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Planning and supervision; Planning and  
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Certified Public Accountants), 1977, Aug. 31

American Institute of Certified Public Accountants. Auditing Standards Executive Committee

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# **EXPOSURE DRAFT**

## **PROPOSED STATEMENT ON AUDITING STANDARDS: PLANNING AND SUPERVISION**

**AUGUST 31, 1977**

**Issued by the Auditing Standards Executive Committee of the  
American Institute of Certified Public Accountants  
For Comment From Persons Interested in Auditing and Reporting**

**Comments should be received by November 30, 1977, and addressed to  
Auditing Standards Division, File Ref. No. 4351  
AICPA, 1211 Avenue of the Americas, New York, N.Y. 10036**

August 31, 1977

To Practice Offices of CPA Firms; Members of Council; Technical Committee Chairmen; State Society and Chapter Presidents, Directors and Committee Chairmen; Organizations Concerned With Regulatory, Supervisory or Other Public Disclosures of Financial Activities; Persons Who Have Requested Copies:

An exposure draft of a proposed Statement on Auditing Standards on "Planning and Supervision" accompanies this letter.

The proposed Statement provides guidance to the auditor making an examination in accordance with generally accepted auditing standards on the considerations and procedures applicable to planning and supervision, including preparing audit programs, obtaining knowledge of the entity's business, and dealing with differences of opinion among firm personnel. The Statement, if adopted, would require an auditor to prepare a written audit program that sets forth in reasonable detail the audit procedures that the auditor believes are necessary to accomplish the objectives of the examination. It would also require the auditor to obtain a knowledge of matters that relate to the nature of the entity's business, its organization, and its operating characteristics, and to consider matters affecting the industry in which the entity operates.

Comments and suggestions on any aspect of the enclosed draft are sought and will be appreciated. They should be addressed to the Auditing Standards Division, File Ref. No. 4351, at the AICPA in time to be received by November 30, 1977. The Auditing Standards Executive Committee will be particularly interested in the reasoning underlying comments and suggestions.

Sincerely,



Philip B. Chenok, Chairman  
Auditing Standards Division



Thomas P. Kelley, Director  
Auditing Standards Division

## PROPOSED STATEMENT ON AUDITING STANDARDS

### PLANNING AND SUPERVISION

1. The first standard of field work requires that "the work is to be adequately planned and assistants, if any, are to be properly supervised." This Statement provides guidance to the independent auditor making an examination in accordance with generally accepted auditing standards on the considerations and procedures applicable to planning and supervision, including preparing audit programs, obtaining knowledge of the entity's business, and dealing with differences of opinion among firm personnel. Planning and supervision continue throughout the examination, and the related procedures frequently overlap.

2. The auditor with final responsibility for the examination may delegate portions of the planning and supervision of the examination to other firm personnel who, for purposes of this Statement, are referred to as *assistants*.

#### **Planning**

3. Audit planning involves developing an overall strategy for the expected conduct and scope of the examination. The nature, extent, and timing of planning vary with the size and complexity of the entity, the auditor's experience with the entity, and his knowledge of the entity's business. In planning the examination, the auditor should consider:

- a. Matters relating to the entity's business and the industry in which it operates (see paragraph 7).
- b. The entity's accounting policies and procedures.
- c. Anticipated reliance on internal accounting controls.
- d. Preliminary estimates of ma-

teriality levels for audit purposes.

- e. Financial statement items likely to require adjustment.
- f. Conditions that may require extension or modification of audit tests, such as the possibility of material errors or irregularities or the existence of related party transactions.
- g. The nature of reports the auditor is expected to render (for example, a report on consolidated or consolidating financial statements, reports on financial statements filed with the SEC, or special reports such as those on compliance with contractual provisions).

4. Procedures that an auditor may consider in planning the examination usually involve review of his records relating to the entity and discussion with assistants and personnel of the entity. Examples of those procedures include:

- a. Reviewing correspondence files, prior year's audit working papers, permanent files, financial statements, and auditor's reports.
- b. Discussion with firm personnel responsible for non-audit services to the entity concerning matters that may affect the examination.
- c. Inquiring about current business developments affecting the entity.
- d. Reading the current year's interim financial statements.
- e. Discussing the type, scope, and timing of the examination with management of the entity, the board of directors, or its audit committee.
- f. Considering the effects of ap-

plicable accounting and auditing pronouncements, particularly new ones.

- g. Coordinating the assistance of entity personnel in data preparation.
- h. Determining the extent of involvement, if any, of consultants, specialists, and internal auditors.
- i. Establishing the timing of the audit work.
- j. Establishing and coordinating staffing requirements.

The auditor may wish to prepare a memorandum setting forth the preliminary audit plan, particularly for large and complex entities.

5. In planning his examination, the auditor should consider the nature, extent, and timing of work to be performed and should prepare a written audit program(s). An audit program aids in instructing assistants in the work to be done and should set forth in reasonable detail the audit procedures that the auditor believes are necessary to accomplish the objectives of the examination. The form of the audit program and the extent of its detail will vary. In developing the program, the auditor should be guided by the results of his planning considerations and procedures. As the examination progresses, changed conditions may make it necessary to modify planned audit procedures.

6. The auditor should obtain a level of knowledge of the entity's business that will enable him to plan and perform his examination in accordance with generally accepted auditing standards. That level of knowledge should enable him to obtain an understanding of the events, transactions, and practices that, in his judgment, may

have a significant effect on the financial statements. The level of knowledge customarily possessed by management relating to managing the entity's business is substantially greater than that which is obtained by the auditor in performing his examination. Knowledge of the entity's business helps the auditor in:

- a. Identifying areas that may need special consideration.
- b. Assessing conditions under which accounting data are produced, processed, reviewed, and accumulated within the organization.
- c. Evaluating the reasonableness of estimates, such as valuation of inventories, depreciation, allowances for doubtful accounts, and percentage of completion of long-term contracts.
- d. Evaluating the reasonableness of management representations.
- e. Making judgments about the appropriateness of the accounting principles applied and the adequacy of disclosures.<sup>1</sup>

7. The auditor should obtain a knowledge of matters that relate to the nature of the entity's business, its organization, and its operating characteristics. Such matters include, for example, the type of business, types of products and services, capital structure, related parties, locations, and production, distribution, and compensation methods. The auditor should also

consider matters affecting the industry in which the entity operates, such as economic conditions, government regulations, and changes in technology, as they relate to his examination. Other matters, such as accounting practices common to the industry, competitive conditions, and, if available, financial trends and ratios should also be considered by the auditor.

8. Knowledge of an entity's business is ordinarily obtained through experience with the entity or its industry and inquiry of personnel of the entity. Audit working papers from prior years may contain useful information about the nature of the business, organizational structure, operating characteristics, and transactions that may require special consideration. Other sources an auditor may consult include AICPA accounting and audit guides, industry publications, financial statements of other entities in the industry, textbooks, periodicals, and individuals knowledgeable about the industry.

#### **Supervision**

9. Supervision involves directing the efforts of assistants who are involved in accomplishing the objectives of the examination and determining whether those objectives were accomplished. Elements of supervision include instructing assistants, keeping informed of significant problems encountered, reviewing the work performed, and dealing with differences of opinion among firm personnel. The extent of supervision appropriate in a given instance depends on many factors, including the complexity

of the subject matter and the qualifications of persons performing the work.

10. Assistants should be informed of their responsibilities and the objectives of the procedures that they are to perform. They should be informed of matters that may affect the nature, extent, and timing of procedures they are to perform, such as the nature of the entity's business as it relates to their assignments and possible accounting and auditing problems. The auditor with final responsibility for the examination should direct assistants to bring to his attention significant accounting and auditing questions raised during the examination so that he may assess their significance.

11. The work performed by each assistant should be reviewed to determine whether it was adequately performed and to evaluate whether the results are consistent with the conclusions to be presented in the auditor's report.

12. The auditor with final responsibility for the examination and assistants should be aware of the procedures to be followed when differences of opinion concerning accounting and auditing issues exist among firm personnel involved in the examination. Such procedures should enable an assistant to document his disagreement with the conclusions reached if, after appropriate consultation, he believes it necessary to disassociate himself from the resolution of the matter. In this situation, the basis for the final resolution should also be documented.

<sup>1</sup> See SAS No. 5, paragraphs 4 and 9.