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## Responsibilities and functions of the independent auditor in the examination of financial statements; Statements on auditing procedure, No. 30

American Institute of Accountants. Committee on Auditing Procedure

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# Statements on Auditing Procedure

No. 30

September 1960

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Committee on Auditing Procedure,  
American Institute of  
Certified Public Accountants  
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## Responsibilities and Functions of the Independent Auditor in the Examination of Financial Statements

*The purpose of this statement is to clarify that section of the Codification of Statements on Auditing Procedure relating to the responsibilities and functions of the independent auditor in connection with his examination of financial statements. Since the issuance of the Codification in 1951, questions have been raised concerning the position taken therein regarding the responsibility of the independent auditor for the discovery of fraud (including defalcations and other similar irregularities), and concerning the proper course of conduct of the independent auditor when his examination discloses specific circumstances which arouse his suspicion as to the existence of fraud.*

*The committee on auditing procedure believes that clarification is best accomplished by a restatement of the pertinent section of the Codification. Accordingly, the section of the Codification beginning on page 11 and ending at the top of page 13 is hereby revised as set forth in the following paragraphs:*

### Responsibilities and Functions of the Independent Auditor in the Examination of Financial Statements

1. The objective of the ordinary examination of financial statements by the independent auditor is the expression of an opinion on the fairness of their presentation. The report is the medium through which he expresses such opinion. This examination is made in accordance with generally

accepted auditing standards. Such standards require him to state in his report whether, in his opinion, the financial statements are presented in accordance with generally accepted principles of accounting and whether such principles have been consistently observed in the preparation of the financial statements of the current period in relation to those for the preceding period.

2. Management has the responsibility for the proper recording of transactions in books of account, for the safeguarding of assets, and for the substantial accuracy and adequacy of financial statements. The transactions which should be reflected in the accounts and in the financial statements are matters within the direct knowledge and control of management; the independent auditor's knowledge is limited to that acquired through his examination. Accordingly, even though the financial statements may show the influence of the independent auditor (for example, as a result of management's acceptance of his advice), the statements are the representations of management. The independent auditor's responsibility is confined to the expression of a professional opinion on the financial statements he has examined.

3. In the observance of generally accepted auditing standards, the independent auditor must exercise his judgment in determining the auditing procedures which are necessary in the circumstances to afford a reasonable basis for his opinion. His judgment is required to be the informed judgment of a qualified professional person.

4. The professional qualifications required of the independent auditor are those of a person trained and qualified to practice as such, but do not include those of a person trained for or engaged in another profession or occupation. For example, the independent auditor, in observing the taking of the physical inventory, does not purport to act as an appraiser, valuer, or expert in materials. Similarly, although the independent auditor is informed in a general manner about matters of commercial law, he does not purport to act in the capacity of a lawyer and is entitled to rely upon the advice of attorneys in all matters of law.

5. In making the ordinary examination, the independent auditor is aware of the possibility that fraud may exist; financial statements may be misstated as the result of defalcations and other similar irregu-

larities, deliberate misrepresentation by management, or both. He recognizes that any fraud, if sufficiently material, may affect his opinion on the fairness of the presentation of the financial statements, and his examination, made in accordance with generally accepted auditing standards, gives consideration to this possibility. However, the ordinary examination incident to the expression of an opinion on financial statements is not primarily or specifically designed, and cannot be relied upon, to disclose defalcations and other similar irregularities, although their discovery may result. Similarly, although the discovery of deliberate misrepresentation by management is usually more closely associated with the objective of the ordinary examination, such examination cannot be relied upon to assure its discovery. The responsibility of the independent auditor for failure to detect fraud (which responsibility differs as to clients and others) arises only when such failure clearly results from noncompliance with generally accepted auditing standards.

6. Reliance for the prevention and detection of fraud should be placed principally upon the maintenance of an adequate accounting system with appropriate internal control. The well-established practice of the independent auditor of evaluating the adequacy and effectiveness of the system of internal control by means of tests of the accounting records and related data and of relying on such evaluation and tests for the selection and timing of his other auditing procedures has generally proved sufficient for the purpose of expressing his opinion. If an objective of an independent auditor's examination were the discovery of all fraud, he would have to extend his work to a point where its cost would be prohibitive. Even then he could not give assurance that all types of fraud had been detected or that none existed because items such as unrecorded transactions, forgeries, and collusive fraud would not necessarily be uncovered. It is generally recognized that good internal control and fidelity bonds provide protection more economically and effectively.<sup>1</sup>

7. When an independent auditor's examination leading to an opinion on financial statements discloses specific circumstances which arouse his suspicion as to the existence of fraud, he should decide whether the

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<sup>1</sup> In the case of fidelity bonds, protection is afforded not only by the indemnification for discovered defalcations, but also by the possible deterrent effect upon employees; the presence of fidelity bonds, however, does not affect the scope of the ordinary examination.

fraud, if in fact it should exist, might be of such magnitude as to affect his opinion on the financial statements. If the independent auditor believes that fraud may have occurred which could be so material as to affect his opinion, he should reach an understanding with the proper representatives of the client as to whether the independent auditor or the client, subject to the independent auditor's review, is to make the investigation necessary to determine whether fraud has in fact occurred and, if so, the amount thereof. If, on the other hand, the independent auditor concludes that any such fraud could not be so material as to affect his opinion, he should refer the matter to the proper representatives of the client with the recommendation that it be pursued to a conclusion. For example, frauds involving "lapping" accounts receivable collections, or frauds involving overstatements of inventory, could be material, while those involving peculations from a small imprest fund would normally be of little significance because the operation of the fund tends to establish a limitation.

8. The subsequent discovery that fraud existed during the period covered by the independent auditor's examination does not of itself indicate negligence on his part. He is not an insurer or guarantor and, if his examination was made with due professional skill and care, in accordance with generally accepted auditing standards, he has fulfilled all of the obligations implicit in his undertaking.

*The statement entitled "Responsibilities and Functions of the Independent Auditor in the Examination of Financial Statements" was unanimously adopted by the twenty-one members of the committee.*

### **COMMITTEE ON AUDITING PROCEDURE (1959-60)**

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 Director of Research