

University of Mississippi

eGrove

American Institute of Accountants

Deloitte Collection

1965

Long-term investments; Statement on auditing procedure, No. 34

American Institute of Accountants. Committee on Auditing Procedure

Follow this and additional works at: https://egrove.olemiss.edu/dl_aia



Part of the [Accounting Commons](#), and the [Taxation Commons](#)

Recommended Citation

American Institute of Accountants. Committee on Auditing Procedure, "Long-term investments; Statement on auditing procedure, No. 34" (1965). *American Institute of Accountants*. 260. https://egrove.olemiss.edu/dl_aia/260

This Article is brought to you for free and open access by the Deloitte Collection at eGrove. It has been accepted for inclusion in American Institute of Accountants by an authorized administrator of eGrove. For more information, please contact egrove@olemiss.edu.

Long-Term Investments

Purpose of the Statement

1. Long-term investments constitute a substantial portion of the assets of a number of enterprises, and are particularly significant for investment and holding companies, such as small business investment companies and bank holding companies. Matters relative to auditing long-term investments therefore are of major interest to the profession. The purpose of this statement is to furnish some guides in applying generally accepted auditing standards to examinations of the financial statements of companies with such investments. These investments may be represented by capital stock and other equity interests, bonds and similar debt obligations, and loans and advances that are in the nature of investments. The statement is concerned mainly with evidential matter corroborating both the amounts at which long-term investments are stated in the financial statements and the related disclosures.

Objective of Examination

2. The independent auditor should ascertain whether the long-term investments are stated on a basis that conforms with

*Issued by the Committee on Auditing Procedure
American Institute of Certified Public Accountants*

generally accepted accounting principles and whether the related disclosures are adequate. He should therefore obtain evidential matter regarding the existence, ownership, cost, and carrying value of the investments and any related disclosures in the financial statements.

Types of Evidence

3. Evidential matter as to existence and ownership of long-term investments includes the accounting records and documents supporting the acquisition of the investment. In the case of investments in the form of securities (such as stocks, bonds, and notes), this evidential matter should be corroborated by inspection of the securities, or in appropriate circumstances, by written confirmation from an independent custodian of securities on deposit or in safekeeping. In the case of loans, advances, and certain bonds and similar debt obligations, the evidential matter obtained from the accounting records and documents should be corroborated by written confirmation from the debtor or trustee.

4. Accounting records and documents relating to the acquisition of an investment provide evidential matter as to its cost.

5. Additional evidential matter supporting an opinion as to whether the investment is stated on a basis conforming with generally accepted accounting principles, which also comprehends the adequacy of disclosure and consideration of whether the investment is impaired, may be available in the following forms:

- A. *Audited Financial Statements.* Financial statements of the company in which an investment in capital stock or other equity interests has been made constitute sufficient evidential matter of the equity in underlying net assets of that company when such statements have been examined by the principal auditor or by another independent auditor whose report is satisfactory to the principal auditor. Audited financial statements also constitute one of the items of evidential matter that may be used with respect

to investments in bonds and similar debt obligations, and loans and advances. When utilization of the reports of other auditors constitutes a major element of the evidence considered competent and sufficient for investments represented by capital stock or other equity interests, the independent auditor should be guided by the standards applicable to reporting on consolidated or combined statements (see paragraphs 32-36, Chapter 10, Statements on Auditing Procedure No. 33).

- B. *Market Quotations.* Quotations of security prices ordinarily constitute sufficient evidential matter as to the current market value of securities, if the quotations are based on a reasonably broad and active market.
- C. *Other Evidential Matter.*
 - (i) Auditing procedures applied to the financial statements of the company in which there is an investment provide evidential matter for long-term investments. Such evidential matter may be sufficient if the auditing procedures are substantive. Substantive auditing procedures would ordinarily include evaluation of the system of internal control and most of the other procedures necessary for an opinion on the separate financial statements of the company in which there is an investment. When there are investments in a number of affiliates under common or uniform management, and operating under satisfactory conditions of internal control, sufficient evidential matter ordinarily may be obtained by examining the financial statements of a representative number of the individual companies or by applying selected auditing procedures with respect to all or most of the affiliates.
 - (ii) When the cost of the investment reflects factors (such as mineral rights, growing timber, and patents) which are not recognized in the financial statements of the company in which there is an investment, evidential matter may be available in the form of current evaluations of these factors. Evaluations made

by persons within the investing company or within the company in which there is an investment may be acceptable; evaluations made by persons independent of these companies will usually provide more competent evidential matter than evaluations made within the companies.

- (iii) Unaudited financial statements, reports such as those issued on examination by regulatory bodies and taxing authorities, and similar data have significance, but are not by themselves sufficient as evidential matter.

6. Often there will be collateral in the form of negotiable securities, real estate, chattels, or other property pledged as security for investments in bonds, notes, loans, or advances. The independent auditor should satisfy himself regarding the existence of the collateral, and if the value of the collateral is an important factor in considering collectibility, he should satisfy himself that the collateral is in transferable form and should obtain evidential matter, such as market quotations, the amount of underlying net assets, or appraisal figures as may be appropriate in the circumstances.

Effect on Opinion

7. Long-term investments may be made in either speculative or established businesses operating in commercial, financial, or industrial fields under a variety of conditions. Because of the intangible and complicated nature of the evidential matter supporting many investments, the independent auditor must exercise judgment in forming the opinion that he may express in each situation.

8. When long-term investments are material in relation to the financial position and results of operations of an investing company, the independent auditor is not in a position to express an unqualified opinion on its financial statements unless he has obtained sufficient evidential matter in support of the objectives described in paragraph 2.

9. The following are suggestions of the types of reports that may be given by the independent auditor when there are restrictions on the scope of his examination or uncertainties as to future developments with respect to the investments:

- A. There may be situations where sufficient evidential matter is not made available to the independent auditor or where he is not permitted to examine a sufficient number of subsidiaries of a holding company so that there is an effective limitation on the scope of his examination. In these circumstances an exception is required in the scope representation of the independent auditor's report, and a qualified opinion or a disclaimer of opinion is required, as contemplated in paragraphs 27-31 of Chapter 10 of Statements on Auditing Procedure No. 33.

- B. There may be situations in which the independent auditor has examined the available evidential matter but finds that because of existing conditions there is uncertainty about the ultimate realization of long-term investments. In such circumstances the independent auditor should either qualify his opinion or disclaim an opinion on the financial statements taken as a whole, depending on the materiality of the investments. In appropriate circumstances, the disclaimer of opinion may be accompanied by a piecemeal opinion. Examples of these types of reports are as follows:

Qualified Opinion

(Scope paragraph)

We have examined the balance sheet of XYZ Investment Company, as of December 31, 19—, and the related statement of income and retained earnings for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other

auditing procedures as we considered necessary in the circumstances.

(Middle paragraph)

Investments described in Note 1 are in companies whose financial statements indicate they are in the promotional and development stage (or other wording descriptive of the facts). Accordingly, the ultimate realization of these investments depends on circumstances which cannot be evaluated currently.

(Opinion paragraph)

In our opinion, subject to the realization of the carrying values of investments referred to in the preceding paragraph, . . .

Disclaimer of Opinion

(Same scope and middle paragraphs as above)

(Opinion paragraph)

Because the investments referred to in the preceding paragraph enter materially into the determination of financial position and results of operations, we do not express an opinion on the accompanying financial statements taken as a whole.

Piecemeal Opinion

See paragraphs 22-25, Chapter 10, Statements on Auditing Procedure No. 33

(Same scope and middle paragraphs as above)

(Opinion paragraph)

Because the investments referred to in the preceding paragraph enter materially into the determination of financial position and results of operations, we do not express an opinion on the accompanying financial statements taken as a whole. However, in our opinion, current assets, current and long-term liabilities, capital stock, revenues, and interest expense are presented fairly in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

The statement entitled "Long-Term Investments" was adopted unanimously by the twenty-one members of the committee.

NOTES

Unless otherwise indicated, Statements on Auditing Procedure present the considered opinion of the twenty-one members of the committee on auditing procedure, reached on a formal vote after examination of the subject matter by the committee and the technical services division. Except where formal adoption by the Council or the membership of the Institute has been asked and secured, the authority of the statements rests upon the general acceptability of the opinions so reached.

The committee on auditing procedure is the senior technical committee of the Institute designated to express opinions on auditing matters. While it is recognized that general rules may be subject to exception, the burden of justifying departures from the committee's recommendations must be assumed by those who adopt other practices.

COMMITTEE ON AUDITING PROCEDURE (1964-65)

ALBERT J. BOWS, JR., *Chairman*
 MARLIN P. ALT
 R. KIRK BATZER
 MILTON M. BROEKER
 FRANK H. EISEMAN
 HAROLD S. GELB
 OSCAR S. GELLEIN
 DAVID O. GILLETTE
 J. SPENCER GOULD
 WILLIAM J. HAJJAR
 NEWMAN T. HALVORSON

JAMES W. HENDRIX
 JACK D. KINGSOLVER
 ROBERT K. MAUTZ
 IRVING RICHARDSON
 JOSEPH L. ROTH
 LESTER I. SWINDELL
 JAMES W. THOKEY
 RALPH E. WALTERS
 IVAN M. WEST
 HOWARD G. WOMSLEY