

MONTHLY BULLETIN

Issued by
EDWARD J. BARRETT
AUDITOR of PUBLIC ACCOUNTS
BANKING DEPARTMENT
State of Illinois

Vol. 13

SPRINGFIELD, ILL., JANUARY 1, 1938

No. 10

QUESTIONNAIRE

BANKING HOUSE

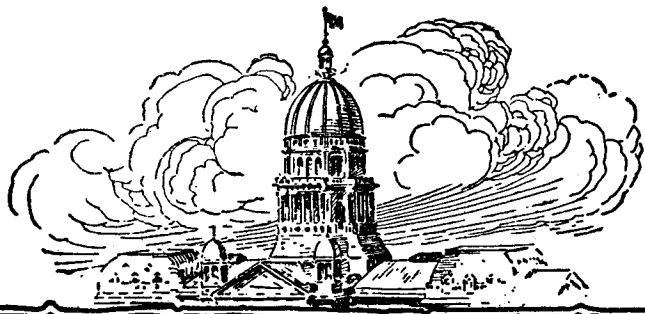
FURNITURE AND FIXTURES

The questions contained in this section need no explanation as they are designed to merely bring out facts that are obviously necessary to determine the character and safety of the banking quarters. There are, however, four questions in this section that have a very important bearing on the condition of the bank—

- No. 3 Book value (of banking house)?
- No. 5 Annual depreciation for each of last five years?
- No. 10 Furniture and Fixtures book value?
- No. 11 Annual depreciation for each of last five years?

Questions No. 3 and No. 10 show how much the bank has invested in so-called fixed assets which ordinarily not only produce no income but are actually a bill of expense to the bank. Questions No. 5 and No. 11 indicate whether or not these two items are a diminishing factor in the bank's condition.

During the past four years, bank managements, as a rule, have gone definitely to the conservative side in valuing



assets on their statements with the result that losses and questionable items are detected and eliminated to a very large extent before they come under the criticism of this Department. This attitude, however, has not so generally extended to banking house and furniture and fixtures; for there are a number of bank managements who insist that the book values of their fixed assets are sound and need no further depreciation. They feel that these values have been written down to a point where full realization can be obtained under any circumstances. Of course, there are two sides to this argument; so let's examine both of them.

The pleasant decade of the 1920's saw a brilliant flourish in bank building. Much of it started during the war period and developed into a decidedly competitive movement. Where two or more banks were in competition, one was almost sure to develop "growing pains" and the others felt compelled to follow suit or lose prestige. Many of these expansion programs started out moderately enough but enthusiasm developed as work progressed and sent them far beyond the original conception. We pause here to recall one Illinois bank that started out to replace a vault door damaged by drilling and finished up with expanded and completely remodeled quarters at a cost of \$115,000.00.

During this period bank managements generally became decidedly building minded and devoted a great deal of time and study to their projects. When they were completed they took great pride in their accomplishments and there was no question in their minds but that their bank properties represented real values. Many of these plants were comparatively new when the revaluation of 1933 became necessary; when intrinsic values had to be forgotten and liquidity not only of deposits but capital became the yardstick. When this yardstick was applied, many a banker was staggered at the write-off required on his pet project. Protests against these revaluations were invariably vigorous and sometimes tearful but the object was to get going again. Being determined men they swallowed their pride and wrote down expensive plants to what they considered would be an all time low.

There was, therefore, considerable amazement when, in ensuing examinations, this Department insisted on annual depreciation of banking house and furniture and fixtures. These latter requirements were admittedly moderate enough but to steadily depreciate these valuable properties from the all-time low was, to many, unthinkable. These individuals and groups are entirely sincere in their convictions and right in their contention from their point of view.

Our point of view is from an entirely different angle and based upon the stern realities of experience. Many of the banks did not survive the crisis of 1933 and it became our job to liquidate such institutions to pay depositors and among the bank assets taken over by the receivers for liquidation were many excellent banking houses splendidly equipped. In the early days of receivership, bids for these properties were few and they were generally carried along for liquidation under more favorable economic conditions. As business improvement appeared, offers came but at ridiculously low figures. It is regrettable to state that bids for receivership bank properties have improved but little and, in many instances, receivers have been forced to the acceptance of extremely

low offers at the insistence of depositors' committees who felt compelled to accept anything in the form of cash realization. Prospective buyers in considering the purchase of such properties are, of course, faced with the fact that they are usually single purpose buildings, the conversion of which to commercial uses entails a considerable outlay of funds. Naturally, in arriving at their bid figure, they mentally add on conversion costs. It has not been an uncommon experience in receivership liquidation that losses taken on banking house and furniture and fixtures have alone wiped out, in a large part, the capital structures appearing on the statements at the time of closing.

We have been told that to measure bank plant and equipment values on the basis of our liquidation experience above outlined is an unfair test and, to that, we are forced to answer that it is the only real test. It seems to us purely hypothetical to state that a banking house and equipment has a certain definite value as a going concern. Such properties are rarely sold in the ordinary course of business and under normal economic conditions and the real test of value only occurs, as a rule, when a bank ceases to be a going concern. We are, therefore, firmly convinced that in insisting upon a reasonable appropriation from each year's earnings to depreciate both banking house and furniture and fixtures, that our position is well founded in experience.

A number of banks have entirely written off both of these fixed accounts and others are well down toward the vanishing point and we have yet to learn of a single one of these institutions that regretted or suffered in any manner from such action.

There is one more question in this section that is of particular significance to directors of smaller banks and that is "Is entry and use of rented boxes properly supervised?" Larger institutions, almost without exception, study this feature of their operation carefully and provide adequate safeguards. However, we all too frequently find in smaller banks that, through carelessness, desperate chances are being taken in operating safety deposit vaults. Bank managements should realize in handling this business that they have a very definite and serious responsibility, first, to provide adequate vault protection in which customers' vaults are housed and secondly, and of equal importance, to provide a system of entry that will insure access only to persons entitled thereto.

To begin with, when a box is rented to an individual, a contract or lease in writing should be entered into between the bank and the box renter in legal form adequately showing the duties and responsibilities of each party to the lease or contract. All keys should be delivered to the renter and a receipt taken therefor. While the bank is open and access is available to renters, the master key should never be out of the possession of the person designated to supervise entry to and exit from the boxes. The master key should never be delivered to the box renter and his box should never be withdrawn from its compartment except in the presence of the bank officer or employee holding the master key. Any time that such precautions are not taken, the bank is being exposed to a potential liability.

CHARTER ISSUED

		Capital.	Surplus.	Reserve.	Date.
✓ Marion.....	Williamson.....	The Bank of Marion, 504 Public Square—Edward Longbons, Pres., J. C. Keltner, Cashier.....			\$50,000 \$5,000 \$2,500 Dec. 4, 1937

CHANGE OF LOCATION

Marion..... Williamson..... The Bank of Marion, from 504 Public Square, Marion, Illinois, to 300 Public Square, Marion, Illinois..... Dec. 10, 1937

IN LIQUIDATION

✓ Fithian..... Vermilion..... Farmers State Bank of Fithian, Illinois..... Dec. 20, 1937

CONSOLIDATED

✓ Springfield..... Sangamon..... First State Trust and Savings Bank of Springfield and The First National Bank of Springfield, under title "The First National Bank of Springfield"..... Dec. 22, 1937

DISSOLVED

Brocton..... Edgar..... The Brocton Bank (In receivership January 24, 1931. Dissolved by order of the Circuit Court of Edgar County)..... Dec. 18, 1937

Newton..... Jasper..... Newton State Bank & Trust Company (In liquidation December 31, 1929)..... Dec. 21, 1937

Chicago..... Cook..... West Irving State Bank (In receivership July 16, 1932. Dissolved by order of the Circuit Court of Cook County)..... Dec. 29, 1937

RECAPITULATION

	Reopened by permit.	Closed under holiday.	Total.
State Banks in Chicago.....	32	1	33
State Banks in Cook County.....	29	--	29
State Banks in Illinois outside Cook County.....	506	--	506
Total.....	567	1	568

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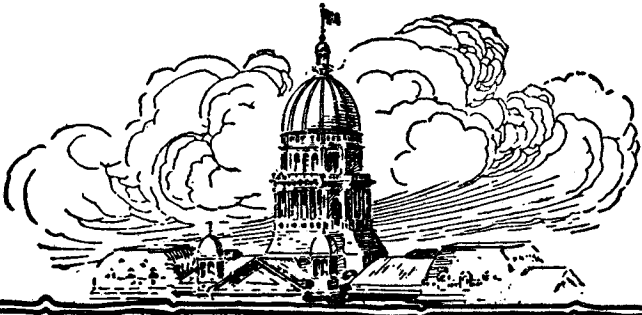
No. 11

INSURANCE COVERAGE

The information contained in this section of the Examination Report is all too frequently dismissed with a glance while as a matter of fact it is one of the most important showings made in the report. This section constitutes a complete exhibit of the bank's insurance protection.

Capable officers and directors can and frequently have operated banks over a long period of time without an asset or an operating loss but there are a number of well recognized risks in the conduct of a bank against which the most capable management is more or less vulnerable and one in particular against which it is almost defenseless. It is probably no exaggeration to call money the most desirable of all commodities and a bank with its large store of this commodity and securities, quickly and fairly easily convertible into money, offers a tempting target for the dishonest and unscrupulous.

There are four principal points through which a bank is vulnerable against loss which, in the order of frequency, are as follows: Dishonesty of employees, robbery, burglary and forgery. A successful attack through any of the first three avenues can quickly convert the soundest and best managed bank into an insolvent wreck unless the bank is adequately protected by insurance.



In the matter of fidelity insurance, actual experience has made this Department very hard-boiled. We consider no individual whose activity brings him in contact with the assets of any of our State banks exempt from fidelity insurance. It is a waste of time to tell us that President So and So owns most of the stock in the bank, is in active charge and watching operations carefully and therefore should be exempt from a bond. We are deaf to the reminder that the Cashier is the son of the President or one of the wealthy directors whose family history goes back unsullied for generations and would be offended by being placed under a surety bond. We have seen principal owners and fair haired boys go just as wrong, and more so, than the most benighted teller or messenger. We are all human and, under the pressure of circumstances, the best of us may do foolish acts. We have in mind, at the moment, a misappropriation of \$10,000.00 carried out over a considerable period of time to cover clerical errors. We recall another case of a misplacement of over \$70,000.00 to cover clerical and accounting errors. There is a wide variety of reasons underlying embezzlement and defalcations of officers and employees with motives ranging from criminal to almost noble but the result is always the same—LOSS.

We have before us figures showing that approximately sixty per cent of all insurable losses suffered by banks result from embezzlement or dishonesty. It is gratifying to note that bank losses from robbery are steadily diminishing. The same figures above quoted show that only six per cent of insurance losses result from robbery and hold up, while less than one per cent result from burglary. During recent years our law enforcement agencies have improved tactics and technique to a point where bank banditry and burglary have become very futile means of livelihood, while further protection has been gained by many modern and improved protective devices and equipment. Forgery losses can be controlled and minimized by alertness and care in signature identification and, particularly, in properly identifying individuals opening new accounts and their transactions. However, all banks are to a greater or lesser degree vulnerable through this avenue, depending upon the volume and character of the clientele.

A bank can and should insure itself against all of these risks to which it is exposed and a bank management that will neglect or refuse to insure the bank to the full extent of its exposure is taking an unwarranted risk to the jeopardy of stockholders' investment and depositors' funds. We have occasionally discussed this matter with bank managements who, while admitting deficiencies of insurance protection, have pointed out that the bank could not afford the protection necessary. Our answer to that contention is also hard-boiled but based upon actual experience. The bank that fails to earn enough from its operations to provide adequate protection against the established risks of the business can hardly justify its bid for public patronage. A bank management finding the institution in such a position should seriously consider the advisability of continuing operation.

In the foregoing, we have attempted to give to bank managements a broad and general view of their risks and we shall now undertake to assist directors in the study and meeting of their own immediate needs in this respect. In this connection, we feel it timely to set down here a recommendation that we have had under consideration for some time. We feel that in all banks the determination of insurance needs and the placing thereof should be done entirely by the Board of Directors. At

reasonable intervals, the Board should make it a regular order of business to review and determine, as accurately as possible, the extent of the various insurable risks and the amount of their exposure. They should consult with reliable and well informed insurance brokers as to details in acquiring the protection they need. And it is particularly important that their minutes show that the bank's schedule of insurance protection and periodical alterations thereof have been considered and approved by the Board of Directors.

In discussing hereinbelow the various forms of coverage, we shall refer entirely to corporate surety for the reason that personal surety in any form is not acceptable to this Department.

Bank insurance has been greatly simplified in recent years by the establishment of the so called blanket policy. In former years separate policies were written for fidelity, burglary and robbery, theft, larceny, misplacement, damage or destruction, forgery, etc. These separate policies required individual handling and watching for lapses. The blanket policy above mentioned consolidates all of this protection into one policy and it is important to note that a blanket policy cannot lapse but must be cancelled by either the bank or the underwriter. Most, if not all, of the nationally recognized companies issue two different blanket policy forms. In referring to these forms below, we shall not use the designation of any particular company but descriptive terms of our own.

The first we will call the "minimum blanket bond." This bond will usually cover any loss sustained through any dishonest, fraudulent or criminal act of any employees, wherever committed. It should further cover the following losses on the bank's premises:—burglary, robbery or holdup, theft, larceny, damage or destruction, damage except by fire to insured's offices, safes, vaults, equipment, etc., caused by larceny or theft in or by burglary, robbery or hold up of such offices or attempt thereat. This same bond will protect the bank against loss of defined property in transit through larceny, robbery or hold up, theft or negligence of employees or of employees of armored motor vehicle companies. It is important to note in this policy that after a loss has been sustained, the coverage of the policy is automatically restored against future losses. To this form may be added, by rider, protection against misplacement or mysterious unexplainable disappearance. A certain amount of forgery and alteration insurance can also be added under the "minimum blanket bond."

We shall call the second form of blanket coverage the "major blanket bond." This form should contain all of the protection provided in the minimum form, above outlined, and added coverage, as follows: misplacement or mysterious unexplainable disappearance either on the bank premises or in transit, damage or destruction in transit, loss through negligence or otherwise on the part of employees or employees of armored motor vehicle companies in transit, loss through misplacement of interim certificates, warrants, rights or other securities. To this form may be added, by rider, protection up to and including twenty-five different acts of forgery. It is important to note that when loss is sustained under this form, the coverage of the bond is automatically restored to cover not only future losses, as in the minimum form, but prior undiscovered losses as well.

(NOTE: We shall continue the discussion of this important subject in our March issue in which we shall elaborate more fully upon the details of bank insurance.)

DURATION EXTENDED

Hartsburg.....Logan.....Hartsburg State Bank. Charter extended 25 years from
April 18, 1938.....Jan. 11, 1938 ✓
Elburn.....Kane.....Kane County Bank and Trust Co. Charter extended 25
years from April 24, 1938.....Jan. 19, 1938 ✓
Cypress.....Johnson.....Farmers and Merchants State Bank of Cypress, Illinois.
Charter extended 25 years from February 5, 1938.....Jan. 26, 1938 ✓

CAPITAL STOCK INCREASED

Chicago.....Cook.....Pioneer Trust & Savings Bank, from \$375,000 to \$750,000.....Jan. 18, 1938

CHANGE OF PAR VALUE OF CAPITAL STOCK

Chicago.....Cook.....Pioneer Trust & Savings Bank, from \$50 to \$100.....Jan. 18, 1938

CLOSED

Belleville.....St. Clair.....Belleville Bank & Trust Company.....Jan. 26, 1938

DISSOLVED

Salem.....Marion.....The Salem State Bank (In liquidation January 17, 1931).....Jan. 6, 1938 ✓
McLean.....McLean.....Farmers State Bank of McLean (In liquidation December
31, 1923. Dissolved by order of the Circuit Court of
McLean County).....Jan. 11, 1938 ✓
Winnebago.....Winnebago.....Peoples State Bank of Winnebago (In receivership October
13, 1931. Dissolved by order of the Circuit Court of
Winnebago County).....Jan. 11, 1938 ✓
Lake Forest.....Lake.....Lake Forest Trust and Savings Bank (In liquidation Oc-
tober 14, 1931).....Jan. 14, 1938
+ Viola.....Mercer.....Viola State Bank (In liquidation June 7, 1928. Dissolved
by order of the Circuit Court of Mercer County).....Jan. 21, 1938

RECAPITULATION

	Reopened by permit.	Closed under holiday.	Total
State Banks in Chicago.....	32	1	33
State Banks in Cook County.....	29	--	29
State Banks in Illinois outside Cook County.....	505	--	505
Total.....	566	1	567

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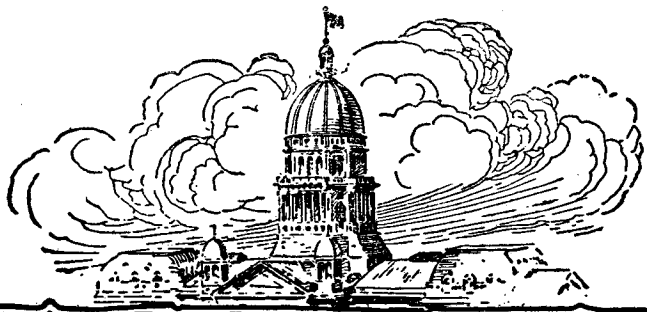
No. 12

INSURANCE COVERAGE (Continued)

(NOTE: We continue hereinbelow our discussion of bank insurance which should be read in conjunction with the discussion on this subject started in our February Bulletin.)

The "minimum blanket bond" is used almost entirely by smaller institutions and is the less expensive of the two forms. Quite frequently, banks will use a combination of both forms to obtain a maximum amount of insurance on their major risks and a smaller amount of coverage on their lesser risks. For instance, a bank would determine a need for \$100,000.00 of protection against all of the risks covered in the "minimum blanket bond." They would apply for a \$50,000.00 "major blanket bond" and a \$50,000.00 "minimum blanket bond." This would provide protection to the extent of \$100,000.00 against all of the major risks covered in the "minimum" bond and \$50,000.00 against the additional risks covered in the "major blanket bond." The "major blanket bond" would then become known as the primary insurance, while the "minimum blanket bond" would be termed excess insurance. The purpose of this arrangement is to reduce the cost of insurance.

The preference of this Department for the bankers' blanket bond is based upon the following contrasts:—



Under individual and schedule fidelity bonds and individual burglary, robbery, hold up and forgery policies, the bank must specify the amount of insurance which is to apply to each of these hazards. There is a natural tendency in surveying hazards to minimize the amount of possible losses due to any of the foregoing which frequently results in under insurance. Under a bankers' blanket bond, the bank purchases a stated amount of protection, \$25,000.00, \$50,000.00 or \$100,000.00, as the case may be, and the entire amount of the bond applies to whatever loss occurs.

To obtain recovery in the event of loss under an individual or scheduled fidelity bond, the bank must prove that the loss was due to the dishonest or fraudulent act of an identifiable bonded employee. If the bank cannot fix the loss upon a particular employee named in the bond, the bank cannot recover. Under a bankers' blanket bond, the bank has only to prove that a shortage exists as the result of a dishonest or fraudulent act of one or more of its employees.

Under individual or scheduled fidelity bonds, bankers frequently do not cover minor employees. The bankers' blanket bond automatically covers every employee up to the full amount of the bond for any one loss or series of losses.

Under individual and scheduled fidelity bonds, the bank must name the employees who are to be covered. Therefore, it is necessary for the bank to notify the surety company and to make arrangements to have every new employee bonded as soon as he or she joins the organization. The bankers' blanket bond automatically covers new employees (except in the case of a merger) without additional cost and without requiring that the surety company be notified.

Under burglary and robbery policies, the bank is usually required to make certain warranties regarding its equipment and it is necessary to see that these warranties are complied with, while no warranties whatever are required under bankers' blanket bonds.

No recovery can be obtained under burglary, robbery, hold up and forgery policies, if it can be proved that there was collusion between the criminals and an employee of the bank. The bankers' blanket bond covers losses due to these hazards regardless of whether or not they were the result of collusion between criminals and one or more employees of the bank.

One of the most difficult conclusions to reach in surveying bank insurance needs is the amount of fidelity coverage that should be obtained. When it is considered, as pointed out above, that sixty per cent of bank insurance losses result from employees' defalcations or embezzlements, it is obvious that there is where the greatest amount of protection is needed. We know of no authoritative yardstick ever devised for the accurate measurement of this risk. It strikes us that a good idea of the bank's fidelity exposure might be gained by computing the bank's daily turnover as represented by the totals of the following transactions:—

- 1) Amount of checks cashed over counter for customers.
- 2) Amount of deposit of checks drawn on that particular bank and deposited by customers.
- 3) Amount of clearings being carried by messenger or transported by employees.

- 4) Amount of incoming clearings.
- 5) Amount of sales of securities made by bank.
- 6) Amount of collateral normally taken in connection with loan business of the bank.

To the foregoing computation should be added the total amount of cash on hand and highly negotiable securities owned by the bank.

Before leaving the matter of the blanket bond and burglary and fidelity coverage, we would add a word of caution to bank directors when they are called upon to deal with defalcation or embezzlement on the part of employees. When such an unfortunate incident occurs, the surety company should be notified immediately and no attempt made "to fix things up quietly." At such a time, the directors have no means of knowing what the entire amount of the defalcation or embezzlement is. Usually situations of this kind come to light in installments and exhaustive audits are needed to tell the entire story. Bank directors should be warned that in attempting to settle these matters quietly, they are seriously jeopardizing their insurance protection.

In the conduct of a banking business, there are additional risks, all insurable, that should not be overlooked in surveying insurance needs and these are as follows:—

- Workmen's compensation and employers' liability.
- Owners, landlords and tenants public liability.
- Boiler and machinery.
- Automobile liability.

These risks arise where banks are forced to take title to and operate properties either as owner or trustee.

There is also the matter of safe deposit vault insurance which is practically equal to the risk of burglary.

In conclusion, we desire to point out that in assembling and setting down the foregoing information and observations, we have endeavored to stimulate bank directors' interests in their insurance needs rather than attempt to deal with the subject academically. We have limited our treatment of the subject to very broad and general terms and there may be some inaccuracies when the foregoing is compared with certain company contracts. When insurance surveys are being made by individual directorates, expert assistance can undoubtedly be readily obtained.

We suggest that after directors have placed their insurance, that they request their company to furnish them with a chart of their insurance coverage. Such a chart will be very valuable in that it furnishes the directors with a brief but comprehensive picture of their insurance protection. All companies are very willing to prepare and furnish these charts upon request.

While on the subject of insurance, banks should watch carefully the protection upon property in which they have an interest. Practically all banks are careful in obtaining "loss payable clauses" for policies covering buildings pledged to secure real estate loans. We have, however, encountered some carelessness in connection with insurance covering chattel property pledged under chattel mortgages. We therefore desire to caution all bankers of the necessity when making loans on a chattel mortgage basis of seeing to it that the company insuring the chattel property is notified, acknowledges the mortgage and agrees to keep the policy in force. Failure to do this will seriously weaken the bank's position in the event of loss by fire or other insured hazards.

DISSOLVED

Junction.....Gallatin.....	First State Bank of Junction (In liquidation November 29, 1937).....	Jan. 20, 1938
Bardolph.....McDonough.....	Bardolph State Bank (In liquidation January 14, 1938).....	Feb. 3, 1938
Loda.....Iroquois.....	State Bank of Loda (In receivership December 5, 1931. Dissolved by order of the Circuit Court of Iroquois County).....	Feb. 5, 1938
Princeville.....Peoria.....	Home State Bank of Princeville (In liquidation June 11, 1929. Dissolved by order of the Circuit Court of Peoria County).....	Feb. 8, 1938
Saybrook.....McLean.....	Saybrook State Bank (In liquidation June 3, 1931. Dissolved by order of the Circuit Court of McLean County).....	Feb. 9, 1938
Urbana.....Champaign.....	First State Bank of Urbana, Illinois (In liquidation July 5, 1927. Dissolved by order of the Circuit Court of Champaign County).....	Feb. 23, 1938
West Union.....Clark.....	First State Bank of West Union (In receivership October 10, 1932. Dissolved by order of the Circuit Court of Clark County).....	Feb. 23, 1938

RECAPITULATION

	Reopened by permit.	Closed under holiday.	Total.
State Banks in Chicago.....	32	1	33
State Banks in Cook County.....	29	---	29
State Banks in Illinois outside Cook County.....	505	---	505
Total.....	566	1	567

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Vol. 14

SPRINGFIELD, ILL., APRIL 1, 1933

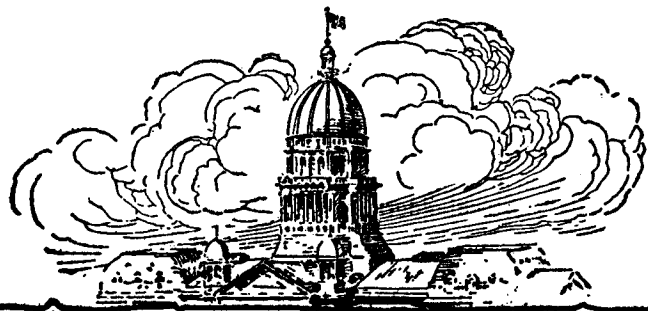
No. 1

CAPITAL STOCK

Before going into the technical and accounting details involved in the handling of a Capital account, we consider it more appropriate to discuss this account in the broader aspects of its importance to the bank. The Capital account should be regarded as the keystone of the bank. The entire business is built upon and around it and the continued existence of the bank is, at all times, dependent upon its soundness.

A study of the Illinois Banking Act cannot fail to leave the impression that the Legislature, in framing our existing banking law, was thoroughly impressed with the importance of the Capital account and devoted considerable thought and study to providing and protecting adequate sound capital. It has written into the law not only very definite requirements to provide sufficient capital but added provisions to insure the maintenance of those requirements in the form of sound assets. These Legislative intentions are brought out very clearly in Section 11.

At the outset of this section, minimum capital requirements are measured according to population. Immediately following these requirements they deal with capital impairment and in a manner that prohibits any bank from operating



longer than sixty days with an impaired capital. We shall mention here briefly the minimum capital required by law.

- a) If not within a City, Village or incorporated town (an unincorporated community)—\$50,000.00; or if within an incorporated municipality of less than 10,000 inhabitants—\$50,000.00.
- b) If in an incorporated municipality of 10,000 and less than 50,000 inhabitants—\$100,000.00.
- c) If in an incorporated municipality of 50,000 or more inhabitants—\$200,000.00.

Capital impairment, simply stated, means loss of capital and occurs when losses on assets or operations, or both, have used up all of the surplus capital accounts (Surplus, Undivided Profits and Reserves) and started using up the Capital account. For instance, let us say that a bank has \$50,000.00 in its Capital account, \$25,000.00 in its Surplus account, \$10,000.00 in Undivided Profits and \$20,000.00 in Reserve against Losses and let us assume that this bank suffered losses of \$65,000.00. The Surplus, Undivided Profits and Reserves would take care of \$55,000.00 of these losses but there would be an additional \$10,000.00 that would have to be absorbed from the Capital account resulting in an impairment of \$10,000.00 or twenty per cent of the Capital account.

Should this Department encounter such a condition, Section 11 of the Banking Act makes it the duty of the Auditor of Public Accounts to require the directors to levy an assessment against the stockholders for an amount sufficient to eliminate the impairment and restore the Capital account to \$50,000.00 of sound capital. This section also provides that the shares of any stockholders who do not pay the assessment may be sold at public auction (after twenty days' notice) for an amount sufficient to meet the assessment. If, through the directors' assessment or the forced sale of stock, the impairment is not made good within a period of sixty days, it then becomes the duty of the Auditor to take possession of the bank for reorganization or liquidation through receivership. If, however, in the example above cited, the bank had a capital of \$75,000.00 and was located in a municipality of less than 10,000 inhabitants, the Capital account could be reduced by stockholders' action to \$50,000.00 and \$25,000.00 transferred to Surplus or Undivided Profits for the purpose of absorbing the \$10,000.00 loss which would then leave the bank with a sound capital of \$50,000.00 and \$15,000.00 unimpaired Surplus. The capital, however, cannot be reduced below the minimum capital requirements hereinabove outlined.

As an added measure of protection to the Capital account, the Legislature, in recent years, added Section 11½, which not only prohibits the withdrawal of any portion of the Capital account for the payment of dividends but also requires the allocation of a portion of its earnings to Surplus up to twenty per cent of the capital stock before dividends to stockholders may be declared.

The decreasing, increasing or changing the par value of capital stock is surrounded in Section 12 with very rigid requirements and restrictions. If any of these three changes are contemplated, they must

be submitted to a meeting of the stockholders and before they are actually made, must be ratified by at least two-thirds of the whole amount of stock outstanding. Any of these changes can be made at a regular annual stockholders' meeting without previous publication of notice. If they are not made at a regular annual stockholders' meeting, a special stockholders' meeting may be called for that purpose in the manner provided under Section 12. This requires a thirty day individual notice to each stockholder and also requires a publication of notice of the date and purpose of said special meeting at least once each week for three consecutive weeks in the local or nearest newspaper. If the required two-thirds vote authorizes any of said changes, the Secretary of the meeting is required to notify the Auditor of Public Accounts of the stockholders' action. If the Auditor of Public Accounts approves of the changes effected, he issues a Certificate of Approval which instrument, together with the certificate of stockholders' proceedings, must be filed for record with the Recorder of Deeds in the County in which the bank is located. It is important to note that until these two documents have been filed for record, that the changes have not been legally accomplished. After all of these steps have been taken, it is then necessary to publish notice of the change made at least once each week for three consecutive weeks in the local or nearest newspaper.

There is another statutory provision that conveys a significant thought of the Legislature pertaining to the Capital account found in Section 5. Into this section it is written that the Auditor of Public Accounts may, in his discretion, withhold the issuing of a Charter when he has reason to believe that a commission or fee has been paid in connection with the sale of stock of the bank. This indicates to us a determination on the part of the Legislature to confine Illinois State banks to the necessities and convenience of communities and to prevent the organization of any Illinois State bank as a purely stock selling enterprise.

In our experience with a larger number of bankers, we find that the more seasoned, skillful and successful bankers devote a great deal of thought and study to the quality and character of the assets that must naturally fall within their Capital account and its protecting sub-structure. Their aim is to not only steadily build up and strengthen the protecting sub-structure from earnings but to keep it supported by assets of unquestionable value.

At the outset of this article, we held up the Capital account as the keystone of the bank yet, strangely enough, this is the point where weakening influences have their effect. A clear idea of the weight that rests upon this keystone can be gained from considering that if a bank has a capital structure of \$100,000.00 and deposits of \$1,000,000.00 that for each dollar of stockholders' capital, the management must invest and otherwise handle Ten Dollars of depositors' funds, but all losses incurred in the handling of depositors' funds must come out of the stockholders' capital.

(NOTE: We shall continue our discussion of the Capital account in our May issue discussing therein details of accounting.)

TRUST CERTIFICATE CANCELLED

La Grange.....Cook.....La Grange State Trust and Savings Bank.....Feb. 17, 1938

CAPITAL STOCK DECREASED

La Grange.....Cook.....La Grange State Trust and Savings Bank from \$400,000 to \$100,000.....Mar. 8, 1938

CAPITAL STOCK INCREASED

La Grange.....Cook.....La Grange State Trust and Savings Bank from \$100,000 to \$200,000.....Mar. 9, 1938

CHANGE OF PAR VALUE OF CAPITAL STOCK

La Grange.....Cook.....La Grange State Trust and Savings Bank from \$100 to \$25.....Mar. 8, 1938

RECEIVER APPOINTED

Belleville.....St. Clair.....Belleville Bank & Trust Company—Charles H. Albers.....Mar. 16, 1938

DISSOLVED

Maquon.....Knox.....Maquon State Bank.....Mar. 1, 1938

Omaha.....Gallatin.....State Bank of Omaha (In liquidation August 11, 1932).....Mar. 2, 1938

Edinburg.....Christian.....Turner State Bank (In liquidation January 2, 1930).....Mar. 3, 1938

Rantoul.....Champaign.....Commerical State Bank of Rantoul (In liquidation August 27, 1923. Dissolved by order of the Circuit Court of Champaign County).....Mar. 8, 1938

Victoria.....Knox.....Victoria Exchange Bank (In liquidation June 4, 1926. Dissolved by order of the Circuit Court of Knox County).....Mar. 10, 1938

Low Point.....Woodford.....Banta Bros. Bank (In receivership February 24, 1933. Dissolved by order of the Circuit Court of Woodford County).....Mar. 17, 1938

Mason.....Effingham.....Farmers State Bank of Mason (In receivership May 5, 1930. Dissolved by order of the Circuit Court of Effingham County).....Mar. 19, 1938

Toluca.....Marshall.....Toluca State Bank (In receivership February 11, 1927. Dissolved by order of the Circuit Court of Marshall County).....Mar. 19, 1938

RECAPITULATION

	Reopened by permit.	Closed under holiday.	Total.
State Banks in Chicago.....	32	1	33
State Banks in Cook County.....	29	---	29
State Banks in Illinois outside Cook County.....	504	---	504
Total.....	565	1	566

MONTHLY BULLETIN

Issued by
EDWARD J. BARRETT
AUDITOR of PUBLIC ACCOUNTS
BANKING DEPARTMENT
State of Illinois

Vol. 14

SPRINGFIELD, ILL., MAY 1, 1938

No. 2

CAPITAL STOCK (Continued)

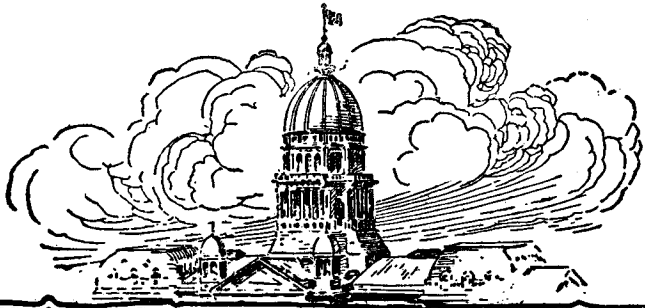
(NOTE.—We continue with our discussion of the Capital account started in the April Bulletin.)

In continuing our discussion of the Capital account, we shall, in this issue, deal with the technical and accounting details involved in the handling of this account.

In the second and third question, we cover the Stock Certificate Book which is the primary record controlling this account. The questions pertaining to this particular record are as follows:

2. State whether Stock Certificate Book is properly kept. Are surrendered Certificates properly assigned, canceled and filed?
3. Are any stock certificates signed in blank? Was amount of stock outstanding proved by check of stubs?

The usual Stock Certificate Book in use is very similar to an ordinary check book, with each sheet being divided by perforation between a stub and a stock certificate. When a stock certificate is issued, the transaction should be fully described upon the stub, showing the number of the certificate issued, the date of issue, the number of shares issued and



the names of the transferor and transferee. A space is provided on this stub for the transferee to sign a receipt, acknowledging delivery of the shares. After the transaction has been recorded upon the stub, the stock certificate itself is then prepared, signed by the authorized officers and sealed with the bank's corporate seal. When a stock certificate is delivered to the bank for transfer, it must be properly assigned by the owner, whereupon the bank cancels the certificate and fastens it permanently to the stub from which it was originally issued and draws a new certificate or certificates to contain the shares previously cancelled.

There are two very important steps in this proceeding that must be carefully watched: (1) That the certificate returned is assigned to the bank by the actual owner. If any one other than the actual owner presents a certificate for transfer, he should be required to present his authority to make the assignment, either in the form of a written power of attorney or his authority to act for a deceased or incompetent person. Said documents of authority should be retained by the bank and attached to the cancelled certificate. (2) It is of equal importance that if any individual other than the actual owner receives a certificate of stock, that he file with the bank evidence of his authority to sign said receipt, which should also be attached to the stub. The bank officers should use extreme care in handling stock certificates that they deal only with the actual owner or person legally qualified, in writing, to act for the owner.

The reason for the first part of the third question was a practice that existed for many years of having the President and Cashier sign a number of stock certificates in blank. The danger of this practice is so obvious as to need little discussion for it can be readily understood that in the event such fully executed certificates were lost or stolen and were later to turn up in the hands of innocent holders for value, that the bank of issue would find itself in a very difficult position.

In the fourth question, we ask the Examiner to "State whether stock ledger is properly kept." At the outset we designated the Stock Certificate Book as the place of original entry of stock transactions. As time goes on and transfers accumulate necessitating the issuance of new certificates and the cancellation of old and the division of certificates into other certificates containing a smaller number of shares, this original record, even though accurately kept, will become so involved as to make it very difficult to trace stock transactions when the occasion arises for doing so. For this reason, a Stock Ledger is just about indispensable. In this Ledger an account is opened with each stockholder which will show, at a glance, his total number of shares as well as all of his transactions in the stock of the bank. If the posting in this

Ledger is properly done, the tracing of stock transactions becomes a relatively easy matter. If a transfer of a certain number of shares is made from the account of one stockholder, the entry in the account of the transferor should show the date and the name of the stockholder to whom the stock was transferred, the number of the Certificate and the number of shares transferred. The account of the transferee should show the date of entry, the number of the certificate from which this transfer was made, the number of the new certificate issued and the number of shares.

If this record is carefully posted with adequate detail and periodically balanced for accuracy, its usefulness will amply compensate for the time employed in keeping it in current condition.

The fifth question—"Are Certificates of Transfer of stock recorded and filed as provided in Section 6?" covers a legal requirement that reads as follows: "It is hereby made the duty of the president and cashier, within thirty days after organization, to file in the office of the recorder of deeds of the county in which such bank is located, a certified list of all the original stockholders, giving the number of shares of stock held by each, and thereafter a certificate of all transfers of stock, not later than ten days after such transfer."

ANECDOTES OF THE ROAD

We do not have to go "way back when" for the anecdote of this month as the following is quite current.

The modern man of letters prizes nothing more highly than the inspiration that enables him to describe an object, a scene or a personality with a few brisk words or a short jolting phrase. The modern reader expects and enjoys such inspirations in his favorite author; but when one pops in over the telephone from a very prosaic Bank Cashier, it carries the so-called "double wallop."

One of our Examiners possesses an appearance that might be artistically described as a study in contrasts. His ruddy and healthful complexion is accentuated with a hirsute adornment in coal black consisting of heavy black and well groomed eyebrows and the kind of a mustache that we would all like to raise if we could. Some months ago he had completed an examination and left the bank and the Cashier discovered that the Examiner had forgotten a note book. Not knowing where to locate the Examiner, he called the divisional headquarters to report the finding of the book. There were several men on the crew and we asked the Cashier which one of the men the book belonged to and received the following reply, "I can't remember his name now, but it was the guy with the three mustaches."

IN LIQUIDATION

Belleville.....St. Clair.....Belleville Bank & Trust Company through The First National Bank of Belleville (Charles H. Albers, Receiver, resigned).....Apr. 4, 1938

CHANGE OF PAR VALUE OF CAPITAL STOCK

Elmhurst.....Du Page.....Elmhurst State Bank from \$100 to \$50.....Apr. 27, 1938

CAPITAL STOCK DECREASED

Elmhurst.....Du Page.....Elmhurst State Bank from \$250,000 to \$125,000.....Apr. 27, 1938

CAPITAL STOCK INCREASED

Elmhurst.....Du Page.....Elmhurst State Bank from \$125,000 to \$250,000.....Apr. 28, 1938

DISSOLVED

Sheffield.....Bureau.....Community State Bank of Sheffield (In liquidation June 23, 1928).....Mar. 10, 1938

Guthrie.....Ford.....Guthrie State Bank (In liquidation November 2, 1926).....Mar. 25, 1938

Danville.....Vermilion.....Commercial Trust and Savings Bank (In liquidation September 5, 1931).....Mar. 30, 1938

Albany.....Whiteside.....Albany State Bank.....Mar. 31, 1938

Lansing.....Cook.....Oak Glen Trust & Savings Bank (P. O. Oak Glen) (In liquidation April 1, 1935).....Mar. 31, 1938

Divernon.....Sangamon.....Divernon State Bank (In liquidation July 10, 1930. Dissolved by order of the Circuit Court of Sangamon County).....Apr. 29, 1938

Divernon.....Sangamon.....First State Bank of Divernon (In liquidation July 16, 1928. Dissolved by order of the Circuit Court of Sangamon County).....Apr. 29, 1938

RECAPITULATION

	Reopened by permit.	Closed under holiday.	Total.
State Banks in Chicago.....	32	1	33
State Banks in Cook County.....	29	---	29
State Banks in Illinois outside Cook County.....	503	---	503
Total.....	564	1	565

MONTHLY BULLETIN

Issued by
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State of Illinois

Vol. 14

SPRINGFIELD, ILL., JUNE 1, 1938

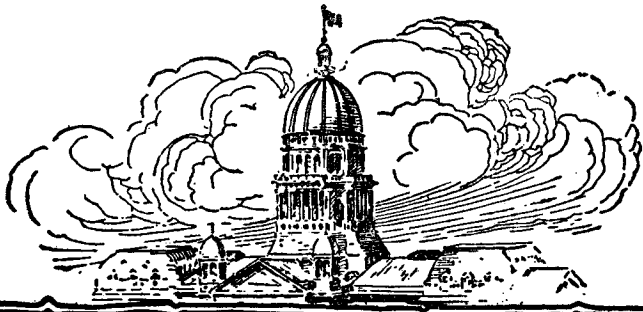
No. 3

AFFILIATED BANKS

It will be noted that the next section of our Examination Report makes inquiry as to the affiliation of a bank under examination with any other banking corporation through the following questions:

- 1) State whether there is an affiliation with any bank or trust company through a controlling ownership of stock by the same shareholders, by practically the same management or in any other manner, giving name of affiliated bank.
- 2) State nature of affiliation.

In former years affiliations between banks through stock control or management was not uncommon but in recent years such affiliations have gradually disappeared to a point where they are but rarely encountered at the present time. Our experience with affiliation among banks has been both good and bad. We have seen banks prosper and enjoy the benefits of excellent management through the controlling influence of another well managed institution. We have also seen banks irreparably damaged from affiliated control. While we have never made a detailed survey of bank affiliations in Illinois, we can safely state in a general way that most of our experience has been on the unfavorable side. For that reason, we feel that at each examination inquiry should be made as to any affiliation with other banks either



existing or in the making. One of the important possibilities of such affiliations that we must be on the alert to recognize is the shifting of assets from one institution to another. Usually a move of this kind is the result of an emergency faced by one of the affiliates and the assets shifted are of the most troublesome type. The splitting of large loans between affiliates which in any one would be an excessive investment is another evil rather common to such arrangements. Then, too, unfortunate developments in one bank can cause considerable embarrassment to another institution known to be affiliated with it.

AFFILIATED CORPORATIONS

(Safe Deposit Company, Securities Company, Etc.)

The questions contained in our report dealing with this matter are as follows:

- 1) State names of such companies, if any.
- 2) Nature of business.
- 3) Amount of capital stock of such companies carried in Bank's assets.
- 4) Other liabilities of such companies carried in Bank's assets.

The Examiner is then requested to obtain sworn statements of affiliated corporations and make such examination of the affairs of same as circumstances warrant.

In the first place, a banking corporation in Illinois has no right to purchase stock in another corporation. This question has been considered by several Attorneys General who are unanimous in that conclusion. As indicated in the caption, this inquiry concerns affiliated safe deposit companies, security companies, real estate corporations or any other non-banking enterprise. Our concern in this respect has mainly to do with the Charter powers and resultant activities of the affiliated non-banking corporations. If they operate within the banking quarters, or closely adjacent thereto, and the name is quite similar to the corporate name of the bank and any of the officers or directors are also identified with the management of the bank, then we feel obliged to learn if the general public, in dealing with the affiliate, has reasonable grounds to believe that it is dealing with the bank. The reason for this is that under certain circumstances the acts of an affiliated corporation might impose liabilities and obligations upon the bank in which we would be directly interested.

Our experience with affiliated corporations has been quite similar to our experience with affiliated banks. Affiliations of this type can serve a very lawful and useful purpose in the hands of a careful and scrupulous management and they can also affect a bank very detrimentally through the careless employment of their activities.

It is not our purpose in this article to take a position either for or against affiliations as a matter of policy. Our sole purpose at this time is to point out the reasons for these two sections in our Examination Report form and to urge directors in banks where such affiliations exist to give very careful consideration to the findings and comments of the Examiner in connection therewith.

BOOKS AND ACCOUNTS

Before going into the details of the accounting section of our Examination Report, we should like to make a few general observations on the subject of bank accounting. Our principal concern in this respect is that a bank as a quasi public institution has a very definitely implied duty to maintain a complete and comprehensive record of all of its transactions. This Department has no pet theories and advocates no particular system of accounting but we do insist that bank accounting in Illinois State Banks be so designed and of sufficient detail that every transaction can be readily reconstructed from its records. Beyond that point, banks are at liberty to adopt any particular system or method of accounting that in their judgment suits their needs. All we ask is that accounting and records be complete and accurately done.

We also insist that the accuracy of accounting be tested at regular intervals through the periodical balancing of accounts. The General Ledger and Journal should be balanced daily and a trial balance statement drawn. Such subsidiary records as commercial accounts should be proved at least weekly, notes and liability ledgers at least twice a month and savings accounts at least monthly. Bond investments and other resource accounts should be verified at frequent intervals. All records of the bank not posted by machine should be posted in ink and all records should be clearly identified with the bank either through printed or stamped legend showing the bank's name. Bank records quite frequently assume vital importance in matters of dispute both in and out of Court and it would be a sad commentary indeed upon a bank management that could not produce sufficient records to completely and accurately reconstruct any transaction handled over its counters.

ANECDOTES OF THE ROAD

About ten years ago a very small bank in the central part of the State had just closed. The Examiner had taken charge and was starting his examination and inventory. The following morning an elderly gentleman of rather intriguing appearance came to the bank, announced that he was a director and stated that he wanted to be present during the examination. His blue denim overalls were tucked into heavy cowhide boots. A somewhat faded black cutaway coat gave him an air of gentility while a black slouch hat pulled well forward over his eyes added an air of mystery, all of which was completed with a heavy black walrus mustache and a bent briar with a copious bowl.

After identifying himself, he paid no further attention to the Examiner but proceeded to pace around the banking room, stopping occasionally to look intently at some article of furniture or book and then resuming his meandering way. A fairly large and unopened packing case that rested in one corner of the room seemed to attract him considerably and each time he would pass it he would stop and tap the sides with the toe of his boot, reflect a few minutes and continue on his journey.

This monotonous routine continued throughout the day and shortly before closing time, after a new inspection of the box, he cleared his throat, ostensibly to attract the Examiner's attention, removed the pipe

and said, "What's in thar?" The Examiner, rather curious himself, found a screw driver, raised the lid and found a recently delivered supply of customers' counter checks. He told the old gentleman what they were, explained their use and went back to his work. The old settler had no comment to make and continued to pace and reflect in silence.

The following morning he was back again and continued the silent routine of the day before until well along in the afternoon. Signaling his readiness to speak with an explosive cough and removing the ever present pipe, he delivered himself of the following verdict: "Young feller, it's a shame that you had to come along and close us up this away. We could 'a done a hell-roarin' business with them if yu'd 'a only let us alone." And he punctuated this with a vicious kick at the box full of checks that would never be used.

DISSOLVED

Alhambra.....Madison.....	Citizens' State Bank of Alhambra, Ill. (In liquidation June 25, 1927).....	Apr. 23, 1938
Adair.....McDonough.....	Farmers State Bank of Adair (In liquidation March 21, 1933).....	Apr. 28, 1938
Kinmundy.....Marion.....	State Bank of Kinmundy (In liquidation March 7, 1931).....	Apr. 28, 1938
Auburn.....Sangamon.....	Farmers' State Bank (In liquidation August 13, 1924. Dissolved by order of the Circuit Court of Sangamon County).....	Apr. 29, 1938
Wilsonville.....Macoupin.....	Wilsonville State Bank (In liquidation August 30, 1924. Dissolved by order of the Circuit Court of Macoupin County).....	Apr. 29, 1938
Seymour.....Champaign.....	Seymour State Bank.....	May 9, 1938
Foosland.....Champaign.....	First State Bank of Foosland (In liquidation April 16, 1926. Dissolved by order of the Circuit Court of Champaign County).....	May 17, 1938
Herrin.....Williamson.....	Herrin State Savings Bank (In receivership May 16, 1930. Dissolved by order of the Circuit Court of Williamson County).....	May 20, 1938
Dakota.....Stephenson.....	Dakota State Bank (In receivership November 14, 1930. Dissolved by order of the Circuit Court of Stephenson County).....	May 21, 1938
Cisna Park.....Iroquois.....	Iroquois County State Bank (In receivership March 15, 1932. Dissolved by order of the Circuit Court of Iroquois County).....	May 28, 1938
Claytonville.....Iroquois.....	Claytonville State Bank (In receivership July 19, 1932. Dissolved by order of the Circuit Court of Iroquois County).....	May 28, 1938

RECAPITULATION

	Reopened by permit.	Closed under holiday.	Total.
State Banks in Chicago.....	32	1	33
State Banks in Cook County.....	29	---	29
State Banks in Illinois outside Cook County.....	502	---	502
Total.....	563	1	564

MONTHLY BULLETIN

Issued by
EDWARD J. BARRETT
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BANKING DEPARTMENT
State of Illinois

Vol. 14

SPRINGFIELD, ILL., JULY 1, 1938

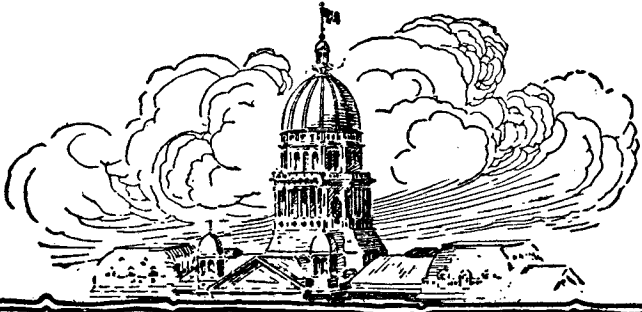
No. 4

BOOKS AND ACCOUNTS

Journal

This record might well be called the parent of all books of account in the double entry system of bookkeeping employed by all banks. To the older generation of business men it was known as the "Day Book". This latter term is highly descriptive for the journal continues today, as formerly, to assemble in one place a record of each day's transactions. This is THE book of original entry for while deposit tickets, debit and credit tickets, etc., are the memoranda used for jotting down the record of transactions as they occur, they will be posted into the journal at the close of the day's business. In the course of time, the memoranda above mentioned will be destroyed but the journal record will remain permanently.

At the close of a day's business, the first concern of the entire operating staff should be as to the accuracy of recording that day's transactions in the journal which can be quickly ascertained by balancing the journal. Proving of the accuracy of the day's work is so important that in most banks there is an iron clad rule that no member of the operating staff may leave the bank until the accuracy of the day's work has been proved by balancing the journal. There are several obvious needs for such a rule. In the first place,



the day's work in a bank cannot be considered as done until it has been proved correctly done; secondly, checking back over the day's transactions can be more correctly done while said transactions are fresh in the minds of the people who handle them. Thirdly, a test such as this at the end of each day's business provides excellent disciplinary training for the clerical staff; for it goes without saying that a clerk whose carelessness frequently holds up the completion of the day's work will be sure to receive some extra attention from his or her fellow employees.

In making up the daily journal, it is of vital importance that every entry made therein contain sufficient explanation to clearly identify each transaction. A journal consisting merely of an assembly of balanced figures is meaningless. There are bank managements who are so thoroughly convinced as to the importance of their journals that they will only use either a permanently bound record or at the end of each fiscal period, will place their loose leaf records into permanent bindings.

Thus far, we have been considering the journal proper or general journal. In practically all banks the volume of business requires several subsidiary journals. For instance, there will be a subsidiary journal for the listing of all deposits made within a given day and checks drawn against depositors' accounts. This journal should show the depositor's name opposite each deposit and the drawer's name opposite each check. There will usually be subsidiary journals for drafts drawn against correspondent banks, Cashier's checks, certified checks, etc. The total of each day's listing in each of these journals is posted into the general journal. While such records are subsidiary to the general journal, they are a very essential part thereof and should be as carefully compiled and preserved.

General Ledger

This is a bank record equal in importance to the journal. The general ledger provides a means of classifying into accounts all of the transactions recorded upon the journal and showing the effect of these transactions upon the condition of the bank. As soon as practicable after the journal has been balanced, each transaction should be posted to its proper account in the general ledger and the postings in the general ledger should be made from no other source than the journal.

We shall now take up the various points brought out in the Examiner's questionnaire.

1) Is form of general ledger satisfactory?

The loose leaf type of general ledger is most generally in use and it is important that each sheet be identified with the name of the bank either printed or stamped thereon. It is sufficient that the columnar and ruling arrangements be such as to show each day's debit and credit postings and the balance at the end of each day's business, together with such legend or explanatory detail as may be necessary.

Is daily statement taken?

The daily statement is in effect a trial balance of the general ledger and should be prepared immediately after posting the general ledger and made up from the general ledger only. This statement is made up merely by copying down the resulting balances in each account at the end of the day's business, as shown by the general ledger, with the credit balances listed and totaled on the right hand side of the statement and the debit balances on the left. This statement furnishes a concise picture of the condition of the bank at the close of any given day of business.

2) Are accounts with correspondent banks reconciled at least monthly?—By whom?

A bank's accounts with its correspondents constitute a major portion of its most vital asset, its cash. Transactions with correspondent banks are numerous and of various types. Through correspondent accounts a bank will handle drafts or exchange for its customers; it will handle out of town collections, sell securities for its own account or for customers; and collect coupons for its own account or for customers. Such volume of transactions requires periodical checking for accuracy and at least once each month a bank's accounts with its correspondents should be reconciled or verified. The same principle of reconciliation applies here as in the case of an individual reconciling the stub calculations on his check book with the balance shown by his bank on any given date. The balance shown by the bank's books should be compared with that of its correspondent and the difference between the balances should be accounted for by outstanding items. The reconciliation of a bank's accounts with correspondents should be made a matter of permanent record and forms of reconciliation books are easily obtainable for this purpose.

4) Are all reconciliements verified?—By whom?

In many banks the reconciliation of bank accounts is assigned to some junior clerk, usually the Exchange Teller. It is important, however, that each month's reconciliation be verified, preferably by an officer who should make it a point to examine the outstanding items and ascertain how long they have been outstanding and inquire into the reason for any items remaining afloat beyond a reasonable period of time. We consider the checking of correspondent bank reconciliements by an officer an important step in internal supervision.

5) Are all general and control accounts kept in the general ledger?—If not, give full explanation.

The general ledger must either contain or control every account carried in the bank. Theoretically all accounts should be carried within the general ledger. However, due to the volume of transactions with certain classes of accounts, certain subsidiary ledgers are necessary and convenient. For instance, due to the fact that a great bulk of a bank's activity is in transacting business with its depositors, the recording of these transactions cannot be conveniently handled through a general ledger and subsidiary ledgers become necessary. Generally, depositary creditors will fall into two groups—demand creditors and time creditors—and each of these two groups will, in turn, have to be subdivided. Time depositary creditors may have to be broken up into savings depositors, time certificate of deposit holders, Christmas savings clubs, etc. Demand creditors will be divided into checking accounts, demand certificates of deposit, trust creditors, municipal deposits, accounts payable, etc. It should be understood that when such segregations become necessary that a separate ledger is provided for each and the total balance due to each group is carried in the general ledger as a so-called control account. This control account each day shows only the total deposits and withdrawals and resulting balance in each particular group.

The purpose of the question under consideration is to direct the Examiner's inquiry as to whether or not these segregations into subsidiary accounts are properly made and strictly adhered to. For example, we will occasionally find in the subsidiary ledgers assigned to checking accounts, accounts representing income from "Other Real Estate" or we may find several Cashier's checks or certificates of deposit that represent profits of various kinds. These belong in the Undivided Profits account. Or we find undistributed collections which may have been received for the account of one or more individuals in the deposit ledgers. These

are not deposits but accounts payable and should be so shown upon the general ledger and statement. We will also find Christmas savings clubs carried in the savings ledger. Christmas savings clubs are obviously different than ordinary savings accounts in that they will be entirely withdrawn at a certain season of the year and an informative statement of condition should show that fact by carrying a control account separately in the general ledger and showing the balance separately upon the statement. While most of these misclassified entries are of minor consequence, a large number and aggregate could falsify a statement of condition to a very considerable extent.

CONVERSION

Chicago.....Cook..... Skala State Bank into The Skala National Bank of Chicago Apr. 30, 1938

PERMIT ISSUED

Chicago.....Cook.....	Rogers Park State Bank of Chicago	Capital.	Surplus.	Reserve.	Date.
		\$200,000	\$25,000	\$25,000	June 24, 1938

TRUST CERTIFICATE CANCELLED

Wenona.....Marshall..... The First State Bank of Wenona..... June 25, 1938

IN LIQUIDATION

Leonore.....La Salle..... State Bank of Leonore..... Apr. 27, 1938
 Wyandot.....Bureau..... Bank of Wyandot..... May 9, 1938

DISSOLVED

Hettick.....Macoupin..... Hettick State Bank..... May 20, 1938
 Laeledge.....Fayette..... Farmers & Merchants State Bank of Laeledge (In liquidation July 13, 1926. Dissolved by order of the Circuit Court of Fayette County)..... June 1, 1938
 Fidelity.....Jersey..... State Bank of Fidelity..... June 2, 1938
 Hamilton.....Hancock..... Peoples State Bank of Hamilton (In receivership January 12, 1931. Dissolved by order of the Circuit Court of Hancock County)..... June 2, 1938
 Kempton.....Ford..... State Bank of Kempton (In receivership February 9, 1932. Dissolved by order of the Circuit Court of Ford County)..... June 2, 1938
 Long Point.....Livingston..... State Bank of Long Point (In liquidation August 18, 1930)..... June 4, 1938
 West Frankfort.....Franklin..... West Frankfort Bank and Trust Co. (In liquidation September 7, 1929. Dissolved by order of the Circuit Court of Franklin County)..... June 6, 1938
 Brookport.....Massac..... Farmers' State Bank of Brookport (In liquidation July 23, 1923. Dissolved by order of the Circuit Court of Massac County)..... June 8, 1938
 Matteson.....Cook..... First State Bank of Matteson..... June 8, 1938
 Tiskilwa.....Bureau..... Farmers State Bank of Tiskilwa (In liquidation May 18, 1931)..... June 10, 1938
 Virginia.....Cass..... Peoples Bank of Virginia (In liquidation December 30, 1936)..... June 20, 1938
 LaHarpe.....Hancock..... LaHarpe State Bank. (In liquidation September 5, 1930. Dissolved by order of the Circuit Court of Hancock County)..... June 23, 1938
 Walnut Hill.....Marion..... First State Bank of Walnut Hill (In liquidation January 9, 1928. Dissolved by order of the Circuit Court of Marion County)..... June 27, 1938
 Genoa.....DeKalb..... Farmers State Bank of Genoa (In receivership March 21, 1930. Dissolved by order of the Circuit Court of DeKalb County)..... June 29, 1938
 Genoa.....DeKalb..... Exchange State Bank of Genoa (In receivership March 21, 1930. Dissolved by order of the Circuit Court of DeKalb County)..... June 29, 1938

RECAPITULATION

	Reopened by permit.	Closed under holiday.	Total.
State Banks in Chicago.....	31	1	32
State Banks in Cook County.....	28	---	28
State Banks in Illinois outside Cook County.....	498	---	498
Total.....	557	1	558

MONTHLY BULLETIN

Issued by
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State of Illinois

Vol. 14

SPRINGFIELD, ILL., AUGUST 1, 1938

No. 5

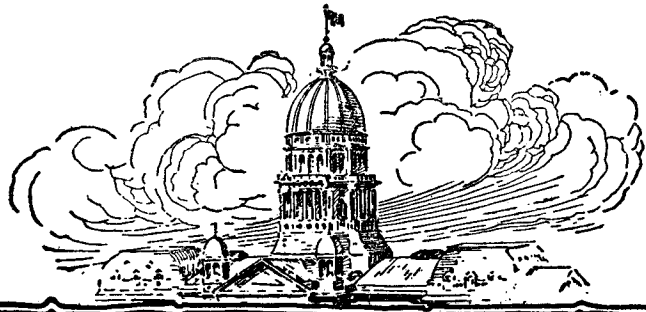
GENERAL LEDGER

- 5) Are all general and control accounts kept in the general ledger?—If not, give full explanation.
(Continued)

While not exactly in line with the question under discussion, we consider this an appropriate place to mention two general ledger accounts that are occasionally mishandled. We refer to accounts payable and receivable. Both are unusual to a bank's ordinary routine of business. Accounts payable are such debts of the bank as arise outside of ordinary depositary or exchange transactions. For instance, a bank receives funds through collection or other channels for a non-depositor. If for any reason immediate remittance cannot be made the credit should be treated as an account payable.

Similarly when a bank advances or expends funds in behalf of a non-depositor the debit is an account receivable. Both are open accounts, the former being unsupported by a depositary agreement and the latter being unsupported by signed evidence debt.

We have on a number of occasions found where banks established an "accounts payable" control and later debited the account with items receivable from entirely different individuals; showing accounts payable as a net difference between payables and receivables. This practice is just as wrong in



principle as it would be to deduct loans and discounts from deposits and show only the net difference upon the statement.

Accounts payable are bank liabilities to certain individuals on open account and receivables are debts due from different individuals on open account and must be controlled separately. To do otherwise falsifies the bank's statement.

Occasionally we find in the depositors' "Individual Ledgers" accounts that are actually accounts payable. No account should be placed in any depositors' ledgers unless supported by a depositary agreement signed by the depositor.

It has been stated above that both accounts payable and receivable are unusual to a bank's ordinary routine. When they become necessary, they should be regarded as temporary entries and should be constantly in the process of elimination. If accounts payable can be converted into deposit accounts that should be done as soon as possible, otherwise prompt payment should be made to the owner.

Expenditures or advances that will create accounts receivable should only be made after arrangements have been made with the debtor to reimburse the bank. Careless handling can result in occasional losses in this account.

- 6) Are certificates of deposit, cashier's checks, certified checks, etc., proved frequently by listing outstanding items?

Ordinarily these are the most inactive of the public liability accounts and by reason of inactivity, one or more of them may not be regularly proved. Each transaction in all of these accounts is represented by a written evidence of debt issued by the bank. As each Certificate of Deposit, Cashier's Check or Certified Check is issued, it is numerically registered in the proper book of record and remains an "open entry" until paid by the bank over its own counter. The registered entry is then closed by marking the item paid. As items are issued the general ledger control account is credited or increased and as items are paid the control account is debited or decreased. The result is that the corresponding control account in the General Ledger should by its balance show the total outstanding Certificates of Deposit, Cashier's Checks, Certified Checks, etc., at any given time. Proof of the accuracy of this control account should be established at least once a month by totaling from the register the outstanding items in each group which should agree with the control total.

Surprising as it may seem, we occasionally learn of the certification of checks by banks without recording the liability incurred; so a few words on that subject are needed here.

When a bank certifies a check for one of its depositors it becomes liable for the payment of that check and must treat it as a bank liability until paid. At the time of certification, the amount of the check should be taken out of the issuing depositor's account and transferred to the "certified check" account. Also, when a certified check is issued it should be numerically registered in the same manner as a draft or certificate of deposit. When paid, it should be cancelled and filed the same as any other evidence of debt issued by the bank. If the depositor

wants the certified check returned to him, a fully descriptive receipt should be taken.

To certify a check for any purpose whatsoever without showing the bank liability created thereby on the statement of condition falsifies every statement of condition issued while said liability remains outstanding.

- 7) Does the employee verifying them issue same?

Here again the Examiner is asked to inquire into the management's thoroughness of internal audit. If a clerk who issues certificates of deposit, cashier's checks, drafts and certified checks also handles cash, he can, through the manipulation of the above mentioned liability account records, cover and carry a large defalcation for a long period of time without detection. And even if he does not handle cash, he can, through collusion with a dishonest cash teller, accomplish the same result. This can be prevented if an officer will, once each month, check the said certificates of deposit, cashier's checks, drafts, etc., against the register and run the lists of open items for comparison against the general ledger control account.

- 8) Is over and short account active? How often is account submitted to the Board for inspection? How frequently closed through profit and loss? Which predominates—over or short?

An "over and short" account is very necessary and proper in the general ledger of every bank. None of us is perfect and the most accurate and painstaking bank officer or clerk handling a large number of more or less complicated business transactions each day is almost bound to make an occasional error that even the most careful and exhaustive checking will fail to locate. The immediate effect of the error will be to throw the bank's books out of balance. By recording the error either as an asset or liability the balance is restored. It is more than probable that the correction will turn up at some future date for adjustment; which can be much more satisfactorily accomplished if the original error has been recorded and described in the "over and short" account.

In most banks one account is used to record overages and shortages and only the net balance is reflected upon the statement. If overages predominate the net balance will be a credit or liability on the statement. If shortages are the greater total, the net balance will be a debit or an asset.

For a number of years this Department has consistently opposed what we regard as a pernicious practice which still persists in a number of banks and that is to absorb overages and shortages through a so-called "kitty". This precocious little animal or accounting gadget is usually a cigar box into which miscellaneous items of income, such as extraordinary fees, exchange or commissions and small cash overages are placed in the form of cash. Naturally there are no book entries covering "kitty" transactions. Then when shortages are encountered the amount is withdrawn from the "kitty" and the books balanced. We call this a pernicious practice, first, because it diverts income from the bank's records and resultingly it keeps the Board of Directors from knowing anything about such matters.

(Further discussion of this question will appear in our September issue).

DISSOLVED

✓ Bellair.....Crawford.....	Bellair State Bank (In liquidation April 6, 1931).....	July 1, 1938	✓
✓ Henning.....Vermilion.....	Lane Bros. State Bank (In liquidation May 29, 1931, Dissolved by order of the Circuit Court of Vermilion County).....	July 5, 1938	✓
✓ Divernon.....Sangamon.....	Divernon State Bank of Divernon (In receivership Oc- tober 6, 1930. Dissolved by order of the Circuit Court of Sangamon County).....	July 6, 1938	✓
✓ Rock Island.....Rock Island.....	American Trust & Savings Bank (In liquidation March 1, 1926).....	July 9, 1938	✓
✓ Bonnie.....Jefferson.....	Bank of Bonnie (In receivership February 29, 1932. Dis- solved by order of the Circuit Court of Jefferson County).....	July 11, 1938	✓
✓ Macon.....Macon.....	Farmers State Bank of Macon (In receivership February 12, 1932. Dissolved by order of the Circuit Court of Macon County).....	July 11, 1938	✓
✓ Nebo.....Pike.....	Minier State Bank of Nebo (In liquidation February 16, 1925. Dissolved by order of the Circuit Court of Pike County).....	July 20, 1938	✓

RECAPITULATION

	Reopened by permit.	Closed under holiday.	Total.
State Banks in Chicago.....	31	1	32
State Banks in Cook County.....	28	---	28
State Banks in Illinois outside Cook County.....	498	---	498
Total.....	557	1	558

MONTHLY BULLETIN

Issued by
EDWARD J. BARRETT
AUDITOR of PUBLIC ACCOUNTS
BANKING DEPARTMENT
State of Illinois

Vol. 14

SPRINGFIELD, ILL., SEPTEMBER 1, 1938

No. 6

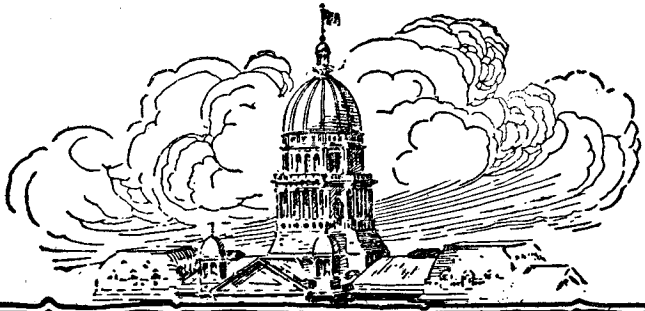
GENERAL LEDGER OVER AND SHORT ACCOUNT

- 8) Is over and short account active? How often is account submitted to the Board for inspection? How frequently closed through profit and loss? Which predominates—over or short? (Continued.)

As previously stated, each unlocated discrepancy should be recorded in the "over and short" account. These entries should show date of occurrence, the name of the person in whose work the difference appeared and the amount; and at each monthly Board meeting this record should be produced and inspected.

If shortages and overages are frequent then there is something wrong with mechanical operations that needs investigating and correcting. Should inquiry disclose that discrepancies show up quite generally throughout the operating personnel, it is pretty safe to assume that there is a laxity of discipline at least as far as accuracy is concerned. Now laxity of discipline can easily develop two serious evils—habitual carelessness in matters of accounting and petty stealing.

There is no limit to the troubles and losses that can result from careless accounting and one of the worst results of such laxity is the effect on the public. There can be little



doubt that where errors are frequent within a bank that a certain number of these errors will be discovered by its customers and we know from experience that such discoveries, no matter how trivial, are not kept secret. There is a surprisingly large number of individuals who take a strange delight in telling and retelling about the mistake that such and such a bank made in his account or in handling his note or collateral. And this is admittedly not good advertising.

Equally limitless are the possibilities of petty stealing. If a clerk with a bit of elastic in his conscience learns that he can get away with a five or ten dollar shortage every week or two without official comment, that discovery is very apt to lead to further exploration and to the inevitable disastrous climax.

If inspection of the "over and short" account shows that one or two individuals are responsible for most of the differences, the work of these individuals needs attention. When frequent discrepancies are traceable to one or two individuals there is very apt to be one of three commonly underlying reasons; carelessness, incompetence or dishonesty.

Carelessness forcefully dealt with is easily correctible. Incompetence, however, does not necessarily call for dismissal. An individual incompetent in one position might work very satisfactorily in another. An incompetent teller's shortcomings might be due solely to inability to work accurately under the pressure of window contacts. Transfer to another department and the removal of strain might produce excellent results. A shift in positions has saved more than one valuable employee. Dishonesty is more difficult to ascertain and often requires careful observation over a period of time.

A number of banks have, in the past, attempted to minimize shortages by requiring employees to personally make them good. Theoretically, of course, such a rule is supposed to make bank employees careful and cautious in their work. In many cases it does more than that. Commenting upon such a rule a veteran bank auditor once said: "If they have to personally make good their shortages, you can be damned sure that very few overages will be reported"; meaning that a certain amount of overages would be held out to cover future shortages and these simple manipulations can develop very serious consequences. In our opinion, frequent discrepancies should be dealt with in one of two ways; either transfer the employee to other work or dismissal, depending on surrounding circumstances.

A very common cause for cash and accounting variations is failure to properly segregate work. When two or more individuals work on the same record or set of books or handle the same allotment of cash, errors will generally occur more frequently and will also be more difficult to locate. When unusually busy hours require extra tellers, each should be allotted and charged with a consignment of cash sufficient for their operations which should be balanced out as soon as their relief work is finished.

In our opinion, the best way to deal with cash and accounting variations is openly and frankly and without penalizing individual occur-

rences. When an employee is over or short at the end of the day's work and is unable, after carefully rechecking his day's work, to locate the error, he should be required to sign a debit or credit ticket to adjust his balance. This ticket should be submitted to a supervising officer who would O. K. it to the general bookkeeper to debit or credit the item to the "over and short" account.

If this is done each day the "over and short" account will be an accurate record and, further, it will put an end to the practice of holding out overages in the form of cash or using cash tickets to plug shortages until an overage occurs to make it up. When the Board of Directors have an accurate record of this kind to examine at each monthly meeting, the "over and short" account will cease being just a gadget to balance the statement and become a very fair efficiency record that the Directors will find worthwhile.

ANECDOTES OF THE ROAD

There was once connected with this Department an examiner who was the most conscientious of men. His reports were models for thoroughness and accuracy; his traveling schedules were arranged and carried out with railroad precision; his expense account was a weight reducing formula in itself. With him the most minor law, rule or regulation stood on a par with the ten commandments—all were to be remembered and strictly obeyed.

Frequently his scruples were carried out to a point of eccentricity; furnishing several anecdotes of which the following is one of the best:

Mr. Conscientious Scruples and another examiner were heading north for Carbondale, Illinois, in the wee hours of a morning in early summer. Both were dead tired. A tedious examination had been climaxed by a long and hectic meeting with the Board of Directors. Mr. C. S. sent his car hurtling along the highway at thirty-five miles an hour (legal maximum at that time). At the southern city limits his headlights flashed on a white road sign proclaiming a speed limit of twenty-five miles per hour and the motor was promptly throttled down to comply with the law. Down the avenue of stately oaks (or maybe they were elms) Mr. S's car sped toward the business district, hotel and rest; the headlights of the car giving the shady avenue the appearance of a long deserted tunnel. His companion dozed.

A screeching of brakes, a rasping of tires and a sudden stop brought the sleeping companion not only to complete wakefulness but bang up on the windshield. Shielding his head with his arms, he ducked low waiting for the inevitable crash. Nothing happened. As he slowly emerged from his crouch, Mr. C. S. calmly engaged low gear and moved slowly ahead.

"Gosh," wheezed the scrupulous one, all out of breath, "that was a close call. I must be gettin' drowsy. I should have known that there was a stop sign at that corner and I darned near ran through it."

Time: 1:30 A. M.—Place: Carbondale, Illinois.

CONVERSION

✓ Stockland.....Iroquois.....Summer State Bank into Summer National Bank of Stockland.....July 30, 1938 ✓

IN LIQUIDATION

✓ Birds.....Lawrence.....State Bank of Birds through The Peoples National Bank in Lawrenceville.....Aug. 6, 1938 ✓

PERMIT ISSUED

Downers Grove.Du Page.....Citizens State Bank of Downers Grove Capital. Surplus. Reserve. \$50,000.00 \$10,000.00 \$5,000.00 Aug. 8, 1938

DISSOLVED

✓ Cisco.....Piatt.....Croninger State Bank (In liquidation May 10, 1927).....July 21, 1938 ✓
 Cottonwood (P. O. Omaha).....Gallatin.....State Bank of Cottonwood (In liquidation January 13, 1932).....July 21, 1938 ✓
 ✓ Logan.....Franklin.....Logan State Bank (In liquidation August 27, 1925).....July 28, 1938 ✓
 Olive Branch.....Alexander.....Olive Branch State Bank (In receivership November 7, 1932. Dissolved by order of the Circuit Court of Alexander County).....Aug. 5, 1938 ✓
 Thornton.....Cook.....The Thornton State Bank (In liquidation August 5, 1936).....Aug. 12, 1938 ✓
 ✓ Rock Grove.....Stephenson.....Rock Grove State Bank (In receivership December 30, 1930. Dissolved by order of the Circuit Court of Stephenson County).....Aug. 20, 1938 ✓
 ✓ Pawnee.....Sangamon.....Pawnee State Bank (In receivership October 9, 1930. Dissolved by order of the Circuit Court of Sangamon County).....Aug. 25, 1938 ✓

RECAPITULATION

	Reopened by permit.	Closed under holiday.	Total.
State Banks in Chicago.....	31	1	32
State Banks in Cook County.....	28	---	28
State Banks in Illinois outside Cook County.....	496	---	496
Total.....	555	1	556

Foreign Exchange License

✓ Issued 9/8/38 to
 Friedrich H. G. Heineken
 160 N. La Salle St. - Chgo., Ill.

Off. #21

MONTHLY BULLETIN

Issued by
EDWARD J. BARRETT
AUDITOR of PUBLIC ACCOUNTS
BANKING DEPARTMENT
State of Illinois

Vol. 14

SPRINGFIELD, ILL., OCTOBER 1, 1938

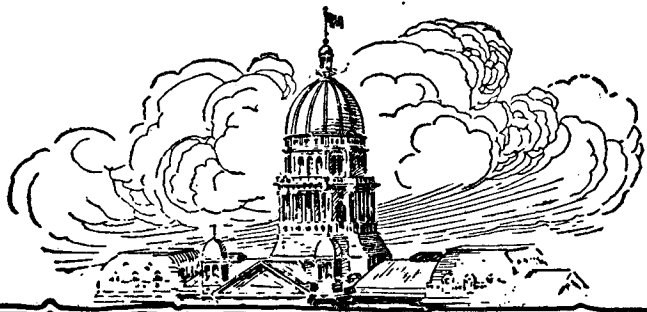
No. 7

CHARGED OFF ITEMS

- 9) Are all charged-off items carried in a subsidiary record?

The charging off of a bank asset simply means its removal from the bank's current books and statement. The mechanical operation of a charge-off is as follows. Let us assume that a \$500.00 note is to be charged off. The "Loans and Discounts" account in the General Ledger is credited (or reduced) \$500.00 and the "Undivided Profits" account is debited (or reduced) \$500.00. The note is then removed from the current files and the record sheet removed from the Liability Ledger. In that operation an entire asset is removed or charged off. Should all or any part of said note be collected, the amount recovered goes back into the Undivided Profits account by a credit (or increase) to Undivided Profits and a debit (or increase) to Cash.

In the partial removal or depreciation of an asset, the asset is reduced in book value by an asset credit and an Undivided Profits debit; remaining on the books at a reduced value. Let us assume that a Note, or a Bond, or a parcel of Other Real Estate is carried on the bank's books at a cost value of \$5,000.00. The Board of Directors decides that \$5,000.00 cannot be collected or realized from the sale of the item and that \$3,000.00 would be closer to a true valuation; so they



order the item reduced, charged down or depreciated to \$3,000.00. The Note, Bond or Other Real Estate account in the General Ledger is credited (or reduced) \$2,000.00 and the Undivided Profits account is debited (or reduced) \$2,000.00. The item now stands on the books at \$3,000.00. Now let us assume that \$4,000.00 is later collected or realized from the sale of the asset. Such a result would require the following three entries to record:

First, a debit to (or increase in) Cash of \$4,000.00; second, a credit to (or decrease in) the Note, Bond or Other Real Estate account of \$3,000.00 to eliminate the liquidated asset and, third, a credit to (or increase in) Undivided Profits of \$1,000.00 to show the recovery of that amount upon the \$2,000.00 depreciation previously charged off. Or let us suppose that this same item is sold for \$5,500.00 or more than the original cost. In that case the first two entries are the same. The third entry, however, should be divided to show \$2,000.00 recovery and \$500.00 profit on the original investment. We cite this last possibility to bring out the distinction that should always be recognized between recoveries and profits.

At such times as charge-offs are being considered by the Board of Directors, the recovery possibilities of the items to be written off should be appraised. There are many losses, of course, that are not recoverable, such as losses taken when assets are sold. On the other hand, constant attention and vigorous administration upon assets with recovery possibilities will often result in surprising returns. It is therefore important that after such items have been charged off and thus removed from the current records of the bank that they be so handled that they are under the constant scrutiny of the directors and managing officers.

This can be accomplished by maintaining a book record of all charged-off assets with recovery possibilities. Many banks use a separate Liability Ledger for this purpose; allowing a sheet for each item. This provides sufficient space for adequate description, the jotting down of important memoranda periodically and the recording of partial liquidation received from time to time.

As a matter of procedure, we suggest that when the Board of Directors acts to charge off assets that they indicate in their minutes the items that contain possibilities of recovery and order them transferred to the subsidiary record. If this is done, our Examiners can make a very accurate audit of the administration upon charged off assets and will do so at each examination.

At each directors' meeting a brief review of charged-off or non-ledger items might well be made a regular order of business. Ordinarily this would take only a few minutes; but especially in the case of local loans, a director might have some newly acquired information concerning a particular debtor with charged-off obligations that would enable the officers to effect a good recovery. Bank directors and officers should bear well in mind that charge-offs and recoveries adversely and beneficially affect the bank's Undivided Profits to a considerable extent and when charge-offs occur, the management should work persistently to get the charge-off amount, or as much of it as may be recoverable, back into the Undivided Profits with the least possible delay.

This seems to be an appropriate place to discuss a rule of this Department pertaining to "non-cash" recoveries or the placing of charged-off items back into the bank's current records through a credit to Undi-

vided Profits. The technical operation is the same as the recovery described in the first paragraph of this article, except that instead of a debit to (or increase in) Cash, the debit will go to some other asset account, for instance, Loans and Discounts. The reasons for these "non-cash" recoveries is usually an improvement in the debtor's financial condition or the acquisition by the bank of additional collateral.

The Department's rule in this respect is that once an asset item has been charged off, only the cash recovered in the liquidation thereof may be credited to Undivided Profits as a recovery.

The complete removal of the conditions that originally caused write-off occasionally justifies an exception to this rule and this Department is only too glad to recognize and agree to such exceptions when they are fully warranted. It is required, however, that all facts surrounding the restoration of a charged-off asset be submitted to this Department for review and agreement before the replacement is made.

A question that seems to fit in well at this point is as to when assets should be charged off or written down. There are probably as many theories on this question as there are bankers and bank examiners. It seems to us that the answer lies, to a considerable extent, in what the banking public has a right to expect when it reads a bank's published statement. When a depositor reads a statement, he should be warranted in assuming that the resources exhibited are sound commercial bank assets collectible or realizable at statement values within a reasonable time. If this is true, he may also assume that Capital, Surplus, Undivided Profits and other capital reserves are composed of assets of the same caliber.

The argument has occasionally been advanced that losses should not be charged off until fully determined and until such determination has been reached, reserves should be accumulated against loss possibilities. There can be no question as to the propriety of that policy from a strict accounting standpoint; but if valuation reserves are permitted to enter into the depositor's calculations as he reads the statement, he immediately begins to speculate as to the sufficiency of reserves for the losses included in total resources.

In an ordinary business corporation, it seems perfectly proper to admit through a valuation reserve that there may be \$25,000.00 in "bad debts" carried among the resources shown upon the statement but to do the same thing upon a bank statement furnishes considerable food for unpleasant thought on the part of the depositor. And unless the valuation reserves are plainly earmarked, the depositor can only assume that all capital accounts are supported by assets of unquestionable merit.

There are many bankers who, as statement call dates approach, review all of their assets and remove, by charge-off, any items that contain any uncertain or involved collection possibilities.

We are reminded here of the attitude expressed to an examiner by a venerable banker who was always several jumps ahead of the Department in charging off assets.

"I mark 'em off," he told the examiner, "when they begin to look like bad investments. When I hand out a statement of the condition of this bank I want to be able to truthfully say that all of the resources on that statement are good investments."

After thoughtfully considering the examiner's request for his definition of a good investment, he finally replied,

"An investment is good when it works out the way it is supposed to. When it don't and I have to wiggle and squirm and go to law and take a man's property away from him to get the bank's money back, then I figure I've made a bad investment. Deals like that are a headache to me and I'd feel pretty embarrassed to read one of my statements knowing that there were notes like that in there. So when they turn out like that, I mark 'em off and then get busy and get what I can out of them and when I get it, I put it back in the bank. I have been doing that for years and now it's got so in late years that I always have more than enough coming in from marked off items to keep my statement good and clean. A time or two when I wanted to mark off some good sized notes it hit my Undivided Profits pretty hard and the directors kicked about it but I was always able to talk them into going along with me and I can't see that anyone has ever been hurt."

An extreme policy, perhaps, but it had an interesting corollary. Less than a year after the old gentleman made that statement, he passed away and the directors decided to discontinue the business. The depositors were called in and paid off immediately and within a year the stockholders received more than the statement value of their stock.

CONVERSION

✓ Belvidere.....Boone.....Farmers' State Bank of Belvidere, Illinois (Converted into The Farmers National Bank of Belvidere).....Aug. 15, 1938 ↗

IN LIQUIDATION

✓ Tilden.....Randolph.....First State Bank of Tilden.....Sept. 14, 1938 ↗

TRUST CERTIFICATE CANCELLED

✓ Blue Island.....Cook.....State Bank of Blue Island.....Sept. 29, 1938 ↗

DISSOLVED

✓ Papineau.....Iroquois.....State Bank of Papineau (In liquidation July 25, 1929).....Aug. 18, 1938 ↗

✓ Claytonville.....Iroquois.....Citizens State Bank of Claytonville (In liquidation December 29, 1928. Dissolved by order of the Circuit Court of Iroquois County).....Sept. 10, 1938 ↗

✓ Palmyra.....Macoupin.....First State Bank of Palmyra (In receivership April 15, 1931. Dissolved by order of the Circuit Court of Macoupin County).....Sept. 10, 1938 ↗

✓ Keithsburg.....Mercer.....Keithsburg State Bank (In liquidation November 5, 1923. Dissolved by order of the Circuit Court of Mercer County).....Sept. 12, 1938 ↗

✓ Franklin Grove.....Lee.....Citizens State Bank of Franklin Grove (In receivership November 10, 1931. Dissolved by order of the Circuit Court of Lee County).....Sept. 17, 1938 ↗

✓ Sherrard.....Mercer.....Sherrard State Bank (In receivership October 14, 1924. Dissolved by order of the Circuit Court of Mercer County).....Sept. 19, 1938 ↗

✓ Mattoon.....Coles.....State Trust & Savings Bank of Mattoon (In liquidation January 7, 1924. Dissolved by order of the Circuit Court of Coles County).....Sept. 20, 1938 ↗

✓ Springfield.....Sangamon.....State Bank of Springfield (In liquidation December 31, 1919. Dissolved by order of the Circuit Court of Sangamon County).....Sept. 30, 1938 ↗

RECAPITULATION

	Reopened by permit.	Closed under holiday.	Total.
State Banks in Chicago.....	31	1	32
State Banks in Cook County.....	28	---	28
State Banks in Illinois outside Cook County.....	494	---	494
Total.....	553	1	554

MONTHLY BULLETIN

Issued by
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State of Illinois

Vol. 14

SPRINGFIELD, ILL., NOVEMBER 1, 1938

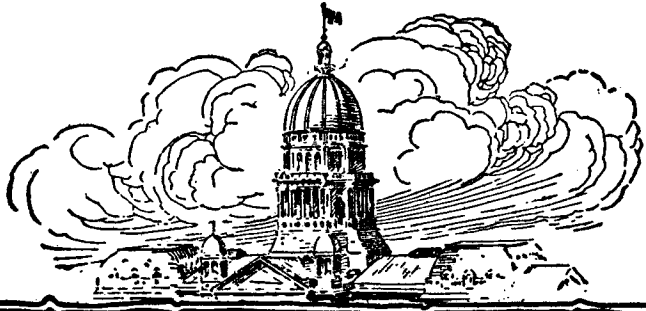
No. 8

GENERAL LEDGER EXPENSE AND INTEREST PAID ACCOUNTS

- 10) Is itemized expense account kept, and did you inspect that account and interest paid account from date of previous examination?

This question is designed to direct the Examiner's attention to the possibility of finding improper entries in the "Expense" and "Interest Paid" accounts. Occasionally we find that the nature of certain transactions confuse bookkeepers or officers as to the proper place of entry and invariably they seem to turn to either the "Expense" or "Interest Paid" accounts as a burial place for odd entries.

We have also encountered a few instances where officers and employees have used these two accounts to run through embarrassing charge-offs. In these particular cases, the Boards of Directors did not make detailed examinations of these two accounts, under which circumstances improper entries could be put through without discovery. To make this last point more clear, charge-offs made directly through Undivided Profits come under Board scrutiny at least twice; first, when they are authorized in the Directors' minutes and, again, in our examination report, where they are listed in detail. On the other hand, if the Board does not require and



inspect an itemized list of expenses, fairly good-sized charge-offs could be run through the expense account without detection. And the same thing can happen in the "Interest Paid" account. We should also like to make clear that the expense analysis contained in our examination report is not an itemized list but a summary of classified totals. We shall have more to say concerning the expense account farther on; our sole purpose at this point being to explain how this account can be misused to an extent that could considerably impair its value. The only figures admissible to the expense account are amounts actually expended by the bank as the cost of conducting its business.

The purpose of the "Interest Paid" account is very simple, being limited entirely to recording amounts paid to a bank's creditors as interest on its obligations. Such obligations are commonly savings deposits, interest bearing certificates of deposit, bills payable or any other liabilities upon which the bank has agreed to pay interest. One of the most common errors that we encounter in this account is the debiting of accrued interest paid on bonds purchased to the "Interest Paid" account. For example, a bank buys a \$1,000.00 bond bearing interest at the rate of three per cent. Interest was paid on the bond on January 1st and the bank buys the bond on February 1st, agreeing to pay par (\$1,000.00) plus accrued interest. The accrued interest is the amount of interest due to the individual who owned the bond from January 1st to February 1st: in this case \$2.50. So the bank pays \$1,002.50 for the bond and charges the bond account \$1,000.00 for the newly acquired asset. The handling of the \$2.50 has puzzled more than one banker, many of whom have settled their doubts by charging it to "Interest Paid". But it is not interest paid. Actually, that \$2.50 is unearned interest that the bank will receive when it collects the next interest coupon taken from the bond which will represent six months' interest. When the bank collects that coupon (\$15.00), it will credit that amount to "Interest Received" but it has already handed back to the former owner \$2.50 so the net amount actually received from that coupon will be \$12.50. Therefore, if the "Interest Received" account is debited or decreased \$2.50 at the time of purchasing the bond and credited or increased \$15.00 when the first ensuing interest coupon is collected, a correct net return will be contained in this account.

An accountant reading the foregoing will quickly object on the ground that the debit to the "Interest Received" account on February 1st (time of purchase) will result in an understatement of the true balance for a period of five months and he will be quite correct. However, in smaller banks, where bond purchases are relatively few and a day to day accrual system of earnings and expenses is not in use, we

cannot see that the result will be at all harmful and a debit to "Interest Received" simplifies the accounting.

In larger banks, where bonds are purchased more frequently and in greater volume, accrued interest paid on bonds purchased should be handled in a separate account. By so doing, such transactions are kept permanently separated from all others. For instance, in the typical transaction mentioned above, the \$2.50 would be debited to "Accrued Interest Paid on Bonds Purchased" at the time of purchase. Then five months later, when the \$15.00 interest coupon is collected, \$2.50 is credited to the "Accrued Interest Paid" account and \$12.50 to "Interest Received". The "Accrued Interest Paid" account now shows that the bank has been reimbursed for the original advance and the "Interest Received" account has only received the actual amount earned by the bank.

A short while ago an interesting and somewhat startling discovery came to our attention involving interest paid on savings accounts. A statistician, in the course of some research, sent a questionnaire to a large number of banks concerning the formula or method employed by each bank in figuring the interest due on savings deposits semi-annually. The questionnaire contained a number of typical savings accounts showing a variety of deposits and withdrawal entries. The banks addressed were asked to figure the interest on these accounts at the rate of two per cent. The returns were somewhat amazing for while the majority were within a reasonable range of accuracy, a large number showed wide variations, both favorable and detrimental to the bank.

Methods and formulae of figuring interest is far too technical a subject for these bulletins but the results above mentioned indicates that a number of banks could save a considerable amount of money by checking the accuracy of their method of calculating interest due on savings accounts.

Earlier in this article, we referred to the "Expense" and "Interest Paid" accounts as the burial places for odd entries. Sometimes this is the result of not having enough general ledger accounts.

We do not advocate, for the ordinary bank, a highly involved and complicated general ledger. Quite to the contrary, we like to see accounting simplified as much as possible but where experience discloses the need for an account in which to record a special type of asset or transaction, there should be no hesitancy in installing it.

The accounting system of a bank in the first instance makes a record of the bank's business. By properly arranging this record, it will tell a very vital story to the officers, directors, the public and this Department. The value of this story, like any other, increases with its completeness and simplicity.

TRUST CERTIFICATE CANCELLED

Knoxville.....Knox.....Farmers National Bank of Knoxville.....Oct. 5, 1938 ✓
 New York City, N. Y.....The Public National Bank and Trust Company of New York.....Oct. 21, 1938 ✓

IN LIQUIDATION

Good Hope.....McDonough.....Good Hope State Bank through Union National Bank of Macomb.....Oct. 20, 1938 ✓

DISSOLVED

Raymond.....Montgomery.....Raymond State Bank (In liquidation March 22, 1929).....Sept. 1, 1938 ✓
 Windsor.....Shelby.....Citizens State Bank of Windsor (In receivership August 22, 1933. Dissolved by order of the Circuit Court of Shelby County).....Oct. 1, 1938 ✓
 Chicago.....Cook.....North Shore Trust & Savings Bank of Chicago (In liquidation November 1, 1926).....Oct. 6, 1938 ✓
 White Heath.....Piatt.....White Heath State Bank (In liquidation June 30, 1927).....Oct. 6, 1938 ✓
 Lyndon.....Whiteside.....First State Bank of Lyndon (In receivership May 19, 1931. Dissolved by order of the Circuit Court of Whiteside County).....Oct. 24, 1938 ✓
 Watson.....Effingham.....Watson State Bank (In liquidation June 17, 1930. Dissolved by order of the Circuit Court of Effingham County).....Oct. 26, 1938 ✓

RECAPITULATION

	Reopened by permit.	Closed under holiday.	Total.
State Banks in Chicago.....	31	1	32
State Banks in Cook County.....	28	---	28
State Banks in Illinois outside Cook County.....	493	---	493
Total.....	552	1	553

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State of Illinois

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No. 9

EXAMINATION REPORT—QUESTIONNAIRE INDIVIDUAL AND SAVINGS LEDGERS

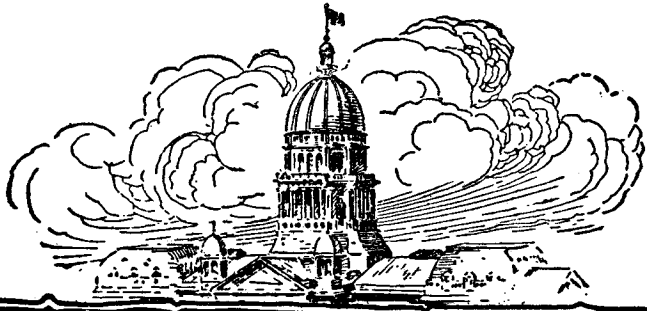
1. State how often individual ledgers are proved.
Savings ledgers?

This question checks the thoroughness of the bank's internal audit of these two groups of accounts.

It might be interesting and enlightening, particularly to directors who are not officers, to review here the steps involved in proving Individual Ledgers (checking accounts) and Savings Ledgers. The word "prove", as used here, simply means testing the accuracy of the entries and balances in these ledgers.

It should be remembered that all of the checking accounts are represented in the bank's "General Ledger" by one account called the "Control". (See Question 5—July, 1938, Bulletin). The balance shown in this Control account at the close of business on any given day represents the total of the balances due to checking depositors on that day. To prove this all of the balances in checking accounts are added together and the total must agree with the General Ledger Control account. If they do not agree, the bookkeeper knows that an error has been made either in posting or proving the individual accounts.

Now let us assume that at the close of a given day the General Ledger Control account showed the total of checking



account balances to be \$500,000.00. The following day checking customers deposit \$50,000.00, while checks against these accounts, totaling \$40,000.00, are presented for payment. The correctness of the above deposit and check totals for the day are first proved in balancing out the day's work. They are then posted into the Control account; the deposits in the amount of \$50,000.00 being credited or added to the \$500,000.00, making \$550,000.00 and \$40,000.00 in checks being debited or deducted, reducing the control balance to \$510,000.00.

The bookkeepers then post the deposits and checks in the proper individual accounts. If all of these individual postings are correctly made the total balances should show an increase of \$10,000.00. Therefore, if they add together all checking balances on that day and they total \$510,000.00, their ledgers are in agreement with the Control account and are considered proved.

Exactly the same procedure is followed in proving the savings accounts. However, the checking accounts, being the more active, are proved more frequently than the savings. Checking accounts should be proved in this manner at least once a week, savings accounts at least once a month. Many large banks prove their checking accounts, in this manner, daily.

While the majority of banks only take a complete proof of their checking accounts once each week, practically all of these run a daily proof on "affected accounts." These are only the accounts in which one or more entries are made thus changing the balance.

This proof is taken in the following manner:

As checks and deposits are posted into the affected accounts, these account sheets are set out. When posting has been completed, the bookkeeper goes back through the affected accounts and calculates the net change (either increase or decrease) in each account. From these individual changes, he computes the total net change in all of the accounts affected and if his postings have been correctly made, his total net change in balances should equal the difference between his check and deposit totals. For example: If his total deposits for the day were \$50,000.00 and the checks were \$40,000.00, his total net change in affected account balances should show an increase of \$10,000.00. When this proof is taken daily, it is quite likely that the weekly run of all the balances will agree with the General Ledger Control.

The tests above described are just about certain to locate all mathematical errors. There is one error, however, that they will not locate and that is posting to the wrong account. This is a type of error to be carefully guarded against for the reason that if not detected in the bank, it is sure to be by the customer which is embarrassing and harmful to the bank.

Carefully managed banks guard against misposting by making a daily comparison of customers' individual ledger sheets with their statement sheets. Most banks do their posting by machine. When the day's checks and deposits have been posted against the individual ledger accounts, the same checks and deposit tickets will be turned over to another bookkeeper to post them into the customers' individual statement sheets. As these sheets are posted, they are set out and before the bookkeeper, who has posted the ledger, runs his daily proof, he will call back the balances on the affected accounts to the bookkeeper who has posted the statement sheets.

It will be seen from this arrangement that the same work has been done by different bookkeepers, both of whom are quite unlikely to make the same error in posting.

To summarize, we repeat, that the commercial or checking accounts should be constantly tested for accuracy, first, by comparing ledger and statement sheets after each day's posting, second, by testing the new balances on affected accounts after each day's posting, and third, the proof of all checking accounts at least once each week by comparing their total with the General Ledger Control.

The frequency of testing savings accounts should be determined by the activity within this group. Some banks handling a large number of savings transactions daily would need a daily test. Others, of lesser volume, could maintain the same degree of accuracy through a weekly proof; but no bank should allow its savings accounts to remain unproved longer than thirty days.

2. Is interest credited on savings accounts at proper intervals?

The rules and regulations of each savings department, as adopted by the Board of Directors, becomes a contract with each depositor who opens a savings account. These rules and regulations provide that on a certain date, or dates, each year, the bank will credit to each savings account the accrued interest due to it. Ordinarily these rules provide for the crediting of interest twice each year (June 1st and December 1st). The purpose of the above question is to record in the report whether or not the bank is strictly observing its contract with savings depositors in this respect.

3. State minimum and maximum rate of interest paid on deposits. Specify classes of accounts.

Under this heading, we learn whether or not all of the bank's engagements to pay interest on time deposits are normal and regular. Should a bank under examination have one or more unusual or extraordinary interest bearing deposit accounts, the disclosure would be made at this point. In the second section of this item, we mean by classes, types or kind of time deposits such as Time Certificates of Deposit, Savings Deposits, Christmas Savings, Thrift Clubs, etc.

4. Are time deposits by any device paid before maturity?

All time deposits are specific contracts between a bank and said depositors, rigidly binding in all of their terms upon both parties. The maturity of the instrument or the withdrawal restrictions governing the deposit is just as binding upon the depositor as the payment of the deposit is upon the bank and, in fairness to all other depositors under identical contracts, each individual agreement should be strictly enforced. There is no statutory provision in Illinois law governing this matter but all State Bank members of the Federal Deposit Insurance Corporation and the Federal Reserve System should bear in mind the strict provision of the Federal Statute on that point.

5. Are all savings accounts bona fide thrift accounts?

Genuine thrift accounts are, ordinarily, accumulations of small deposits made by individuals for the sole purpose of saving money. Withdrawals from such accounts are usually in nominal amounts and well scattered. There are other types of accounts occasionally found in the Savings Ledgers generally containing large balances, such as undistributed estate funds, corporation deposits, escrows, etc., that are not thrift accounts and should more properly be on a definite maturity basis in order to give the management an opportunity to protect itself against large withdrawals.

IN LIQUIDATION

Wapella.....DeWitt.....Farmers & Merchants Bank of Wapella through The
 DeWitt County National Bank of Clinton.....Nov. 3, 1938

DISSOLVED

Birds.....Lawrence.....State Bank of Birds (In liquidation August 6, 1938).....Oct. 13, 1938
 Tilden.....Randolph.....First State Bank of Tilden (In liquidation September 14,
 1938).....Oct. 21, 1938
 Wyandot.....Bureau.....Bank of Wyandot (In liquidation May 9, 1938).....Oct. 24, 1938
 Chicago.....Cook.....The Peoples Trust and Savings Bank of Chicago.....Nov. 2, 1938
 Mineral.....Bureau.....First State Bank of Mineral (In receivership September 21,
 1931. Dissolved by order of the Circuit Court of Bureau
 County).....Nov. 4, 1938
 Hudson.....McLean.....Hudson State Bank (In receivership September 21, 1933.
 Dissolved by order of the Circuit Court of McLean
 County).....Nov. 5, 1938
 LaMoille.....Bureau.....LaMoille State Bank (In receivership December 26, 1931.
 Dissolved by order of the Circuit Court of Bureau
 County).....Nov. 10, 1938
 Spring Grove.....McHenry.....Spring Grove State Bank (In receivership July 22, 1931.
 Dissolved by order of the Circuit Court of McHenry
 County).....Nov. 12, 1938
 Troy Grove.....La Salle.....Troy Grove State Bank (In receivership October 27, 1931.
 Dissolved by order of the Circuit Court of La Salle
 County).....Nov. 14, 1938
 Plymouth.....Hancock.....Tri-County State Bank (In liquidation March 16, 1925.
 Dissolved by order of the Circuit Court of Hancock
 County).....Nov. 15, 1938
 Forrest.....Livingston.....Farmers and Merchants State Bank of Forrest (In liqui-
 dation November 22, 1923. Dissolved by order of the
 Circuit Court of Livingston County).....Nov. 21, 1938
 Pecatonica.....Winnebago.....Farmers State Bank of Pecatonica (In receivership January
 27, 1932. Dissolved by order of the Circuit Court of
 Winnebago County).....Nov. 21, 1938
 Pecatonica.....Winnebago.....Pecatonica State Bank (In receivership September 5, 1931.
 Dissolved by order of the Circuit Court of Winnebago
 County).....Nov. 21, 1938
 Mahomet.....Champaign.....Mahomet State Bank (In liquidation February 18, 1929.
 Dissolved by order of the Circuit Court of Champaign
 County).....Nov. 22, 1938
 St. David.....Fulton.....State Bank of St. David (In liquidation October 10, 1931.
 Dissolved by order of the Circuit Court of Fulton
 County).....Nov. 22, 1938
 Glencoe.....Cook.....Citizens State Bank of Glencoe (In receivership June 20,
 1932. Dissolved by order of the Circuit Court of Cook
 County).....Nov. 23, 1938
 Lovington.....Moultrie.....The Lovington State Bank (In liquidation October 10,
 1931. Dissolved by order of the Circuit Court of
 Moultrie County).....Nov. 26, 1938
 Kincaid.....Christian.....Kincaid Trust & Savings Bank (In receivership August 16,
 1933. Dissolved by order of the Circuit Court of
 Christian County).....Nov. 30, 1938

RECAPITULATION

	Reopened by permit.	Closed under holiday.	Total.
State Banks in Chicago.....	30	1	31
State Banks in Cook County.....	28	---	28
State Banks in Illinois outside Cook County.....	492	---	492
Total.....	550	1	551