company (a Canadian bank) of carrying the McKesson accounts in United States dollars. In the case of other dollar balances difficulties were encountered as reflected in the Price, Waterhouse & Co. memorandum on the Canadian Company accounts for 1931 where it was stated that McGloon did not give his reasons for maintaining that no adjustment for exchange between Canadian and United States dollars should be made in the balances carried with two Canadian banks. Thorn explained that the two banks must have been the Royal Bank of Canada and the Canadian Bank of Commerce and that McGloon probably thought the adjustment of $601.68 was too small an amount to bother with, that it was a minor matter and might well have been left out of the memorandum. The foreign exchange situation was reviewed again the next year, for the first item in the memorandum on the 1932 accounts stated "Two of the bank accounts with Canadian banks were stated in Canadian currency but the balances have been adjusted to U. S. dollars." [729]

But as for Manning & Company, Thorn made sure it carried McKesson's balances in U. S. dollars (no adjustments therefore being necessary). Thorn's understanding of the situation was summarized in his testimony at page 951:

"Q. [By Mr. GALPEER.] If I understand you correctly, you assumed that Manning & Company would have covering commitments with New York banks for the amount of the balance that McKesson had with it?

A. They would simply have an account in the New York banks. I have a note in my papers there in the year that account was opened which states that this account was to be carried in United States dollars. The collection would be made in United States dollars and deposited by Manning in their New York Account. This note also states that it is a collection account and not a deposit account and that checks will not be drawn on the account [730] and that remittances will be made to Bridgeport as requested."

He felt justified in including the balance of this account under cash in banks because the amount was available on demand and he had seen deposits in New York bank accounts of McKesson coming from Manning & Company.[731] Thorn never discussed the classification of the Manning & Company account balance with Rowbotham.[732] On this point of classification it may be noted here that George Dietrich's department prepared a daily cash report,[733] copies of which went to the treasurer and comptroller of the Company. There is no evidence

[729] Ex. 205; R. 949.

[730] On the 1931 Manning & Company confirmation, however, there is no answer to the request, "State if balance is not subject to withdrawal by check." Ex. O. P.

[731] Page 67, footnote 200 *supra* and pages 212–213 *infra*.

[732] "Q. [By Mr. GALPEER]. Did you discuss this with Mr. Rowbotham or anybody else, I mean the sort of point we are discussing now?

A. [By THORN.] No, in the first place I have no recollection of discussing it with him and I think I wouldn't discuss any matter like a bank account with him." R. 952.

[733] Ex. 228.

that this type of report which was an internal memorandum of the Company, was ever examined by the auditors. The report showed seven bank accounts with names of the banks in print and others were written in as required. Balances were shown for "Maryland Account," "Wholesalers' Division Account," "Connecticut Division Account" and "Totals." This report did not cover the Canadian Company and never included Manning & Company. Why it did not include Manning & Company, McGloon, the comptroller of the Company, was unable to say. On this point he referred us to Thompson, the treasurer, who, when he first learned of Manning & Company, did not have a clear picture of how it functioned but later got the impression it was not a true bank account.[734]

Pursuing still further Thorn's knowledge of how the Manning & Company account operated more confusion develops. Despite the fact that all invoices to foreign crude drug customers were stamped "Payment for this invoice must be made in U. S. currency" [735] and the printed invoices stated "Important:—Bills not paid when due will be subject to draft with exchange on New York" [736] Thorn testified that Manning & Company, a collection receiver,[737] might receive drafts on London or Montreal as well as on New York, but all collections would be deposited in New York and hence the former converted into U. S. dollars.[738] Although all debit memoranda for sight drafts drawn by vendors against Manning & Company indicated that the amount was in U. S. currency, the credit memoranda on payments purportedly received by Manning & Company for McKesson did not specify whether in Canadian or United States dollars.[739] When asked why, if the payments were to be in U. S. dollars and balances were to be carried by it in New York bank accounts, Manning & Company of Montreal was employed to handle this business Thorn said he

[734] R. 1643, 2068, 2117.

[735] Ex. 229.

[736] Ex. 8D.

[737] "Q. [By Mr. GALPEER.] In the particular situation here, how would these customers spread all over the world be notified to pay Manning and not McKesson?

A. [By THORN] As I understood it, they used the regular McKesson billhead, but attached a notice of some kind to it, I thought in sticker form.

Q. Who attached that notice?

A. I thought it was George Dietrich.

Q. Did you ever ask him, did you ever see that sticker?

A. No, I never did, and I might say and in general at that point, I might say that I am not particularly concerned with forms, as to just what the particular form of any of these items is, from my standpoint." R. 1141.

[738] "Q. [By Mr. GALPEER.] So that it was your conception that Manning & Company would receive United States funds and would deposit it in some account which it had in the United States?

A. Well, I shouldn't say they would receive United States funds, but they would receive funds which they would convert into United States funds. That is, if they didn't receive a draft drawn on New York they received a draft on London or Montreal, they would deposit that in New York for conversion into United States dollars." R. 952.

[739] Ex. 33, 34.

could not tell but he probably got an explanation "right from the source"—Coster.

"A. The explanation I imagine I got from him would be the matter of goodwill, to have those funds collected within the British Empire,—the funds held within the British Empire, to put it another way, than to have them collected in Bridgeport.

Q. [By Mr. GALPEER.] The contract itself, as you know, provided,—and the bills themselves that went out to the customers provided that the payment was to be made in U. S. Dollars?

A. Yes, sir.

Q. So that to that extent, at any rate, it would not be a question of paying in Empire currency, I mean it was apparent on the face that it would have to be U. S. dollars?

A. Yes, sir." [740]

While Thorn considered the Manning balance to be available on demand he admitted that he saw no evidence that such transfers as were made [741] might not have been made after notice. This did not disturb him, however, for he felt the amounts involved were insignificant, being only $75,000, approximately, at December 31, 1937 in a total of $3,358,571.39 cash in banks and on hand as reported in the consolidated balance sheet on that date. Other years the balance, Thorn testified, was more nearly $5,000. The real significance of the account then lies in the millions of dollars of transactions which were supposed to have gone through it rather than in the year end balance.[742] Thorn testified that it was not customary and it did not occur to him to ask the Montreal office of the Canadian firm of Price, Waterhouse & Co. to make such inquiries as would have revealed that Manning & Company was merely a mailing address and not a bank, although he had conducted correspondence with that office in respect to work they did on some wholesale drug houses which McKesson sought to acquire in Canada but never did.[743]

A final point in connection with Manning & Company on which Thorn, on the basis of his banking experience might have had special knowledge, was the documentary evidence which should accompany a bank debit advice. He got the impression from reports on a Norwegian subsidiary that foreign countries did not return checks or other documents but he did not know about Canadian practice although he did think that the Royal Bank of Canada and the Canadian Bank of Commerce did return checks. Thorn only professed to have a general knowledge of United States practice, he did not consider that he was an authority, although he thought it was customary here for banks to return drafts drawn against its depositors. In any event, he was

[740] R. 954-955.

[741] See pages 212-213 *infra*.

[742] R. 953-954.

[743] R. 1204-1205.

satisfied in this case with receipt from the bank of a debit advice unsupported by any documents other than the monthly statements and the year end confirmation.[744]

Thorn apparently was reassured on all of these Manning transactions by explanations obtained from Coster and George Dietrich and the apparent similarity to him of the transactions with those carried on with New York banks prior to the transfer of the business to Manning in 1931. Thorn stated that had he been in Bridgeport after 1931 he would not have learned about letters of authority to draw on Manning & Company or other documents in connection with purchases for it was his understanding that Bridgeport was not to get documents other than the debit advice and vendor's invoice. Thorn's recollection was that these suppliers were authorized to draw on Manning by presenting a copy of McKesson's original purchase order and that no other documents were required.

"Since that document, of course, didn't carry title to the goods that was not sent to Bridgeport. Manning & Company would charge McKesson's account and remit to the supplier and simply advise McKesson of the amount of the charge." [745]

Thorn was asked whether he should not have been interested in these mechanical details in connection with his review of the client's system of internal check and control. His answer indicated his reliance on the fact that the Manning transactions appeared to him to be similar to those of other banks and his belief that the mechanics of internal control were unimportant so long as available evidence indicated to him that adequate control existed:

"Q. [By Mr. GALPEER.] Would you have said that the manner in which Manning & Company was advised to meet the draft of the suppliers or the manner in which the suppliers were advised to draw on Manning was or was not within the realm of things that you would have checked or cared about in this connection?

A. I think the exact manner was not. I think what was important there from the standpoint of internal control, what authorization we had for that payment, whether it was independently supported, and as I understood these transactions, there was the purchase order from McKesson, there was the purchase invoice from the supplier, there was the debit advice from the bank, and that was satisfactory to me.

It seemed to me that McKesson was protected there as much as they are protected on any revolving letter of credit, and it seemed to me that their payments were well controlled.

Q. In connection with the question of internal control, would it have been pertinent to you to find out who prepared the purchase orders, who received the purchase invoices and who received the Manning debit advices, that is, who at McKesson?

A. I think I would want to know who prepared the purchase order. I am not sure that I have the other questions in mind now. What was the next?

[744] R. 1127–1131.

[745] R. 1138–1139.

Q. Generally speaking, I mean the mechanics in which these three instruments that you speak of that you would have been satisfied with were handled at McKesson; in other words, the sources from which they emanated and how they were subsequently handled.

A. No, I don't believe I would be particularly concerned with that." [746]

In respect to collections from customers Thorn's opinion was very much the same for he pointed out that the entire selling and collecting routine were related in such a way that seeing the cash collected was evidence of the authenticity of the series of transactions culminating in the collection:

"Q. [By Mr. GALPEER.] As a matter of fact, when you say that you see all the cash received from the customer, again just a definition of terms, what we have in mind is the credit advice from Manning stating that they had credited McKesson's account on account of a remittance from a certain customer.

A. I think it should always be borne in mind that that was to me the same as a credit advice from Guaranty Trust Company which, prior to 1931, we had.

Q. When somebody paid the Guaranty Trust Company and you received a credit advice of that, there would have been some notice or notification by McKesson to that party to pay the Guaranty Trust Company?

A. No doubt." [747]

Although Thorn assumed that McKesson must have advised its customers to pay the Guaranty Trust Company he saw no documents to that effect—in fact no more evidence than he saw in connection with Manning & Company. In both cases the money was assumed to have come from customers who paid it directly to the banks.[748] As in the case of payments for purchases, Thorn was not much concerned with the manner in which transactions were handled. "* * * from an auditing standpoint I have no concern with the exact mechanics down to the last particular with which they are able to do it. The main thing with me; after all, is that it works." Thorn summed up the receipts side of the Manning transactions as follows:

"* * * Similarly, I don't think the manner in which the customer is advised to remit direct to McKesson or to remit to a certain bank—I don't think that is a part of the internal control, and I don't think I would have inquired into it if I had been on the job at all. I don't think I would care." [749]

The 1931 memorandum on the Canadian Company written by Thorn seems to have been followed by Ritts in covering the Canadian Company for 1932 as he repeated material from the 1931 memorandum in respect to the Bradstreet report, recited the terms of the Smith

[746] R. 1150–1151.

[747] R. 1141.

[748] "MR. STEWART. To sum it up, in the days when the Guaranty Trust Company was used, the system was the same as far as you can tell as it was in the days when Manning & Company was used except in one case, it was Manning and in the other it was the Guaranty.

The WITNESS. We shouldn't restrict it entirely to Guaranty Trust Company because I don't know what banks were used in addition to the Guaranty Trust Company. That is, I don't want to say that all of this business was handled through the Guaranty Trust Company. I don't know." R. 1144.

[749] R. 1149. "If I had been on the job" refers to the last 3 years when Ritts was in charge at Bridgeport.

contract, and did not mention Manning & Company.[750] The same holds true for the 1932 memorandum on the Connecticut Company.[751] Any possibility of a doubt as to Manning & Company's authentic character seems to have passed by the time Ritts took charge of the engagement at Bridgeport on the 1932 examination which was the second year of Manning & Company's treatment as a bank. Ritts had been an assistant on the work the preceding two years.

When questioned as to how he knew that Manning & Company was a bank, Ritts replied, "Well, actually the only knowledge we had that any of these institutions really existed was the documentary evidence that we had received from them in response to our requests." [752] He had, however, seen the offices of some of the other banks in the United States with which McKesson did business [753] such as The Bridgeport-City Trust Company and branch offices of Guaranty Trust Company of New York, Manufacturers Trust Company, and National City Bank. But there were other banks with which McKesson dealt that he knew no more about than Manning. He recalled that the latter included the Crocker State Bank of San Francisco; Chicago and foreign banks; and William Brandt and Son and William Bingham and Company (he did not recall the exact names), which did not include the words "bank" or "bankers" in their titles. It never occurred to Ritts to look in a bank directory to check on Manning & Company nor to ask the Montreal office of the Canadian firm of Price, Waterhouse & Co. to make an inquiry.[754]

Ritts referred to the minutes of a Board of Directors meeting of the Canadian Company held on April 4, 1935 which he had read and copies of which were retained in his working papers. He felt that he was entitled to rely on these minutes for there were two commercial bankers, H. B. Merwin and C. B. Seeley, and an investment banker, R. W. Phillips, among the directors present at the meeting at which Manning & Company was approved as a bank depositary for the Canadian Company.[755] Ritts understood that Manning & Company were fiscal agents for the McKesson Companies rather than factors, but he could not say from whom he got that impression.[756] And Ritts did not know that since 1932 all foreign crude drug accounts throughout the year were supposedly collected through Manning & Company.[757] He did not recall ever having discussed the condition of any of the

[750] Ex. 205; R. 4347-4348.

[751] Ex. 81.

[752] R. 447; cf. R. 143-144.

[753] R. 446-447.

[754] R. 453.

[755] R. 694-695. Quoted at page 68 *supra*. See also R. 144, 455, 693-696, 726. The minutes of April 4, 1935 also refer, in connection with Manning & Company, to the minutes of the meeting held on September 3, 1931 (quoted at page 60 *supra*) which approved the August 1, 1931 contract with Manning & Company of which Price, Waterhouse & Co. were unaware. See page 202 *supra*.

[756] R. 455.

[757] R. 558-559, 140.

banks with Thompson, the treasurer of the Corporation, nor for that matter any other phase of the audit, although he agreed it would be the treasurer's duty to be familiar with such matters.[758]

Documentary evidence Ritts had seen which indicated that Manning & Company was a bank included the bank's statement and debit and credit memoranda which Price, Waterhouse & Co. representatives inspected each year and a confirmation of the balance which was filled in on a standard form supplied by Price, Waterhouse & Co. He had seen no checks nor check books nor record of acceptances payable or any other record dealing exclusively with Manning & Company. The Manning account was carried in the general cash book and written up from the debit and credit advices which Ritts understood were received by the McKesson Companies throughout the month. Ritts said duplicates were included in the statements which appeared unopened when they were given to the auditors at January 31.[759] Miss Walsh, bookkeeper for the Canadian Company, testified that no documents of any kind were received by her with the monthly statements from Manning & Company.[760]

The bank confirmations referred to were on standard forms copyrighted by the American Institute Publishing Co., Inc., and for 1937 reported balances of $44,041.06 and $32,486.08 respectively for the Connecticut Division and Canadian Company at December 31. The balances were labelled in each case "U. S. A. Dollar Account, No Interest", and there was no answer to the request "State if balance is not subject to withdrawal by check * * *."[761] The answer was "None" to questions relating to liabilities on loans, acceptances, endorsements, and other contingent liabilities. The signatures in type were "Per Pro. Manning & Co." with identical illegible signatures below in the space provided for the name and title of the officer. The corresponding bank statements and credit advices did not indicate that the account was in U. S. A. dollars but the debit advices did. Ritts never questioned whether the account could have been carried in U. S. A. dollars in a Canadian bank for he thought it could have been.[762]

The strongest indication Ritts had, which convinced him beyond doubt that Manning & Company was a bank, was that he actually saw evidence of cash transfers to New York bank accounts of McKesson which indicated to him, as he had been told, that whenever cash

[758] R. 446. See also page 207 of this report referring to testimony of Thompson at R. 2116–2117 to the effect that he did not know when the account with Manning was opened and did not consider it to be a bank.

[759] R. 146, 151, 742–744. But compare a junior's testimony, page 199 *supra*.

[760] "Q. [By Mr. GALPEER.] And when you received the statement of Manning & Company, did that statement contain any supporting vouchers, documents, duplicate copies of advices, or anything of that sort. A. No, just the statement." R. 4385.

[761] Cf. Ex. M-17, confirmation at December 31, 1934 which stated: "Balance subject to withdrawal by drafts;" and Ex. O and P, confirmations at December 31, 1931, which did not mention a restriction on withdrawal by check.

[762] R. 432, 451; Ex. 30A, 30B, 31A, 31B, 33.

was needed these funds were drawn from Manning & Company. The audit working papers for 1931 indicated a transfer of $50,000 to a New York bank in November and another of $120,000 in December of that year.[763] Seal of S. D. Leidesdorf & Co. explained how these transfers were effected. The item of $120,000 was drawn on the account in the name of Manning & Company in the Chase National Bank, Hamilton Branch, in favor of McKesson & Robbins, Incorporated, and deposited in their account at the Guaranty Trust Company. The funds drawn against came from various members of the chain explained in detail earlier in this report.[764]

This transfer of funds coupled with the fact that at December 31, 1931, the close of the first year of Manning & Company as a bank, the confirmations from Manning listed two revolving commercial letters of credit, one with the Connecticut Company for $250,000, and one with the Canadian Company for $150,000, both dated August 5, 1931, expiring August 5, 1932, made Manning & Company appear like other banks. To Ritts these Manning letters of credit were similar to letters of credit with the National City Bank of New York and the Guaranty Trust Company.[765] While the other banks reported such letters of credit in recent years, Manning & Company did not indicate on their confirmations that there were "any letters of credit except in the year 1931 when the account was first opened."[766]

Knowledge of this situation led to the questioning of Ritts as to the authority by which Manning & Company issued debit memoranda covering payment of invoices from the several Canadian vendors. On direct examination Ritts was not certain how Manning was authorized to make the payments but assumed that the suppliers were authorized to draw on Manning & Company. These assumptions seem to have been based on what he was told,[767] rather than on documentary evidence which it now appears might have been available to

[763] R. 145, 692.

[764] The last of these transfers in the Connecticut Company was in 1933 and in the Canadian Company in 1936. Thereafter the Manning & Company accounts on the McKesson Companies' books, included only entries based on debit and credit advices pretending to reflect payments and receipts by Manning for the account of McKesson. See footnotes 200 and 407 *supra*.

[765] R. 688–691.

[766] R. 734–735.

[767] R. 120–122.

"Q. [By Mr. GALPEER.] But, just to summarize this one point,—you have no knowledge of how Manning & Company was advised to meet these drafts supposed to be drawn by the Canadian vendors?

A. [By RITTS.] I don't think it is entirely fair to say I have no knowledge. You are asking me to testify that I actually saw authorizations. No, I did not, but in conducting my examination and making inquiries of the various people that handle such transactions, that is what I was told.

Q. Told what, sir?

A. That this was the way these purchases were made and that is the way they were paid for.

Q. You were told that Manning was advised how to meet these drafts by what method?

A. That the purchase order submitted to the various suppliers, these suppliers were authorized to draw on Manning, and Manning, in turn, I believe, was authorized to honor such drafts.

Q. How was Manning authorized to honor such drafts?

A. I couldn't state specifically how. I never saw such authorizations." R. 128.

him.[768] The purchase orders and vendors' invoices which led to these debits at Manning & Company quoted terms, "CASH AGAINST DOCUMENTS NET NO DISCOUNT U.S. CY. F. O. B. BRIDGEPORT OR NEW YORK U. S. A." Ritts had never seen the "documents" referred to but assumed that they would be submitted to Manning & Company but he did not know this as a matter of fact and he saw no necessity for asking such a question. He supposed though that Manning & Company would demand some evidence before paying out cash.[769] He did not think it his duty as an auditor to go beyond the debit advice as authority for the disbursement entry in the McKesson cash records.[770] The debit advices said on their face "Per your letter of authority", so he assumed that it meant exactly that, but he saw no purpose in looking up the letters to see if any were in existence for these letters would merely authorize the discharge of a liability rather than the creation of one,[771] and the books showed that the liabilities were in fact properly discharged.

The letters of authority referred to above Ritts thought might have been general in form and similar in effect to the revolving letter of credit with which he was familiar or they might have been specific letters similar to letters of credit for millions of dollars by which purchases were handled through other banks. In these other cases McKesson kept a credit register and an acceptances payable register in which all letter of credit transactions were recorded. The original revolving letter of credit on Manning & Company was included in the register but no other transaction described as a letter of credit with Manning & Company appeared.[772]

No drafts came back with the debit advices as far as Ritts knew but he assumed that bills of lading were attached for otherwise McKesson could not have claimed the shipment. The bill of lading he thought would have been released to the carrier so it would not have been available, hence it seemed to him to follow that he was justified in assuming that all was in order when he had a vendor's invoice and a Manning debit memorandum which matched.[773] This practice was similar in all respects to McKesson's method of handling payments under letters of credit with New York banks.

Summarizing the foregoing, so far as Ritts was concerned, his knowledge of Manning & Company appears to be based on what he was told, reenforced by what seemed to him to be a record of transactions supported by genuine documentary evidence and similar in many respects to those carried on under letters of credit with well

[768] Ex. 230, 231; pages 73-74 *supra*.
[769] R. 719.
[770] R. 224-228.
[771] R. 699, 753.
[772] R. 687, 746-748.
[773] R. 722, 739-741.

known New York banks. The principal concern Ritts had with Manning & Company was to determine that the balances of McKesson's accounts with them were the right amounts. This he did by reconciling the accounts with the bank statements and confirming direct with Manning & Company. The accounts themselves Ritts testified were entirely written up from documents submitted in the first instance by the bank, as no transactions with Manning & Company since the debit and credit advice procedure was established were recorded originally on McKesson's books. The accounts therefore could not fail to reconcile except for a possible arithmetical error or for an item in transit from Manning & Company at the end of a month. On this latter possibility Ritts testified that he did not think there were many, if any, outstanding items as at the audit dates.[774]

Wyman, who followed the audit program and prior year's papers as his guide, had heard of the banks involved in the Canadian Company and the Connecticut Division work except for Manning & Company. The manner in which the Manning transactions were conducted did not seem unusual to him although he had never seen a situation in which all of the business was conducted in that manner.

"Q. [By Mr. GALPEER.] * * * the moneys came in directly to Manning & Company, apparently?

A. [By WYMAN.] That was the arrangement.

Q. How did you know that was the arrangement?

A. From the evidence offered.

* * * * * * *

Q. What evidence?

A. From the fact that I knew that it could be the case and it was presented to me as the case.

Q. Who presented it to you as the case?

A. There was no discussion of it at any length that would have involved that, just simple explanation of this is the way it works with this thing. I don't know who gave it to me or when, but it was to no great extent." [775]

A junior, who it may be recalled performed most of the cash work during the 1 week he was on the job, relied upon Wyman for guidance in the work he did.

Material reviewed in the foregoing pages indicates the reliance placed upon the bank transactions as proof of the authenticity of the customers' accounts. The next subsection will be devoted to a more thorough study of the audit of receivables.

E. ACCOUNTS RECEIVABLE

The work on accounts receivable on the 1937 audit of the Connecticut Division and Canadian Company followed the same mimeographed program prepared by Thorn for all work done on McKesson Divisions

[774] R. 129-130.

[775] R. 323-321.

by the New York office. Work under this program was carried out on the Canadian Company by Wyman with a few points covered by Ritts and by a junior. The work on the Connecticut Division was done by Ritts and the junior with one point covered by Wyman.

The work program was as follows:

"(1) Obtain the adding machine trial balances of the accounts receivable ledgers at the close of the period. Verify footings and summarize totals; agree grand total with general ledger control.

(2) Obtain aging schedules from the company and make a brief test check of the footing.

(3) Summarize aging schedules and compute the percentage of past-due accounts for the several periods to the total outstanding balances.

(4) Check the accounts receivable ledger balances to the adding machine trial balance and see that no past-due balance of a substantial amount is omitted from the aging schedules. Make a brief test check of the aging.

(5) Note on the aging schedule all pertinent information that will assist the senior in charge in discussing the collectibility of the accounts, including payments received since December 31st.

(6) Examine credit memorandums issued after the close of the period for credits applicable to the period under review.

(7) Scrutinize accounts for balances due from affiliated houses, officers, and employees.

(8) Obtain confirmations direct from officers, directors, and employees for open balances at close of the period.

(9) Transfer credit balances to accounts payable.

(10) Make inquiries as to whether balances represent either merchandise consigned to customers or charges for merchandise to be delivered subsequent to the close of the period.

(11) Analyze accounts receivable control account for the month of December and reconcile approximately the charges to this account with the credits to sales.

(12) Analyze the reserve for doubtful accounts.

(13) Check the branch's schedule of bad debts written off and see that these items are properly approved.

(14) Discuss collectibility of substantial balances with responsible officials, review available credit information and consider small doubtful accounts in total. Determine amounts of specific and general reserves required.

(15) Segregate receivables and reserves applicable thereto between current and non-current and give branch a copy of reclassification entry.

(16) Ascertain whether any differences existed between the accounts receivable ledgers and the general ledger control during the period, and state what disposition was made of these differences, if any.

(17) Prepare receivable certificate and obtain signatures of responsible officials." [776]

This was followed by an item 18 which was similar to the last item on the cash program stating that the work outlined was a minimum and might be added to or modified and that such changes should be noted. Wyman added one point on the Canadian Company—the preparation of a geographical summary of accounts receivable balances. This last point was added by Wyman because he noted that it had been done the previous year. He presumed Ritts told him that the purpose

[776] Ex. 22, 32.

of this analysis was to determine whether any amounts were due from customers in countries where there were blocked currencies or other regulations which might impede collection.[777]

The foreign accounts receivable in the Connecticut Division amounting to $7,505,730.50 as at December 31, 1937 were found to be large in individual amounts and none past due. Ritts had told his assistant when putting him to work on these accounts "* * * that they would probably be in good order."[778] Wyman found conditions in the Canadian Company "unusually good" at the same date in respect to $1,579,143.00 then due. Of this total only three items, $14,520.00, $10,788.00, and $13,485.00, were past due. On inquiring of George E. Dietrich, Wyman was told "* * * that the customers had probably taken the date of his receipt of the goods to figure his time allowed for payment." These accounts were paid soon after the due date. This good record struck Wyman "as a little unusual" but if he discussed it with anyone it would merely have been to check with the preceding year's working papers in which he found a similar situation with no question of impropriety apparently raised. Rather than to increase his skepticism this, and a discussion as to the nature of the accounts generally, convinced him that they reflected a normal condition.[779]

The accounts were also remarkable in that they contained no credits for returns, allowances, discounts, or bad debts charged off.[780] This unusual condition also does not appear to have aroused the suspicions of the junior or of Wyman who worked on the accounts.[781] Wyman, who considered these "* * * an unusually good set of accounts," was questioned at some length in regard to the fact that the books he examined for 1937 reflected no bad debt losses and no credits for damaged goods or other allowances in shipments to England, Scotland, Wales, Ireland, Australia, British Guiana, New Zealand, India, South Africa, Sweden, and Holland. Wyman knew of some other companies with exceptional collection records but did not know of any with no bad debts and no allowances of any kind. He never discussed these matters with anyone for he had read the W. W. Smith & Company, Inc. contract and conceived it to be "* * * possible that such claims might have been made and satisfied against W. W. Smith & Co. without anybody knowing of it."[782] When questioned on this conclusion, Wyman testified:

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[777] R. 355.

[778] R. 1109.

[779] R. 336-338, 343. In his memorandum to Thorn and Rowbotham covering his work Wyman wrote, "So far as we have been able to determine no losses have ever been sustained on these accounts in the past, nor have any of the accounts been charged back to W. W. Smith & Company, Inc. because of McKesson's failure to collect." Ex. 26.

[780] R. 4425.

[781] R. 339-340, 1110.

[782] R. 343-347, 351.

"Q. [By Mr. GALPEER.] The goods that were sold or purportedly sold by W. W. Smith and Company were for the account of McKesson and Robbins; were they not?

A. Yes.

Q. So that, if there were any deteriorations or if there were any losses and so forth, it would really be McKesson's loss, wouldn't it? How did you reach the conclusion?

A. Not necessarily. I was aware that the contract stated $900,000 guarantee.

Q. That was on collectibility, wasn't it?

A. It was on collectibility, but I think it is a fair inference that it might take care of small items in related categories.

Q. Well, you mean that someone——

A. Damaged goods——

Q. You mean that someone who guarantees the collectibility of accounts might be intended to include in that the losses arising from deterioration in freight?

A. I am saying that because you asked me to visualize the circumstances in which losses, allowances or adjustments might be made, not because I have any knowledge that adjustments were made." [783]

The unusual character of the accounts did not disturb him because they were being collected and the only thing he was interested in was the worth of the accounts.[784]

A primary factor in the entire audit was the reliance placed on the contract with the New York firm, W. W. Smith & Company, Inc., and the supporting guaranty of the Liverpool firm, W. W. Smith & Co., which in turn was supported by Dun & Bradstreet reports on the latter firm's credit rating. Wyman referred to this in his memorandum on the Canadian Company's accounts which he said was a copy of Ritts' for the preceding year except for necessary changes in the figures.[785] The credit reports were not obtained directly from the credit agency but from George E. Dietrich who produced the last one 3 or 4 days after the request was made.

"Q. [By Mr. GALPEER.] Was it an independent check of the responsibility or not?

A. [By RITTS.] No, it was not an independent check." [786]

These forged reports from the first one dated October 14, 1931, through successive renewals, dealt with the credit rating of the pretended sales agency W. W. Smith & Co., a co-partnership of Liverpool, with branches in Brooklyn, N. Y., Montreal, and other cities. All of these reports told much the same story about the partnership and noted its phenomenal growth through the depression years.[787]

[783] R. 348-349.

[784] R. 352.

[785] R. 380.

"As in the past, we have obtained a credit report from the foreign department of Dun & Bradstreet, Inc. on W. W. Smith & Company, Inc., guarantor of these obligations under the agreement previously referred to. It states that W. W. Smith & Co. is an old and well-established concern with branch offices and resident agents in the principal world markets * * *." Ex. 26.

[786] R. 576.

[787] Page 61 *supra*.