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## Special reports (applicability of reporting standards in special circumstances); Statements on auditing procedure, No. 28

American Institute of Accountants. Committee on Auditing Procedure

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# Statements on Auditing Procedure

No. 28

October 1957

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Issued by the  
Committee on Auditing Procedure,  
American Institute of  
Certified Public Accountants  
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**Special Reports**  
(Applicability of Reporting Standards  
in Special Circumstances)

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## INTRODUCTION

1. The independent certified public accountant has long had authoritative literature and accepted practice to guide him in that part of his work which has to do with reporting on the more usual types of financial statements of corporate business enterprises organized for profit. When he has undertaken to report on matters outside that category, he has had little besides his own experience and judgment to guide him, since the profession has not clarified the applicability of generally accepted auditing standards in such circumstances.

2. The purposes of this statement are:
- a. To provide a basis for differentiating between reports for which the wording of the usual short-form opinion or certificate (whether used in a short-form or long-form report) is appropriate and reports for which special wording in the opinion or certificate seems to be necessary. These latter reports are generally referred to hereinafter as "special reports."
  - b. To clarify the applicability of generally accepted auditing standards to such special reports.

**TYPES OF SPECIAL REPORTING CIRCUMSTANCES**

3. Special reports (see paragraph 2a.) may include:
  - a. Reports on financial statements of organizations which maintain their accounts and prepare their statements on a cash or other incomplete basis of accounting which is materially at variance with accounting practices customarily followed in preparing accrual basis statements. These organizations may include some organized for profit, particularly those carried on by individuals and partnerships, as well as some nonprofit organizations.
  - b. Reports on financial statements of some nonprofit organizations which follow accounting practices differing in some respects from those followed by business enterprises organized for profit. These organizations may include municipalities, hospitals, co-operatives, and educational institutions.
  - c. Reports prepared for limited purposes, such as:
    - (1) Reports that relate only to certain aspects of financial statements. These reports may include reports, sometimes in letter form, relating to special studies, to compliance with certain provisions of bond indentures, or to the determination of the amounts of rentals, royalties, profit-sharing bonuses and the like.
    - (2) Reports that are filed with various agencies on prescribed forms which provide a uniform statement presentation, in some cases with a *preworded opinion or authentication*. These reports may include reports prepared for filing with various governmental authorities or with credit and similar agencies.
4. Compliance by financial institutions, insurance companies, railroads, and the like, with accounting practices prescribed by a regulatory authority may create reporting problems; however, the committee, for the present, is not dealing with the usual reports on financial statements of regulated companies and this statement is not intended to apply to them or to alter any previous pronouncements applicable to them. Nor is this statement intended to apply to reporting problems relating to tax returns or to management service reports.

## **APPLICABILITY OF GENERALLY ACCEPTED AUDITING STANDARDS**

5. The wording of the usual short-form opinion or certificate on examination of financial statements (whether included in a short-form or long-form report) is designed for an expression of opinion on the fairness with which such statements present financial position and results of operations. While no precise definition of the term financial statements has been made by the committee, it is quite clear that the term as used in the pamphlet *Generally Accepted Auditing Standards*, as well as in Statement on Auditing Procedure No. 27, *Long-Form Reports*, refers to financial statements which purport to show financial position and results of operations; such financial statements usually consist of a balance sheet and statements of income, retained earnings, and capital.

6. *Generally Accepted Auditing Standards* characterizes the term generally accepted auditing standards as used in auditors' reports on financial statements in such a way as to include (a) general standards, (b) standards of field work, and (c) standards of reporting. It is the opinion of the committee that, to the extent appropriate in view of the character of the engagement, the substance of the general standards and of the standards of field work applies to engagements involving special reports.

7. The four standards of reporting require (1) an opinion as to conformity of financial statements with generally accepted principles of accounting, (2) an opinion as to the consistency with which these principles have been observed, (3) adequate informative disclosures, and (4) an expression of opinion regarding the financial statements taken as a whole, or a statement to the effect that an opinion cannot be expressed, together with the reasons therefor, and, in all cases, a clear-cut indication of the character of the auditor's examination, if any, and of the degree of responsibility he is taking.

8. Although there may be occasions when it is appropriate for the auditor to report upon conformity with generally accepted accounting principles of incomplete financial presentations, such as in reports upon

compliance with certain provisions of bond indentures, the committee is of the opinion that the requirement of the first standard of reporting does not apply to statements which do not purport to set forth financial position and results of operations. Statements prepared on the basis of cash receipts and disbursements, for example, usually do not purport to present financial position or results of operations. In reporting on statements which do not so purport the auditor should make sure that it is clearly stated what they do purport to present and the basis on which they have been prepared. He should express his opinion as to whether or not the statements fairly present the data on the basis indicated. The committee believes it to be generally preferable in these circumstances to avoid the use of the terms "balance sheet," "income statement," or similar titles with respect to such statements; notwithstanding this preference, the committee recognizes the long-established acceptance of these terms and accordingly feels that it should not, at this time, do more than express its preference.

9. In reporting on statements prepared on a cash basis (or substantially so) which nevertheless may appear to present financial position and results of operations, disclosure should ordinarily be made in the statements or their footnotes or, less preferably, in the auditor's report, (a) of the fact that the statements have been prepared on the basis of cash receipts and disbursements and (b) of the general nature of any material items omitted (such as accounts receivable and accounts payable) and, where practicable, of the net effect of such omissions on the statements. The auditor's opinion might then be worded somewhat as follows:

"In our opinion, the accompanying statements present fairly the assets and liabilities of the XYZ Company, at December 31, 19\_\_\_, arising from cash transactions, and the revenues collected and expenses disbursed by it (and changes in proprietary interest, fund balances, etc., where reflected in cash basis statements) during the year then ended, on a basis consistent with that of the preceding year."

Notwithstanding the foregoing, where the auditor thinks that misleading inferences may still be drawn from the statements, he should include an

explanation in his report that the statements do not present financial position and results of operations.

10. In reporting on statements prepared on a modified accrual basis of accounting, which nevertheless usually purport to present financial position and results of operations, the auditor may consider the resulting statements to be materially incomplete or to have been prepared in accordance with accounting practices materially at variance with those customarily followed in preparing accrual basis statements. In such cases it is desirable to disclose the nature and amounts of the major items involved and, in his report, to state an exception or explain clearly why he is unable to express the usual opinion on the fairness of presentation of financial position and results of operations.

11. If the statements are those of a nonprofit organization they may reflect accounting practices differing in some respects from those followed by business enterprises organized for profit. It is recognized that in many cases generally accepted accounting principles applicable to nonprofit organizations have not been as clearly defined as have those applicable to business enterprises organized for profit. In those areas where the auditor believes generally accepted accounting principles have been clearly defined (as indicated by authoritative literature and accepted practice, etc.) he may state his opinion as to the conformity of the financial statements either with generally accepted accounting principles, or (alternatively, but less desirably) with accounting practices for nonprofit organizations in the particular field (e.g., hospitals, educational institutions, etc.), and in such circumstances he may refer to financial position and results of operations; in either event, it is assumed that the auditor is satisfied that the application of such accounting principles and practices results in a fair presentation of financial position and results of operations or that he will state his exceptions thereto. In those areas where the auditor believes generally accepted accounting principles have not been clearly defined, the other provisions of this statement apply.

12. When the report relates to statements which purport to present financial position or results of operations, the second standard of reporting as to consistency in the application of generally accepted accounting

principles is, of course, applicable. When the report relates to other matters, reference to consistency is frequently appropriate, depending upon the nature of the matter reported upon.

13. As to the third standard of reporting, adequate informative disclosures are, of course, required at all times. Where the auditor considers the basis on which the financial statements have been prepared to be inappropriate or unsuitable in the circumstances, appropriate disclosures should be made.

14. The fourth standard of reporting requires that the report shall contain either an expression of opinion, or an assertion to the effect that an opinion cannot be expressed and the reasons therefor. This standard also requires that 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. At the time this standard was adopted the major concern was with statements purporting to show financial position or results of operations. The requirements of this auditing standard, however, are, in the committee's opinion, applicable to special reports.

### **OTHER ASPECTS**

15. Special reports in which incomplete financial presentations or no financial presentations are made (e.g., calculations of royalties, profit-sharing bonuses, rentals, etc.) should be drafted with a view to their special purpose and, accordingly, should state what information is presented, the basis on which it was prepared, and whether, in the auditor's opinion, it is presented fairly on that basis. As indicated in paragraph 8 there may be occasions when it is appropriate for the auditor to report upon conformity with generally accepted accounting principles of incomplete financial presentations; such occasions usually arise when there is interest in establishing that a part only of the financial statements is in conformity with generally accepted accounting principles, such as the determination of "working capital" under a bond indenture. There may be occasions, in reports containing an expression of an opinion on the fairness with which financial statements present financial position and results of operations, where the auditor also expresses an opinion as to

the adequacy or reasonableness of specific accounts, such as those for the allowance for doubtful accounts receivable or the liability for income taxes. The usual examination of financial statements is designed for the purpose of formulating an opinion with respect to financial statements taken as a whole and not necessarily with respect to specific accounts. Accordingly, it is generally undesirable for an auditor to render a separate opinion on a specific account, but where the situation is such that he considers it appropriate to do so, he should be cognizant of the added responsibility he may thereby be assuming and the possible necessity of extending the scope of his examination.

16. Statements prepared on printed forms designed by the authorities with which they are to be filed may require inappropriate classifications or other similar procedures that, in the auditor's opinion, do not fairly present the financial position or results of operations of the particular company filing the statements, even though they purport to do so. Also, such forms may involve the additional problem of conforming the preworded auditor's opinion or certificate to professional standards. Many of these forms are not acceptable to the independent certified public accountant because the desire for uniform financial presentation conflicts with fair presentation in the particular case, or the printed language of the auditor's opinion or certificate calls for assertions by him that are not part of his functions and responsibilities as an independent certified public accountant. Some forms can be made acceptable by typing in additional captions or wording; others can be made acceptable only by complete revision. Whenever the printed forms call upon the auditor to make an assertion which he believes he is not justified in making, he generally has no alternative but to reword them or to submit his separately typed report.

*The statement entitled "Special Reports (Applicability of Reporting Standards in Special Circumstances)" was adopted unanimously by the twenty-one members of the committee, of whom one, Mr. Sprague, assented with qualification.*

Mr. Sprague qualifies his assent because he believes the reporting problems referred to in paragraph 4 should have been outlined for clarification and that the statement should have included a discussion of the

manner in which the auditor's opinion can meet the requirements of existing standards of reporting and also deal with the requirements of regulatory bodies.

### **COMMITTEE ON AUDITING PROCEDURE (1956-1957)**

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