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Statements on Auditing Procedure

No. 27
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Issued by the
Committee on Auditing Procedure,
American Institute of
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270 Madison Avenue New York 17, N. Y.
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Long-Form Reports

INTRODUCTION

1. In 1949, the membership of the Institute approved Statements on Auditing Procedure No. 23, entitled *Clarification of Accountant's Report When Opinion Is Omitted*. This action added a new auditing standard to those approved by the Institute membership in 1948. Accordingly, the substance of this statement was incorporated in the 1954 revised edition of *Generally Accepted Auditing Standards*, being stated therein as the fourth standard of reporting in the following manner:

“4. The report shall either contain an expression of opinion regarding the financial statements, taken as a whole, or an assertion to the effect that an opinion cannot be expressed. When an over-all opinion cannot be expressed, the reasons therefor should be stated. In all cases where an auditor's name is associated with financial statements the report should contain a clear-cut indication of the character of the auditor's examination, if any, and the degree of responsibility he is taking.”

2. Much of the material comprising the *Codification of Statements on Auditing Procedure* and *Generally Accepted Auditing Standards* has been written in terms of reference to the so-called short-form of auditor's report, which has become generally considered to constitute the basic content for auditors' reports on financial statements. In many instances, however, this same material refers to the application of these standards and procedures to the more detailed forms of reports.

3. While the accounting profession has generally adopted the short-form report in connection with financial statements intended for publication, it is recognized that independent certified public accountants issue a substantial volume of so-called long-form reports on financial statements. These reports include greater details of the customary basic financial statements, statistical data, explanatory comments, and sometimes description of the scope of the auditor's examination beyond that which normally appears in the short-form reports. In some cases, both a long-form report and a short-form report are issued on the same engagement, but in many cases the long-form report constitutes the only report issued by the auditor. The committee believes that long-form reports often serve a valuable purpose in meeting the requirements of management and others, and accordingly it encourages the continued issuance of such reports, where appropriate.

4. For purposes of discussion, the financial and statistical material normally included in long-form reports is classified in the following categories:

- (a) Basic financial statements (balance sheet and statements of income, retained earnings and capital).
- (b) Financial data representing details of the basic financial statements.
- (c) Statistical data and informative material, some of which may be of a non-accounting nature.

APPLICATION OF STANDARDS OF REPORTING

Current Year's Data

5. The committee believes that the basic concept "the report should contain a clear-cut indication of the character of the auditor's examination, if any, and the degree of responsibility he is taking," is applicable to both short-form and long-form reports. A study of current long-form report practices discloses that in many cases the usual short-form type of auditor's opinion is used, specifically covering the current year's basic financial statements, but without specific reference to the other data in the report. As a result of this practice, no distinction is made between data covered by the auditor's examination and data which may not have been examined by him, which may lead to an inference that he is assuming more responsibility than is his intention. This practice has also been questioned as to whether it is consistent with the concept of setting forth "a clear-cut indication of the character of the auditor's examination, if any, and the degree of responsibility he is taking" with respect to the data described under items (b) and (c) of paragraph 4 above.

6. It is the opinion of the committee that, in the absence of a statement by the auditor to the contrary, it may be presumed that he assumes responsibility for such other data in the long-form report, to the same degree that he does for individual items in the basic financial statements; that is, that they are fairly stated in all material respects in relation to the basic financial statements, taken as a whole.

7. The committee believes that in some instances the auditor may wish to clarify his position in the foregoing respects by a brief statement in his comments, or as a preface to a separate section of the report which includes the other data, explaining:

- (a) That the auditor's examination has been made primarily for the purpose of formulating his opinion on the current year's basic financial statements, taken as a whole,

- (b) That the other data included in the report, although not considered necessary for a fair presentation of the financial position and results of operations, are presented primarily for supplementary analysis purposes, and either (1) that they have been subjected to the audit procedures applied in the examination of the basic financial statements and are, in his opinion, fairly stated in all material respects in relation to the basic financial statements, taken as a whole, or (2) that they have not been subjected to the audit procedures applied in the examination of the basic financial statements, stating the source of information and the extent of his examination and responsibility assumed, if any.

Some auditors follow the practice of indicating the extent of their examination and the responsibility they are assuming, if any, with respect to the detailed financial schedules and other data in long-form reports by footnotes on the various schedules or exhibits. Regardless of the method of presentation, the committee emphasizes the necessity of maintaining a clear-cut distinction between the management's representations and the auditor's representations.

Prior Year's Data

8. In the usual case where basic financial statements and details thereof for the prior year are presented primarily for comparative purposes (in either long-form or short-form reports), the committee believes that the auditor need not extend his opinion to cover the prior year's figures. Where the auditor has made an examination for the prior year, he may prefer to so state (for example, by an addition to the standard scope paragraph disclosing that he has previously examined and reported on the prior year's financial statements). Where the auditor has not made an examination of the prior year's figures, or where he presently has significant exceptions or reservations as to the prior year's figures, he should ordinarily make appropriate disclosure to that effect.

OTHER LONG-FORM REPORTING PROBLEMS

9. The committee believes it advisable to focus the profession's critical attention on two additional questions relating to long-form report practices:

- (1) Where a long-form report is co-existing with a conventional short-form report,
 - (a) Does the long-form report contain data which, if omitted from the short-form report, might support a contention that the short-form report was misleading because of inadequate disclosure of material facts known to the auditor?, and
 - (b) Do any of the comments or other data contained in the long-form report lend themselves to a contention that they constitute exceptions or reservations, as distinguished from mere explanations?
- (2) Does the long-form report, taken by itself, contain other financial data in such form as to support a contention that the auditor has made *factual* representations with respect to the financial statements or books of account rather than expressed an *opinion* on financial data consisting of management representations?

10. In connection with the first of the above questions, the auditor should recognize that, with both the long-form and short-form reports in hand, the reader may reasonably assume that the other financial data and textual comment in the long-form report are sufficiently relevant and significant to warrant their inclusion therein but that their omission from the short-form report does not result in inadequate disclosures in that report. It should be noted further that the report reader in this case may have the benefit of hindsight in appraising the auditor's exercise of judgment in the disclosures deemed material to a fair presentation and understanding of the financial statements included in the short-form report. The committee believes

that the profession should be continually alert to the possible problems inherent in the issuance of co-existing short-form and long-form reports. Care should be exercised to differentiate between the basic financial statements and the explanatory details and other informative data included in long-form reports, and to avoid any implications that the latter materials are necessary to a fair presentation of the financial position and results of operations.

11. Regarding the second question, the concept of management's basic responsibility for financial statements and of the auditor's representations being confined to his opinion on such statements has become firmly established since the general adoption of the conventional short-form report. Under this concept, the independent certified public accountant is expressing his professional opinion and is not "certifying" to facts true to his own knowledge. The committee believes that this same basic concept underlies the long-form report and directs the attention of each practitioner to the need for careful preparation of long-form reports in a manner that makes it clear that he is expressing therein the same type of professional opinion as in short-form reports.

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