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## AICPA audit and accounting manual : nonauthoritative technical practice aids, as of June 1, 1980

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# AICPA AUDIT AND ACCOUNTING MANUAL

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Nonauthoritative  
Technical Practice Aids

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AS OF JUNE 1, 1980

AICPA AUDIT AND ACCOUNTING MANUAL

6/1/80

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

# **AICPA**

## **AUDIT AND**

### **ACCOUNTING MANUAL**

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Nonauthoritative  
Technical Practice Aids

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AS OF JUNE 1, 1980

*Published for the*  
American Institute of  
Certified Public Accountants  
*by*

COMMERCE CLEARING HOUSE, INC.  
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## PREFACE

The AICPA has been working diligently, especially in the last few years, on projects that are of special importance to the local practitioner. The project on GAAP for smaller and closely-held businesses, which resulted in the FASB exempting nonpublic companies from reporting earnings-per-share and segment information, the issuance of a new statement on compilation and review services, and the activities of the private companies practice section are only a few examples of those projects.

However, local practitioners have frequently told us that their greatest need is for an audit and accounting manual and that the AICPA should give publication of a manual the highest priority. This need has been expressed most often in the last year or two as more and more practitioners began the process of documenting their quality control policies and procedures.

This audit and accounting manual, which is a nonauthoritative kit of practice aids developed solely by AICPA staff, is intended to meet that need. I hope practitioners will find it a worthwhile addition to their technical libraries and a helpful tool in the conduct of their practices.

The staff intends to add to and revise the manual as appropriate. For example, the staff plans to develop additional illustrations of flowcharting techniques, internal control questions and financial statement presentations, including illustrative notes. Perhaps practitioners will feel it should include material related to computer auditing, statistical sampling, or first-time audits. We will be able to make the manual more useful if practitioners provide us with their suggestions—including illustrations from their practices—for material that should be improved or added.

Wallace E. Olson  
President

July, 1979

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# HOW TO USE THIS VOLUME

## Scope of the Volume...

This Volume, which is a reprint of the looseleaf edition, brings together for continuing reference a set of nonauthoritative audit tools and illustrations prepared by the staff of the Technical Information Division of the American Institute of Certified Public Accountants.

## How This Volume Is Arranged...

The contents of this Volume are arranged as follows:

Introduction

Engagement Planning and Administration

Internal Control

Audit Approach and Programs

Working Papers

Correspondence, Confirmations & Representations

Disclosure Checklists

Review and Report Processing

Accountants' Reports

Financial Statements

## How to Use This Volume...

The arrangement of material is indicated in the general table of contents at the front of the Volume. There is a detailed table of contents covering the material within each major division.

The major divisions are subdivided into sections, each with its own section number. Each paragraph within a section is decimally numbered. For example, AAM section 7100.01 refers to the first paragraph of section 7100, *Control of Confirmations and Correspondence*. Section and paragraph numbers located on each page are provided as corner references at the bottom of each page.

The Appendixes provide cross references from pronouncements of the American Institute of Certified Public Accountants and the Financial Accounting Standards Board to sections in the text.



## AAM Section 1000

# INTRODUCTION

This manual has not been approved, disapproved, or otherwise acted upon by any senior technical committees of the American Institute of Certified Public Accountants or the Financial Accounting Standards Board and has no official or authoritative status.

.01 This manual has been prepared by the staff of the American Institute of Certified Public Accountants and issued as a nonauthoritative kit of practice aids. The materials included in it are designed to serve as working tools and illustrations for timesaving purposes. They are not intended as a substitute for the professional judgments which must be applied by practitioners in any engagement. The manual, where practicable, offers choices and alternatives rather than particular positions. The manual is not a substitute for authoritative technical literature and users are urged to refer directly to applicable authoritative pronouncements for the text of technical standards.

.02 Some sections of the manual include quotations from Statements on Auditing Standards and other authoritative pronouncements. Those quotations are intended only to illustrate certain matters, not to serve as a substitute for careful study of the relevant pronouncements. References are made throughout the manual to the original authoritative pronouncements and to their section numbers in *AICPA Professional Standards* to help users locate those authoritative pronouncements.

.03 The authors hope that the manual will be helpful to local firms and practitioners in the conduct of their audit and accounting practice. However, no generalized material, such as that included in this manual, can be a substitute for development and implementation by a firm of a system of quality control which is appropriately comprehensive and suitably designed in relation to the firm's organizational structure, its policies, and the nature of its practice.

.04 The manual is in looseleaf format in anticipation of updating and expansion. Changes are expected to arise from three main sources:

- (1) Comments and suggestions from practitioners. Since this manual is a product of AICPA staff, not of a committee of practi-

tioners, it is particularly important that practitioners advise the staff of any suggestions for material that could be improved or added.

- (2) Issuance of new official pronouncements.
- (3) Other additions to or deletions from the manual as a result of continued staff study.

Comments and suggestions should be addressed to:

Technical Information Division  
AICPA  
1211 Avenue of the Americas  
New York, NY 10036

.05 The authors wish to acknowledge the contributions of Dennis Alfredo, Mary Greenstein, Richard Pannell, Richard Rikert and Jack Shohet of the technical information division, and the secretarial services of Gail Shoffner and Carolyn Piccoli.

George R. Dick, Director, Technical Information Division  
Morris W. Wishnack, Manager, Technical Information Division

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Thomas P. Kelley, Managing Director—Technical

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## AAM Section 3000

# ENGAGEMENT PLANNING AND ADMINISTRATION

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This manual is a nonauthoritative kit of practice aids and accordingly, does not include extensive explanation or discussion of authoritative pronouncements. Users of this manual are urged to refer directly to applicable authoritative pronouncements when appropriate.

The samples are for illustrative purposes only. They are included as conveniences for users of this manual who may want points of departure when drafting engagement letters to meet their individual needs.

Much of the material in this section has been extracted from the MAP Handbook and has been edited for this manual. Information with respect to compilation and review engagements has been taken from Statement on Standards for Accounting and Review Services No. 1.

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»»»→ *The next page is 3101.* ←«««

## AAM Section 3100

### *Planning the Engagement*

.01 An important part of every engagement is the planning stage. It is during this phase of the engagement that the partner and the staff obtain (or renew) the necessary level of knowledge of the client's business and the industry in which it operates and develop an overall strategy for the expected conduct and scope of the engagement. Although it is not required by authoritative auditing literature, an engagement letter—discussed in the next section—makes good business sense. It should be prepared before any significant work is undertaken on the engagement.

.02 The need for planning is highlighted by item C, Rule 201, General Standards, AICPA Code of Professional Ethics, which states that:

A member shall adequately plan and supervise an engagement.

.03 Planning is also addressed in the first standard of field work of Generally Accepted Auditing Standards; SAS No. 22, "Planning and Supervision" (AU section 311), provides authoritative interpretive guidance on the first standard of field work.

.04 Aside from the requirements in authoritative literature, proper planning makes good business sense.

.05 Two common planning vehicles are the planning memo and the planning checklist. The style and complexity of these documents will depend on firm preference and engagement needs. The same memo or checklist may be used in the review process to ensure that the items highlighted in the planning phase are given adequate attention during the audit engagement.

.06 The following list of topics to consider in planning an audit engagement is taken from SAS No. 22:

- Matters relating to the entity's business and the industry in which it operates, such as type of business, types of products and services, capital structure, related parties, locations and production, distribution and compensation methods. Also, economic conditions, government regulations, changes in technology, accounting practices common to the industry, competitive conditions, and, if available, financial trends and ratios should be considered.

- The entity's accounting policies and procedures.
- Anticipated reliance on internal accounting control.
- Preliminary estimates of materiality levels for audit purposes.
- Financial statement items likely to require adjustment.
- 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.
- The nature of reports expected to be rendered.

.07 SAS No. 22 notes that "Procedures that an auditor may consider in planning his examination usually involve review of his records relating to the entity and discussion with other firm personnel and personnel of the entity." It provides the following examples of those procedures:

- Reviewing correspondence files, prior year's audit working papers, permanent files, financial statements, and auditor's reports.
- Discussing matters that may affect the examination with firm personnel responsible for non-audit services to the entity.
- Inquiring about current business developments affecting the entity.
- Reading the current year's interim financial statements.
- Discussing the type, scope, and timing of the examination with management of the entity, the board of directors, or its audit committee.
- Considering the effects of applicable accounting and auditing pronouncements, particularly new ones.
- Coordinating the assistance of entity personnel in data preparation.
- Determining the extent of involvement, if any, of consultants, specialists, and internal auditors.
- Establishing the timing of the audit work.
- Establishing and coordinating staffing requirements.

.08 SAS No. 22 requires the preparation of a written audit program as part of the planning process. Section 5000 of this manual discusses audit programs.

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➤➤➤ *The next page is 3201.* ←➤➤➤



## AAM Section 3200

### *Preparing an Engagement Letter*

.01 In an engagement letter, the firm and the client indicate their mutual understanding and agree to the nature and terms of the engagement. Engagement letters are not a professional requirement, but a matter of sound business practice. They cover the scope of services rendered and the responsibility the firm assumes. Therefore, they should be prepared with the care exercised in entering into other contracts.<sup>1</sup>

.02 Any limitations the client imposes on the scope of the audit are specifically stated. Every letter covering audit, compilation and review, or accounting services should point out the limitations in the accountant's responsibility for the discovery of fraud and other irregularities.

.03 The engagement letter should also describe the terms of billing and payment. If unusual or extraordinary services are to be performed, the engagement letter should completely describe them.

.04 If the auditor has reason to believe the client may publish all or a portion of an audit report, he should advise the client (preferably in the engagement letter) that firm policy is to read printer's proofs of the report and any other accompanying material. This precaution will protect both the client and CPA against condensation of financial statements, omission of footnotes, erroneous layout, or other errors such as misstatement of figures used in a president's letter, other narrative or statistics.

.05 *An engagement letter should be used for every engagement.* A letter need not be issued more often than annually. Thus, interim audits or unaudited financial statement preparation can all be provided for in one annual letter. The letter should be sent to the client in duplicate so he may sign a copy and return it for the CPA's files. Alternatively, the CPA may decide not to request that the client sign and return a copy of the letter. In that case, the letter should be sent to the client with an additional paragraph stating that, unless the client replies to the contrary, the CPA will assume the client agrees to the arrangements described in the letter. In those rare instances when the CPA decides that even this approach is not suitable, an engagement memorandum should be prepared for the file. This should

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<sup>1</sup> Paragraph 8 of SSARS No. 1 states that "The accountant should establish an understanding with the entity, preferably in writing, regarding the services to be performed."

provide all relevant information which would have been included in an engagement letter.

.06

### Reasons for Engagement Letters

1. *Avoid misunderstanding with the client.* In today's environment, an engagement letter is needed for both old and new clients. To avoid misunderstanding, the engagement letter describes in detail the services to be rendered, the fee, and other terms and conditions of the engagement. Oral agreements may result in differences of recollection or understanding between the CPA and the client. They become completely valueless on the death of either.
2. *Avoid misunderstandings with the staff.* The members of the staff working on the engagement must have a complete understanding of what is required of them. A copy of the engagement letter in the working papers provides them an authoritative reference to supplement their oral instructions. This will eliminate confusion and misunderstanding as to the type of engagement to be performed, the date and period covered by the financial statements, and the nature of the report expected to be rendered.
3. *Legal liability.* The engagement letter should establish the scope and the nature of the accountant's contractual obligation to his client by setting forth, clearly and specifically, the duties the accountant has agreed to perform. Many adverse consequences may result from failing to obtain a written engagement letter.
4. *Practice management.* Generally, the executive (managing) partner would review an engagement letter before the firm issues it. A timely review may be the vehicle that permits the executive partner to correct or amend the terms of the engagement, review the proposed fee and method of payment, and set up guidelines to minimize possible collection problems.
5. *Contractual obligation.* Engagement letters recognize that a contract is created when the accountant agrees to render services and a client agrees to pay for them. The engagement letter should be clear-cut in delineating the duties and responsibilities of the client and of the firm.
6. *Other.* An engagement letter permits the orderly assessment and review by partners and staff of the services performed and the terms of the engagement. This review facilitates drafting extensions or amendments to current or succeeding years' engagements.

.07 Some firms use one engagement letter to cover several types of services; others use separate engagement letters for each service rendered. In any case, firms should consider keeping separate internal records for time incurred on the separate types of services.

.08

### **Special Considerations**

1. Type of engagement (audit, compilation or review, or other accounting service).
2. Do the circumstances preclude an unqualified opinion? Examples:
  - a. The auditor is retained after the beginning of the client's fiscal year and did not observe inventories or confirm receivables at the beginning of the year and was unable to satisfy self through application of alternative procedures.
  - b. The client imposes restrictions on the scope of the audit and anticipated effect on the report. (SAS No. 2, paragraph 12; AU section 509.12)
  - c. Significant litigation or other matters exist which may affect the opinion.
3. Should fee be stated as a range, in hourly rates, as standard per diem charges for the engagement, or (in unusual cases) as a maximum or flat fee?
4. To whom should reports be addressed?
5. How many copies of the report and to whom distributable?
6. Deadlines for reports or analyses.
7. Out-of-pocket costs.
8. Additional work not contemplated in original engagement.
9. Condition of records or circumstances other than those contemplated in engagement letter (e. g., deficient internal control, etc.).
10. Retainer.
11. One-time engagements.
12. Start-up costs when client changes accountants.
13. Underwriters' requirements in connection with public offerings.
14. Long-time clients who have not previously been requested to approve engagement letters.
15. Part of work to be done by other accountants.

.09

## Checklists for Engagement Letters

1. *Items ordinarily covered in engagement letters:*
  - a. Name of entity (and subsidiaries, if any) and its year end.
  - b. Statement(s) to be examined, compiled, or reviewed.
  - c. Scope of services, as detailed as necessary—include limitations imposed by client.
  - d. Type of opinion, disclaimer or other report to be rendered.
  - e. Disclaimer of responsibility for detecting fraud.
  - f. Obligations of the client's staff to prepare schedules and statements (see checklist 2, below).
  - g. Requirement that accountant read all printed material in which his report appears.
  - h. Responsibility for preparation or review of tax returns and subsequent tax examinations.
  - i. Fee or method of determining fee (see section 3300).
  - j. Frequency of billing and client's obligations for payment, including retainer if applicable.
  - k. Provision for client's acceptance signature and date.
  - l. Expression of thanks for being selected as auditors or to perform other services.
  - m. In new engagements, the client should take the responsibility for getting the cooperation of the prior accountant.
2. *Preparation work to be performed by client's staff.* The following is a checklist of instructions to a client's accounting staff. It includes analyses a CPA may expect them to prepare for his examination. Either include this list (or part of it) in the engagement letter, or refer to it and then submit it as a separate memorandum.
  - Balance the general ledger.
  - Prepare a reconciliation for each bank account.
  - Fill in and sign bank confirmation forms, to be provided by the CPA.
  - Prepare a trade accounts receivable aging.
  - Prepare accounts receivable confirmation letters, using drafts to be provided by the CPA.
  - Prepare a schedule of accounts receivable from officers and employees.
  - Prepare a schedule of bad debts written off during the year.

- Prepare a schedule of notes receivable. The notes should be available for inspection.
  - Prepare a schedule of transactions with affiliated enterprises.
  - Price, extend, and foot the original inventory sheets, and have them available.
  - Analyze all transactions affecting marketable securities.
  - Prepare an insurance schedule. The policies should be available for inspection.
  - Prepare a schedule of property and equipment additions and retirements.
  - Prepare a depreciation schedule.
  - Prepare a schedule of life insurance for officers.
  - Prepare a schedule of accounts payable. The creditor's regular monthly statements for (*date*) should be retained and made available.
  - Prepare a schedule of notes payable.
  - The corporate stock book and minutes should be up to date and available for inspection.
  - Prepare a schedule of all transactions to partners' capital and drawing accounts.
  - A copy of the partnership agreement or corporate charter should be available for inspection.
  - Copies of all leases, including equipment rental contracts, should be available for inspection.
  - Copies of employment contracts with salesmen or executives should be available for inspection.
  - Copies of pension, profit-sharing, deferred compensation, and stock option agreements, and letters of acceptance from the Treasury Department should be available for inspection.
  - Prepare a schedule of repairs in excess of \$.....
  - Prepare a schedule of each officer's salary and expense account payments.
  - Prepare a schedule of contributions.
  - Prepare a schedule of tax expense.
  - Prepare a schedule of professional fees.
3. *Optional inclusions in engagement letter*
- a. Description of particular audit procedure, if requested by client or deemed necessary for protection of the auditor (the detailed audit program should not be made available to client personnel, orally or otherwise).
  - b. Extent and timing of interim auditing.

- c. Name of client's personnel to be contacted during engagement.
  - d. Review of internal control and report thereon (this would be a special engagement, not a part of the normal audit routine).
  - e. Interim contact and cooperation with internal auditor.
  - f. List of services specifically excluded.
4. *Common engagement letter deficiencies*
- a. Reference in the letter to examination of the books and records rather than the examination of financial statements.
  - b. Adverse comments about other firms.
  - c. Failure to specify *in detail* the services to be rendered when a maximum fee is quoted.
  - d. Inclusion of a review of internal control as one of the services when what is really intended is the study and evaluation of internal accounting control as required by auditing standards.
  - e. Failure to identify accounting or other problems which may have an effect on the opinion.
  - f. Failure to change, in writing, the terms of the engagement when conditions are found to be different (such as the inability to express an opinion without extensive additional auditing because internal accounting control was found to be deficient).
  - g. Failure to include fee basis and payment terms.
  - h. Failure to identify subsidiaries.
  - i. Failure to identify specific tax returns to be prepared.

### **Client Approval**

.10 It is recommended that the client's written approval of general arrangements for the engagement be secured by the accountant before proceeding with the engagement (especially in new engagements). The addressee of the letter is usually the one asked to approve the engagement. In some situations, the accountant may not feel it advisable to send a client an engagement letter which requests his signature. An alternative approach might be to send the client a letter confirming the terms of the engagement, without asking him to sign it, but asking him to reply if he does *not* agree with the terms.

### **Addressee of Letter**

.11 Ordinarily, the accountant should address the letter to whomever retained the firm. If it is a corporate client's board of directors,

the letter should be addressed to the board, its chairperson, or the chief executive, depending on the arrangement. If the CPA is appointed by an audit committee, it is appropriate to address the letter to the committee chairperson. If the engagement was arranged with a corporate official, the letter may be addressed to him, personally, indicating his title, followed by the name of the corporation.

### **Investigatory Procedures for Individuals**

.12 When credit information is requested about individuals who are new clients, the investigative procedures are subject to the Fair Credit Reporting Act of 1971.

.13 An individual should be informed in writing that an investigative consumer report, including information as to his character, general reputation, personal characteristics and mode of living, is being made. The individual should also be advised, within three days of the time the report is requested, that he may within a reasonable period of time, by written request, be furnished disclosure of the nature and the scope of the investigation.<sup>2</sup>

### **Filing of Engagement Letters**

.14 The signed engagement letter (or original of the confirming letter) is a contract and should be filed in the client's permanent file. A copy may also be filed with the current working papers, if desired, because of the possible overlapping of billing and collecting as compared to the term of the actual engagement. This also permits easy access when reference to the previous year's letter is needed to prepare the letter for the following year's engagement.

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➤→ *The next page is 3301.* ←➤

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<sup>2</sup> For a more complete discussion, see Carlos Martinez, "A Guide to the Fair Credit Reporting Act," *The Practical Lawyer*, December 1972.





## AAM Section 3300

### *Sample Engagement Letters*

.01 Following are illustrative engagement letters (and one engagement memorandum). They may be used as guides in the design of specific letters, tailored to satisfy the terms of a particular engagement.

#### **.02 Audit Engagement Leading to Opinion**

SWIFT, MARCH & COMPANY            Certified Public Accountants

(Date)

Mr. Thomas Thorp, President  
Anonymous Company, Inc.  
Route 32  
Nowhere, New York 10000

Dear Mr. Thorp:

This will confirm our understanding of the arrangements for our examination of the financial statements of Anonymous Company, Inc., for the year ending (Date).

We will examine the Company's balance sheet at (Date), and the related statements of income, retained earnings, and changes in financial position for the year then ended, for the purpose of expressing an opinion on them. Our examination will be made in accordance with generally accepted auditing standards and, accordingly, will include such tests of the accounting records and such other auditing procedures as we consider necessary in the circumstances.

Our procedures will include tests (by statistical sampling, if feasible) of documentary evidence supporting the transactions recorded in the accounts, tests of the physical existence of inventories, and direct confirmation of receivables and certain other assets and liabilities by correspondence with selected customers, creditors, legal counsel, and banks. At the conclusion of our examination, we will request certain written representations from you about the financial statements and matters related thereto.

Our engagement is subject to the inherent risk that material errors, irregularities, or illegal acts, including fraud or defalcations, if they exist, will not be detected. However, we will inform you of any such matters that come to our attention.

We will review the Company's federal and state [identify states] income tax returns for the fiscal year ended (Date). These returns, we understand, will be prepared by the controller.

Further, we will be available during the year to consult with you on the tax effects of any proposed transactions or contemplated changes in business policies.

Our fee for these services will be at our regular per diem rates, plus travel and other out-of-pocket costs. Invoices will be rendered every two weeks and are payable on presentation.

We are pleased to have this opportunity to serve you.

If this letter correctly expresses your understanding, please sign the enclosed copy where indicated and return it to us.\*

Very truly yours,

SWIFT, MARCH & COMPANY

.....

Partner

APPROVED:

By .....

Date .....

\*Some accountants prefer not to obtain an acknowledgement, in which case their letter would omit the paragraph beginning "If this letter . . ." and the spaces for the acknowledgment. The first paragraph of their letter might begin as follows: "This letter sets forth our understanding of the terms and objectives of our engagement . . ."

**.03 Audit Engagement Leading to Opinion (Including Financial Information for Form 10-K)**

SWIFT, MARCH &amp; COMPANY Certified Public Accountants

(Date)

Mr. Frederick Mead, President  
Thor Tool Co., Inc.  
473 Canyon Road  
Noplace, NJ 07000

Dear Mr. Mead:

This letter confirms our arrangements with Thor Tool Co., Inc. for the year ended (Date).

We will examine the Corporation's balance sheet as of (Date), and the related statements of income, retained earnings, and changes in financial position for the year then ended. Our examination will be made in accordance with generally accepted auditing standards and, accordingly, will include such tests of the accounting records and such other auditing procedures as we consider necessary in the circumstances.

Our procedures will include tests (by statistical sampling, if feasible) of documentary evidence supporting the transactions recorded in the accounts, tests of the physical existence of inventories, and direct confirmation of receivables and certain other assets and liabilities by correspondence with selected customers, creditors, legal counsel, and banks. At the conclusion of our examination, we will request certain written representations from you about the financial statements and matters related thereto.

Your accounting department personnel will prepare the necessary detailed trial balance and supporting schedules. We will assemble and examine the financial information required for Form 10-K and for the annual report to stockholders. Both must be submitted to us for approval before publication.

Our engagement is subject to the inherent risk that material errors, irregularities, or illegal acts, including fraud or defalcations, if they exist, will not be detected. However, we will inform you of any such matters that come to our attention.

Fees for these services will be at our standard per diem rates. Invoices, including out-of-pocket expenses, will be submitted every

two weeks as the work progresses, and are payable on presentation. We estimate that our fee for this engagement will be between \$10,000 and \$12,000. Should any situation arise that would materially increase this estimate, we will, of course, advise you.

Please indicate your agreement to these arrangements by signing the attached copy of this letter and returning it to us.\*

Sincerely,

SWIFT, MARCH & COMPANY

.....

Partner

APPROVED:

By .....

Date .....

---

\*Some accountants prefer not to obtain an acknowledgment, in which case their letter would omit the paragraph beginning "Please indicate your . . ." and the spaces for the acknowledgment. The first paragraph of their letter might begin as follows: "This letter sets forth our understanding of the terms and objectives of our engagement . . ."

**.04 Change in Circumstances from Those Contemplated in Original Engagement Letter**

SWIFT, MARCH & COMPANY Certified Public Accountants

(Date)

Mr. James Johnson, Treasurer  
Birdie Country Club  
64 Eagle Road  
Noplace, New York 10000

Dear Mr. Johnson :

As we agreed in our original engagement letter dated (Date) we are notifying you that our examination of your (Date) financial statements requires additional procedures.

We have found that certain guest checks are held for only three months after they are paid. Thus, a substantial number of guest checks are not available for examination. Fortunately, your system of internal control allows us to use alternative procedures to satisfy ourselves on this part of the examination. However, this will require substantially more time than examining guest checks.

The fee for these additional services will be billed at our standard per diem rates and added to the \$5,000 fee quoted in our previous letter.

The problem has been discussed with your controller, who assured us that in the future all guest checks will be kept for two years. Please indicate your acceptance of these added terms by signing the copy of this letter and returning it to us.\*

Very truly yours,

SWIFT, MARCH & COMPANY

.....  
Partner

APPROVED:

By .....

Date .....

---

\* Some accountants prefer not to obtain an acknowledgment, in which case their letter would omit the paragraph beginning "Please indicate your . . ." and the spaces for the acknowledgment. The first paragraph of their letter might begin as follows: "This letter sets forth our understanding of the terms and objectives of our engagement . . ."

**.05 Conditions Encountered Which Do Not Permit Expression of Opinion as Anticipated in Original Engagement Letter**

SWIFT, MARCH & COMPANY      Certified Public Accountants  
(Date)

Ms. Helene Brown, President  
ZYX, Inc.  
1234 West Street  
Noplace, New York 10000

Dear Ms. Brown:

Our March 15, 197X letter described our present engagement as an examination for the purpose of expressing an opinion on the company's (Date) financial statements. This letter is to inform you that because of the circumstances described below, we will be required to qualify our opinion on these statements.

As you know, the Internal Revenue Service has proposed total income tax assessments of approximately \$180,000 for the three fiscal years ended (Date). Your tax counsel has advised us that although you have a defensible position and will protest the assessments, counsel cannot offer an opinion as to your ultimate liability. No provision for this assessment or any portion of it is included in your (Date) financial statements, nor do you feel any is necessary. You agreed, however, that the proposed assessment and its present status will be disclosed in the notes to the financial statements.

Because of the uncertainty as to your ultimate liability, we will be unable to express an unqualified opinion. Our report will state that the financial statements are subject to the effects of such adjustments, if any, as might have been required had the outcome of this income tax matter been known.

You and your tax counsel have advised that you will inform us of any new developments in the proposed assessment before our report is issued so that we may consider their effect on your financial statements and on our report.

Very truly yours,  
SWIFT, MARCH & COMPANY

.....  
Partner

**NOTE:** The client is not asked to sign this letter. Its purpose is to inform him of the altered circumstances and the effect on the opinion. There is no change in the terms of the engagement. However, it might be desirable to have the client acknowledge receipt of this letter by signing a copy and returning it where—for example—it is a problem client, or when there has been a history of misunderstandings.

**.06 SEC Engagement: Initial Registration, Form S-1**

SWIFT, MARCH &amp; COMPANY Certified Public Accountants

(Date)

Mr. John James, President  
Odin Company, Inc.  
3 Bay Drive  
La Mancha, California 99999

Dear Mr. James:

This letter confirms the arrangements for our services for the registration statement Odin Company will file with the Securities and Exchange Commission.

We will examine the consolidated balance sheet of Odin Company, Inc., as at December 31, 197X, and the related statements of income, retained earnings, and changes in financial position for the three years then ended, which will be included in a Form S-1 registration statement. Our examination will be made in accordance with generally accepted auditing standards and, accordingly, will include such tests of the accounting records and such other auditing procedures as we consider necessary in the circumstances. We will assemble and examine all of the financial information necessary for the S-X schedules in the registration statement.

We will perform these services as expeditiously as possible. Your accounting personnel will assist us and cooperate in the timely preparation of trial balances, schedules and account analyses, and provide clerical assistance as needed. Mr. John Brown of the law firm of Green & Brown will be liaison with counsel.

If during our engagement we find that we are unable to express an unqualified opinion on the financial statements or that we are otherwise unable to comply with the requirements of Form S-1, we will notify you of the problems encountered.

We will also fulfill the portion of the underwriter's agreement directed to the independent accountants, provided the requirements are within the purview of Statement on Auditing Standards No. 1, section 630 (Letters for Underwriters), issued by the American Institute of Certified Public Accountants, and provided the material can properly be reported on by accountants pursuant to that Statement. In this regard, we require that a copy of the tentative underwriting contract be given us as soon as it is available. Should that portion of the underwriting contract that deals with the details of the comfort letter be available before the balance of the underwriting contract is completely drafted, you will arrange for us to receive a copy of it.

Our engagement is subject to the inherent risk that material errors, irregularities, or illegal acts, including fraud or defalcations, if they exist, will not be detected. However, we will inform you of any such matters that come to our attention.

It is our policy that all printer's proofs of reports to be filed with the Securities and Exchange Commission be submitted to us for approval. This requirement extends to the entire registration statement and all other material which accompanies the financial statements.

Our fee for services will be computed at our standard per diem rates, and will be billed to you, together with out-of-pocket costs, every two weeks. Invoices are due and payable on presentation. Before our services begin, you have agreed to pay us a \$15,000 retainer, which will be applied to the final billing for this engagement.

We appreciate your confidence in our firm by retaining us as your independent certified public accountants.

If this letter correctly expresses your understanding, please sign the enclosed copy where indicated and return it to us, together with your check for \$15,000.

Sincerely,

SWIFT, MARCH & COMPANY

.....

Partner

APPROVED:

By .....

Date .....



**.07 Compilation of Financial Statements and Tax Services**

SWIFT, MARCH &amp; COMPANY Certified Public Accountants

(Date)

Mr. Tom Jones, President  
ZYXWV Freight Corporation  
648 Crystal Lane  
Noplace, Anystate 00000

Dear Mr. Jones:

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following services:

1. We will compile, from information you provide, the annual and interim balance sheets and related statements of income, retained earnings, and changes in financial position of ZYXWV Freight Corporation for the year 19XX. We will not audit or review such financial statements. Our report on the annual financial statements of ZYXWV Freight Corporation is presently expected to read as follows:

The accompanying balance sheet of ZYXWV Freight Corporation as of December 31, 19XX, and the related statements of income, retained earnings, and changes in financial position for the year then ended have been compiled by us.

A compilation is limited to presenting in the form of financial statements information that is the representation of management. We have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

Our report on your interim financial statements, which statements will omit substantially all disclosures, will include an additional paragraph that will read as follows:

Management has elected to omit substantially all of the disclosures required by generally accepted accounting principles. If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about

the company's financial position, results of operations, and changes in financial position. Accordingly, these financial statements are not designed for those who are not informed about such matters.

If, for any reason, we are unable to complete the compilation of your financial statements, we will not issue a report on such statements as a result of this engagement.

- 2. We will assist your bookkeeper in adjusting the books of account so that he will be able to prepare a working trial balance from which financial statements can be compiled. Your bookkeeper will provide us with a detailed trial balance and any supporting schedules we require.
- 3. We will also prepare the federal and state [identify states] income tax returns for ZYXWV Freight Corporation for the fiscal year ended December 31, 19XX.

Our engagement cannot be relied upon to disclose errors, irregularities, or illegal acts, including fraud or defalcations, that may exist. However, we will inform you of any such matters that come to our attention.

Our fees for these services . . . .

We shall be pleased to discuss this letter with you at any time.

If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.\*

Sincerely yours,

.....  
Swift, March & Company

Acknowledge:  
ZYXWV Freight Corporation

.....  
President

.....  
Date

---

\* Some accountants prefer not to obtain an acknowledgment, in which case their letter would omit the paragraph beginning "If the foregoing . . ." and the spaces for the acknowledgment. The first paragraph of their letter might begin as follows: "This letter sets forth our understanding of the terms and objectives of our engagement . . ."

**.08 Review of Financial Statements and Tax Services**

SWIFT, MARCH &amp; COMPANY

Certified Public Accountants

(Date)

Mr. Tom Jones, President  
ZYXWV Freight Corporation  
648 Crystal Lane  
Nowhere, Anystate 00000

Dear Mr. Jones:

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following services:

1. We will review the balance sheet of ZYXWV Freight Corporation as of (Date), and the related statements of income, retained earnings, and changes in financial position for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. We will not perform an audit of such financial statements, the objective of which is the expression of an opinion regarding the financial statements taken as a whole, and, accordingly, we will not express such an opinion on them. Our report on the financial statements is presently expected to read as follows:

We have reviewed the accompanying balance sheet of ZYXWV Freight Corporation as of (Date), and the related statements of income, retained earnings, and changes in financial position for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management of ZYXWV Freight Corporation.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

If, for any reason, we are unable to complete our review of your financial statements, we will not issue a report on such statements as a result of this engagement.

2. We will provide your chief accountant with such consultation on accounting matters as he may require in adjusting and closing the books of account and in drafting financial statements for our review. Your chief accountant also will provide us with a detailed trial balance and any supporting schedules we require.

3. We will also prepare the federal and state [identify states] income tax returns for ZYXWV Freight Corporation for the fiscal year ended (Date).

Our engagement cannot be relied upon to disclose errors, irregularities, or illegal acts, including fraud or defalcations, that may exist. However, we will inform you of any such matters that come to our attention.

Our fees for these services. . . .

We shall be pleased to discuss this letter with you at any time.

If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.\*

Sincerely yours,

.....  
(Signature of accountant)

Acknowledge:  
ZYXWV Freight Corporation

.....  
President

.....  
Date

---

\* Some accountants prefer not to obtain an acknowledgment, in which case their letter would omit the paragraph beginning "If the foregoing . . ." and the spaces for the acknowledgment. The first paragraph of their letter might begin as follows: "This letter sets forth our understanding of the terms and objectives of our engagement . . . ."

## .09 Sample Engagement Memorandum (When No Formal Engagement Letter Is Sent)

### Engagement Memorandum

(Date)

Client	ABC, Inc.
Address	711 Easy Street, La Mancha, Calif. 99999
Phone	QUincy 7-1234
Final arrangements made with	Oscar Brown, President
Date final arrangements made	February 15, 197X at a meeting in the ABC offices
Client's personnel responsible for accounting matters	Tom Smith, Treasurer Joe Green, Controller
Responsibilities of client's per- sonnel in preparation for en- gagement	Trial balance of G/L and completion of schedules, a list of which we will sub- mit two weeks before beginning of en- gagement
Reports to be addressed to Financial statements to be ex- amined	Board of Directors (twelve copies) Balance sheet at March 31, 197X and statements of income, retained earnings, shareholders' equity and changes in fi- nancial position for year ended March 31, 197X
Nature of engagement	Opinion audit and federal and state in- come tax returns for year ended March 31, 197X
Date audit to commence	Approximately April 24, 197X (check with controller about April 10)

Estimated time required	About three weeks
Staff requirements	Manager, supervisor, an in-charge senior, and two staff assistants
Billing arrangements	Every two weeks, at standard plus out-of-pocket costs; invoices to attention of Tom Smith; payable on presentation
Special accounting problems	Client was involved in a substantial sale and lease-back transaction during the year  Imputed interest may be required on long-term liabilities resulting from purchase of business
Other comments	Client is presently negotiating with machinists union

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➤➤➤ *The next page is 3401.* ←➤➤➤

## AAM Section 3400

### *New Client Reports*

.01 When an accounting firm obtains a new client, a responsibility is incurred to perform certain work within specific deadlines. To meet this obligation, it is important that the firm have standard procedures for recording facts about the engagement. The information that follows is extracted from the MAP Handbook. Firms may wish to insert here copies of their own procedures and forms.

.02 The first step is to prepare a New Client Report or Client Data Sheet (samples A, B, and C, paragraphs .05, .06, and .07, respectively). A new client report is prepared when (a) a new client is engaged (including a newly acquired or newly formed entity of an existing client); (b) an existing client is transferred from another office of the firm; and (c) a "one-time" client engages the firm to perform recurring services.

.03 The person responsible for the initial contact with the client usually prepares this form, and the partner having authority to accept new clients approves it. It is good either to circulate the report throughout the office or to inform those not familiar with the engagement of the name of the new client, the type of business, and the nature of the services to be rendered.

.04 A new client report should be prepared immediately upon receiving the signed acknowledgement copy of the proposal or engagement letter from the client. After the partner has approved the new client, the new client report can be used as the basis for preparing the client's master card, assignment of the client's number, changes in mailing and phone lists, staff assignment sheets, engagement ledgers, and other records. While some firms include a great amount of such detail in the new client report, many firms find it more practical to enter it on a Client Master Record (samples A, B, and C, paragraphs .05, .06, and .07, respectively) or on Operations Cards.

.05

New Client Report – Sample A

Office \_\_\_\_\_

Date \_\_\_\_\_

Fiscal year \_\_\_\_\_

Client's name \_\_\_\_\_

Address \_\_\_\_\_

Phone \_\_\_\_\_ Major contact at client \_\_\_\_\_ Title \_\_\_\_\_

Nature of business \_\_\_\_\_ S.I.C. code number\* \_\_\_\_\_

Latest year \_\_\_\_\_ Sales \_\_\_\_\_ Profits \_\_\_\_\_

Form of Organization:  Individual  Partnership  Corporation  Other—indicate \_\_\_\_\_

Publicly held:  no  yes—indicate:  O.T.C.;  N.Y.S.E.;  A.S.E.;  Other \_\_\_\_\_

a. Source of client:  Personal acquaintance of partner or staff member;  Client;  Attorney;

Bank;  Another office, new client;  Another office, existing client;  Other \_\_\_\_\_

b. Name of source \_\_\_\_\_

c. Name of partner or staff member responsible for source contact \_\_\_\_\_

d. Acknowledgment to source by \_\_\_\_\_

Partner in charge \_\_\_\_\_ Client code number \_\_\_\_\_

Nature of assignment and assignment code number:

Audit \_\_\_\_\_  Tax returns \_\_\_\_\_  MAS \_\_\_\_\_

Compilation of Financial Statements \_\_\_\_\_  Special tax \_\_\_\_\_  Monthly service \_\_\_\_\_

Review of Financial Statement \_\_\_\_\_

Estimated fees: a) Annual \_\_\_\_\_ b) Nonrecurring or special \_\_\_\_\_

Previous auditors \_\_\_\_\_

Reason for change (if known) \_\_\_\_\_

Attorney and law firm \_\_\_\_\_

Federal identification no. \_\_\_\_\_ State unemployment insurance no. \_\_\_\_\_ Sales tax registration no. \_\_\_\_\_

Comments re assignment, fees, audit, etc. \_\_\_\_\_

Related clients, parent, or affiliates \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

Approved \_\_\_\_\_ By \_\_\_\_\_

Managing Partner

Account Administrator

INSTRUCTIONS

1. This report should be prepared on all new clients.
2. This report should also be prepared when an existing client is transferred from one office of the firm to another.
3. Multiple copies of this report should be prepared and distributed as indicated at the top of each copy.
4. Estimated fees must be recorded.
5. The report must be approved by the managing partner.

\*Standard industrial classification code number



.06

New Client Report – Sample B

Date \_\_\_\_\_

1. Client \_\_\_\_\_ Account number \_\_\_\_\_

2. Address \_\_\_\_\_

3. Telephone number: Office \_\_\_\_\_ Home \_\_\_\_\_

4. Form of organization \_\_\_\_\_

5. Nature of business \_\_\_\_\_ S.I.C. code number\* \_\_\_\_\_

6. Names of key personnel and titles:  
 \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

7. Name of person authorizing engagement \_\_\_\_\_

8. Name of comptroller/bookkeeper \_\_\_\_\_

9. Client's attorney \_\_\_\_\_  
 Address \_\_\_\_\_

10. Person referring our firm \_\_\_\_\_  
 Was "Thank You" referral letter sent? Yes  No   
 If no, why? \_\_\_\_\_

11. Was engagement letter prepared: Yes  No   
 If no, state why \_\_\_\_\_  
 If yes, short description of work to be performed \_\_\_\_\_

12. Was method of billing and fee discussed? Yes  No   
 Estimated fee arrangements \_\_\_\_\_

13. Member(s) of firm discussing arrangements:  
 \_\_\_\_\_ Partner \_\_\_\_\_ Staff member (if appropriate)

\*Standard industrial classification code number

.07

New Client Report - Sample C - Designed as a Client Data Sheet

Prepared by \_\_\_\_\_ Date \_\_\_\_\_

**Client Information**

Type of entity \_\_\_\_\_  
Year end \_\_\_\_\_

Name \_\_\_\_\_  
Attention \_\_\_\_\_  
Address \_\_\_\_\_  
City, state \_\_\_\_\_  
Telephone \_\_\_\_\_  
ID no: Federal \_\_\_\_\_  
State \_\_\_\_\_  
City \_\_\_\_\_

Affiliated companies listed on reverse side  Yes  
Officers or principals:

Name	Title
_____	_____
_____	_____
_____	_____
_____	_____

Description of business \_\_\_\_\_

Attorney \_\_\_\_\_  
Bank \_\_\_\_\_  
Banker \_\_\_\_\_  
Insurance agent \_\_\_\_\_

**Work Required**

	<u>Time Period</u>			
	<u>M</u>	<u>Q</u>	<u>SA</u>	<u>A</u>
Compilation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Review	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Other Unaudited Services	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Audit	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Management Advisory Services	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Other	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	<u>Fed.</u>	<u>State</u>	<u>City</u>	<u>Other</u>
Income taxes	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Pension and profit-sharing	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Payroll taxes	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
W-2s and 1099s	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Franchise and annual report	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Estate and trust	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Other	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

**Follow-up Procedures**

Client number \_\_\_\_\_  
Person originating account \_\_\_\_\_  
Partner-in-charge \_\_\_\_\_

Referred by \_\_\_\_\_  
Previous accountant \_\_\_\_\_

Special fee arrangements (if any):- \_\_\_\_\_

Approximate annual fee \_\_\_\_\_  
Send thank you note \_\_\_\_\_  
Letter of understanding \_\_\_\_\_  
Engagement letter \_\_\_\_\_  
Standard industrial classification code no. \_\_\_\_\_

**Clerical and File Setup**

1. Assign client number
2. Prepare alphabetical and numeric rolodex cards
3. Enter client on client header sheet
4. Enter name on firm mailing list
5. Prepare tax engagement memo:  
Income  
Franchise  
Estate and trust  
Pension and profit-sharing  
Other
6. Prepare report engagement memo
7. Set up files
  - a. Tax wallet
  - b. Current year tax file
  - c. Prior year tax file
  - d. Workpaper wallet
  - e. Workpaper file
  - f. Permanent file
  - g. Correspondence file
  - h. Financial statement file
  - i. Miscellaneous tax file
  - j. Notebook
  - k. EDP binder
  - l. Payroll EDP binder
  - m. Other

Check	Initials	Date

»»»→ The next page is 3501. ←«««

## **AAM Section 3500**

### ***Client Master Records***

.01 While the new client report can be designed as a client data document, in most firms it is more frequently used only for new engagements as a document that initiates other records. Therefore, it is ordinarily supplemented by a Client Master Record (samples A, B, and C, paragraphs .05, .06, and .07, respectively) which is a permanent record of all the engagement data.

.02 The client master record can be used to help generate notices to other parts of the record system, such as telephone operators, mail departments, staff schedulers, and billing department, if the information is not picked up from the new client report.

.03 One of the problems most firms have with master records is keeping them up-to-date. Information must be updated; if it becomes obsolete, the control of accounts may break down. It is essential that responsibility be assigned for keeping the records for each client current. One way of accomplishing this is to furnish a photocopy of the record to the in-charge accountant for review during preliminary or year-end work. Follow-up is maintained to assure that the corrected photocopies are returned for posting in the master file. Some firms handled the problem by storing the master record information on computer tape so that mailing labels and other information lists can be produced automatically. Periodically, a printout is prepared to permit review and to correct obsolete information.

.04 All client master records should be filed in one place for easy reference.

.05

Client Master Record -- Sample A

Client number \_\_\_\_\_

Client's name \_\_\_\_\_  
 Address \_\_\_\_\_ Tel. \_\_\_\_\_  
 City \_\_\_\_\_ State \_\_\_\_\_ Zip \_\_\_\_\_

Corporation  Partnership   
 Individual  Fiduciary   
 Other \_\_\_\_\_  
 State of incorporation \_\_\_\_\_  
 Date org. or incorp. \_\_\_\_\_

Principals \_\_\_\_\_  
 \_\_\_\_\_ Mail reports to \_\_\_\_\_  
 Partner contact \_\_\_\_\_ Referred by \_\_\_\_\_  
 Related clients \_\_\_\_\_  
 Attorney \_\_\_\_\_  
 Banker \_\_\_\_\_  
 Type of business \_\_\_\_\_

Recurring Operations

Annual Audit

Compile Financial Statements

- Monthly
- Quarterly
- Yearly

Review Financial Statements

- Monthly
- Quarterly
- Yearly

Ending

Monthly work,  
no report

Other \_\_\_\_\_

- 1120     1065
- 1040     1040ES

Other \_\_\_\_\_

State tax returns and due dates

Special tax matters \_\_\_\_\_

Special reports \_\_\_\_\_

Nonrecurring  
Operations

Description

Date mailed

Description	Date mailed
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____

Remarks

	1	2	3	4	5	6	7	8	9	10	11	12	Year ends
_____													

.06 Client Master Record -- Sample B

Client no. \_\_\_\_\_ Client name: \_\_\_\_\_ Client address: \_\_\_\_\_  
 Policy held:  Yes  No  Underwriter  
 Stock exchanges \_\_\_\_\_

Bank name \_\_\_\_\_ Banker's name \_\_\_\_\_ Client no. \_\_\_\_\_ Law firm name \_\_\_\_\_ Lawyer's name \_\_\_\_\_  
 Principal client \_\_\_\_\_  
 Related client \_\_\_\_\_

S.	No.	Title	Name	Client													Mailing types					
				Salutation	1	2	3	4	5	6	7	8	9	10	11	12		13	14	15	16	Description
1		Chairperson of the Board																			1	Taxes general
2		President																			2	Taxes trusts
3		Executive																			3	Taxes corp
4		Chairperson of the Board																			4	Taxes partnership
5		Vice President																			5	Taxes individual
6		Vice President																			6	Auditing
7		Treasurer																			7	Accounting
8		Controller																			8	Management advisory service
9		Chief account.																			9	SEC bulletin
10		Auditor																			10	Foreign interests
11																					11	
12																					12	
13																					13	
14																					14	
15																					15	
16																					16	

Remarks:

\_\_\_\_\_  
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 \_\_\_\_\_  
 \_\_\_\_\_

Client Master Record -- Sample B (Continued)

Client no.	Principal • Client • Related	Type of Business	Fiscal Year	Recurrent Assignments	Form of Organization	Relationship to Principal	Tax Assignments			M.A.S. Assignments			Group Fees		Code No.				
							Contact Assignment Date	Partner	Date	Man.	Date	M. A. S. Man.	Year	Amount					
																1	Opinion	Subsidiary	Annual
																2	Review	Affiliate	Semi-annual
																3	Compilation	Division	Quarterly
																4	Write-up Work	Partner	Monthly
																5	1040	Officer	Weekly
																6	1041	Director	
																7	1065	Stockholder	
																8	1120	Employee	
																9	Other Fed Return	Parent	
																10	State Returns		
																11	Special Reports		

.07

Client Master Record – Sample C

Name \_\_\_\_\_  
Address \_\_\_\_\_ Tel. \_\_\_\_\_  
City \_\_\_\_\_ State \_\_\_\_\_ Zip Code \_\_\_\_\_  
Principals \_\_\_\_\_ Date of first service \_\_\_\_\_

Type of business \_\_\_\_\_ Mail reports to \_\_\_\_\_  
Corp. state \_\_\_\_\_ Date \_\_\_\_\_ Referred by \_\_\_\_\_  
Year ends \_\_\_\_\_ Related clients \_\_\_\_\_  
Type of work \_\_\_\_\_ Attorney \_\_\_\_\_

Yearly fee information summary \_\_\_\_\_

Date	Hours	Actual rate per hour	Fee only		Expense	Billing total
			Actual	Standard		

➡ The next page is 3601. ←





**AAM Section 3600*****Audit Assignment Controls***

.01 Effective control of an assignment requires preparing a time budget against which the actual time spent can be measured. The more detailed the budget, the easier it will be to identify segments of the assignment on which a disproportionate amount of time was spent.

.02 Time requirements should be estimated objectively on the basis of a review of the records being audited and a knowledge of the work involved. The resulting estimate should then be compared with the previous year's actual time spent; such a review might furnish clues to problem areas. Time budgets should not be prepared based solely on the prior year's experience without analysis, since a unique situation encountered in the previous year might make it an unrealistic basis for this year's estimate.

.03 Time budget forms differ depending upon firm preference and needs. Some firms use separate forms for the time budget report and the job progress report or analysis (Audit Time Budget—Sample A, paragraph .07) whereas others combine these reports into one form (Sample B, paragraph .08).

.04 Longer, more detailed sets of forms are sometimes used. These forms combine the features of a time budget, a source document for staff scheduling, and a job progress report that compares each assigned person's actual daily hours to the budget. Some firms use a shorter, less-detailed form for jobs of under a predetermined number of staff hours (for example, 100 hours) (Audit Time Analysis—Short Form, paragraph .09) and a longer form for jobs requiring more time (paragraph .10). Some firms use a Weekly (or daily) Progress Report (paragraph .11). This report, submitted weekly by the in-charge accountants, shows the time actually spent in relation to the estimate, the estimated additional time required, and the estimated variance from the original estimate. Some firms also use an Engagement Status Report (paragraph .12).

.05 When the combined time budget and progress report form is used, it must be kept current with the progress of the assignment. This form is carried in the working papers file and is filled in daily by the in-charge accountant for all persons applying time on the assignment. This procedure is vital to identify and control time as it is applied so that it can be compared to the budgeted time for that phase of the engagement.

.06 Irrespective of the type of form used, the prompt identification of actual time variances from the original time estimates is important so immediate corrective action can be initiated. In some cases, this may entail arranging with the client an additional fee for unforeseen work when the engagement was arranged; in other cases, alternative or more efficient procedures may be used for the balance of the assignment.

**.07 Audit Time Budget – Sample A**

Client \_\_\_\_\_ Examination date \_\_\_\_\_

Prepared by \_\_\_\_\_

Approved:

Supervisor \_\_\_\_\_ Date \_\_\_\_\_ Partner \_\_\_\_\_ Date \_\_\_\_\_

Preliminary work:

Start \_\_\_\_\_ End \_\_\_\_\_

Final work:

Start \_\_\_\_\_ End \_\_\_\_\_

	Budget (in hours)	
	May to Nov.	Dec. to April
Cash	_____	_____
Receivables:	_____	_____
Confirmation of balances	_____	_____
Review ledgers, etc.	_____	_____
Inventories:	_____	_____
Observation of physical counts	_____	_____
Price tests, etc.	_____	_____
Securities and investments	_____	_____
Property, plant, and equipment	_____	_____
Accumulated depreciation and amortization	_____	_____
Other assets	_____	_____
Notes and accounts payable	_____	_____
Tax accruals	_____	_____
Other liabilities	_____	_____
Capital stock	_____	_____
Retained earnings	_____	_____
Other equity accounts	_____	_____
Income accounts	_____	_____
Costs and expense accounts	_____	_____
)	_____	_____
Current provision for taxes	_____	_____
Other income and expense accounts	_____	_____
Minutes, agreements, etc.	_____	_____
Conferences with client	_____	_____
General supervision and planning	_____	_____
Review computer programs and auditability	_____	_____
Review of internal control	_____	_____
Review and update permanent files	_____	_____
Travel	_____	_____
Report and statement review	_____	_____
Other matters	_____	_____
	_____	_____
	_____	_____
	_____	_____
<b>Total budgeted hours</b>	=====	=====
<i>(Excludes tax and report departments' time)</i>		

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**Audit Time Analysis (Short Form)**

.09

	Client		Year ended		Actual daily hours	Next year's budget
	Prior years	Total	Budgeted hours			
			Week beginning			
Administration						
Accounting systems review						
Confirmations						
Permanent file						
Client advisory comments						
Report preparation						
Tax returns						
Initial review						
Overall review						
Detailed review						
Tax accrual review						
Trial balance						
Cash						
Receivables						
Inventories						
Other assets						
Liabilities						
Equity						
Operating accounts						
Totals						
Accountants						
In-Charge						
Totals						

**.10**      **Audit Time Analysis (Long Form)**

	Client		Year ended		Actual Daily Hours		Next year's Total budget
	Prior Years	Total	Budgeted Hours	Week beginning			
Administration							
Client conferences							
Planning and scheduling							
Staff supervision							
Accounting systems review							
Internal control							
EDP installation							
General ledger							
Cash							
Sales							
Voucher register							
Payroll							
Journal entries							
Confirmations							
Permanent file							
Client advisory comments							
Report preparation							
Financial statements							
Footnotes							
Tax return preparation							
Review							
Initial review							
Overall review							
Detailed review							
Tax accrual review							
Subtotal to next page							

**Audit Time Analysis (Long Form) (Continued)**

	Client _____ Year ended _____		Actual Daily Hours	Next year's Budget
	Prior Years	Budgeted Hours		
		Total		
Year-end verification				
Trial balance				
Cash				
Notes receivable				
Accounts receivable				
Inventories				
Prepaid expenses				
Intercompany accounts				
Securities and investments				
Fixed assets				
Other assets				
Notes payable				
Accounts payable				
Tax grouping and accrual				
Accrued liabilities				
Deferred credits				
Contingencies and commitments				
Equity				
Audit of/with computer				
Operating accounts				
Subtotal from previous page				
Totals				
Accountants				
Manager				
In-Charge				
Totals				

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.11

<b>Weekly Progress Report</b>					
				Date _____	
Supervisor _____	In-charge accountant _____				
Client _____	Case _____				
Staff days—seven hours					
	<u>Original Estimate</u>	<u>Used to date</u>	<u>Unused</u>	<u>Est. to complete</u>	<u>Variance</u>
In-charge accountant	_____	_____	_____	_____	_____
Assistants ( <i>list</i> ):	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____
Total assistants	_____	_____	_____	_____	_____
Grand total	=====	=====	=====	=====	=====

Engagement Status Report

.12

Month ended

Client no.	Client name	Responsible staff member	Year end	Date preplanning completed	Preliminary work date		Year-end work date		Audit review completed	Date submitted to typing	Practice review completed	Date rpt. letter del.	Date rpt. letter del.
					started	completed	started	completed					



## AAM Section 4000

## INTERNAL CONTROL

The material included in these sections on internal accounting control is presented for illustrative purposes only. The comments and illustrations are neither all inclusive nor are they prescribed minimums. They are intended as conveniences for users of this manual who may want assistance when developing materials to meet their individual needs.

This manual is a nonauthoritative kit of practice aids and, accordingly, these sections on internal accounting control do not include extensive explanation or discussion of authoritative pronouncements. Users of this manual are urged to refer directly to applicable authoritative pronouncements when appropriate.

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## AAM Section 4100

### Introduction

.01 The second standard of field work states, “There is to be a proper study and evaluation of the existing internal control as a basis for reliance thereon and for the determination of the resultant extent of the tests to which auditing procedures are to be restricted.”

.02 SAS No. 1 includes discussion of the subdivision of internal control into internal accounting control and internal administrative control (SAS No. 1, sections 320.12 and 320.27-29; AU § 320.12<sup>1</sup> and AU § 320.27-29<sup>1</sup>) and states that, “accounting control is within the scope of the study and evaluation of internal control contemplated by generally accepted auditing standards while administrative control is not” (SAS No. 1, section 320.49; AU § 320.49<sup>1</sup>). Accordingly, the term “internal accounting control” is used throughout these sections.

.03 The following Statements on Auditing Standards present authoritative interpretation of the second standard of field work:

- SAS No. 1, section 320 (AU section 320<sup>1</sup>), “The Auditor’s Study and Evaluation of Internal Control.”

For convenience, the subheadings within section 320 of SAS No. 1 are repeated here as follows:

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<sup>1</sup> Section reference in *AICPA Professional Standards*.

	<u>Paragraph</u>
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- SAS No. 3 (AU section 321<sup>2</sup>), “The Effects of EDP on the Auditor’s Study and Evaluation of Internal Control.”
- SAS No. 20 (AU section 323<sup>2</sup>), “Required Communication of Material Weaknesses in Internal Control.”

.04 Guidance on internal accounting control is also presented in the various AICPA industry audit guides and in the audit guide, “Audits of Service Center Produced Records,” and the audit and accounting guide, “The Auditor’s Study and Evaluation of Internal Control in EDP Systems.” Another source of information is “The Report of the Special Advisory Committee on Internal Accounting Control” (AICPA, 1979).

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<sup>2</sup> Section reference in *AICPA Professional Standards*.

.05 These sections include comments on working tools used in performing the study and evaluation of internal accounting control and illustrative examples of the following:

- Internal accounting control questions—small business.
  - Specific internal accounting control objectives and related questions—medium to large business.
  - Internal accounting control flow charts—small business.
- 

»»»→ *The next page is 4201.* ←«««





## AAM Section 4200

### *General Approach*

.01 The auditor usually starts obtaining or updating current knowledge and understanding of the client's prescribed internal accounting control procedures at the beginning of field work. This timing is important because the auditor uses this current understanding in determining the nature, extent and timing of compliance and substantive tests to be applied in performing the audit. During preliminary meetings with the client, before commencing field work, the auditor may make inquiries about the client's system or about significant changes in the system since the last audit. In this sense, the auditor starts the review even before starting field work.

.02 Ordinarily, the auditor obtains knowledge and understanding of the client's internal accounting control procedures through discussions with appropriate client personnel and reference to documentation such as procedures manuals, job descriptions, flowcharts and decision tables. Some auditors follow the practice of tracing one or a few of the different types of transactions through the related documents and records as part of their review of the system. They believe this practice is helpful to clarify their understanding. This technique is referred to by various terms, such as "walk through," "transaction review," and "transaction flow review." This practice also may be considered as part of the tests of compliance. Some auditors, as a matter of policy, require this practice as part of their reviews before making a preliminary evaluation to identify the procedures to be subjected to compliance tests.

.03 After obtaining sufficient knowledge and understanding of prescribed internal accounting control procedures, the auditor makes a preliminary evaluation (see SAS No. 1, sections 320.54 and 320.64-.68) to identify those prescribed procedures he may wish to rely upon in determining the nature, timing and extent of substantive tests of particular classes of transactions and balances. The auditor performs compliance tests of those prescribed procedures to be relied upon to obtain reasonable assurance that they are applied as prescribed. Compliance tests are not necessary for other prescribed internal accounting control procedures which the auditor decides not to rely upon in designing substantive tests. The auditor may decide not to rely on a client's prescribed internal accounting control procedures because he concludes either (a) that the procedures are not satisfactory for that purpose, or (b) the audit effort required to test compliance with the procedures to justify reliance on them in making substantive tests would exceed the reduction in effort that could be achieved by such reliance.

.04 At the conclusion of compliance testing, the auditor again evaluates internal accounting control (SAS No. 1, section 320.64-.68) based on both his understanding of prescribed procedures and the results of his compliance tests. Using this evaluation as a basis, the auditor prepares or revises the program for substantive tests necessary to complete the examination. This may also be an appropriate time to bring to the client's attention such matters as material weaknesses in internal accounting control (SAS No. 20, paragraph 5; AU section 323.05).

### **Aids Used in Performing the Study and Evaluation**

.05 The auditor may record his understanding of the system obtained from the review in the form of answers to a questionnaire, narrative memoranda, flowcharts, decision tables, a combination of these forms or any other form that suits the auditor's needs or preferences. Some auditors have preferences for a particular form such as flowcharts and require the form as a matter of firm policy.

.06 Auditors may find aids such as questionnaires, checklists, instructions or similar generalized materials to be useful tools in making their study and evaluation of internal accounting control. These aids generally present questions or statements about internal accounting control objectives and specific procedures or techniques. These aids also generally include caveats that the auditor must use professional judgment in applying them in actual circumstances (including recognition of when to modify their content and when to prepare or obtain supplementary material).

.07 Some auditors design the aid to serve as a working paper when properly annotated. This type of aid is generally in checklist or questionnaire form. Others design the aid as a reference document with explicit instructions that it is intended for reference purposes and not to be annotated for use as a working paper document. Auditors who incorporate checklists or questionnaires into their working papers believe that they provide efficiency and evidence that certain predetermined matters were considered.

Auditors who use reference type aids rather than aids designed to be annotated and retained in the working papers are concerned that standardized checklists may be prepared by rote. Both approaches require that the auditor use professional judgment in the circumstances. Both approaches also require that the auditor remain alert to any matters that may not be covered in the checklists or reference material.

### **Special Considerations for Public Companies**

.08 Auditors of public companies should be aware of the Foreign Corrupt Practices Act of 1977 which, among other things, requires public companies to “. . . devise and maintain a system of internal

accounting controls . . .” Also, in its Release No. 34-15772, the SEC has proposed rules which would require inclusion of a statement of management on internal accounting control in annual reports on Form 10-K and in annual reports to security holders furnished pursuant to the proxy rules. The SEC also is proposing that such a statement be examined and reported on by an independent public accountant. Guidance concerning compliance with the Act and with any final rules on reporting is beyond the scope of this section. However, the AICPA Auditing Standards Board is developing guidance for independent accountants on this matter.<sup>1</sup>

### **Organization of Checklist Questionnaires and Other Generalized Aids**

.09 Checklist questionnaires and other generalized aids on internal accounting control typically present numerous questions, statements, or a combination of both, about specific internal accounting control objectives, procedures, and techniques. These materials are generally organized into groupings to aid the auditor in identifying each significant class of transactions and obtaining an understanding of the flow of transactions. Auditors differ in how they structure their materials on internal accounting control. Some auditors group their internal accounting control material into balance sheet and related income statement classifications to ease cross-reference with sections of their working papers on substantive tests. Other auditors organize their material into broad transaction cycles. For example, purchases and accounts payable, payrolls, accrued expenses, and cash disbursements may be grouped as an expenditures cycle. This approach transcends the differences in how companies are organized and helps to get an overview of all the effects of transactions across various functional lines within a company. Other auditors organize their material by functions within a company. Examples are requisitioning, purchasing, receiving, invoice processing, accounts payable recording, and payment functions which may be grouped as purchases and payables. This approach follows the established organizational lines in a company and aids in determining who is responsible for performance of prescribed internal accounting control procedures. These approaches are conceptual notions and may be applied to large or small organizations. The decision to structure internal accounting control material on the statement classification approach, cycle approach, business function approach, or any other suitable approach rests with the individual auditor or firm. Following are some further illustrations of these grouping approaches:

---

<sup>1</sup>An exposure draft dated December 31, 1979 of a proposed statement on auditing standards, “Reporting on Internal Accounting Control,” was issued for comments to be received by April 15, 1980.

- **Related Balance Sheet and Income Statement Classifications:** (1) general; (2) cash receipts, disbursements, and balances; (3) accounts receivable and sales; (4) inventory and cost of sales; (5) property, plant and equipment, and related depreciation; (6) investments; (7) accounts payable and purchases; (8) payroll; (9) debt; and (10) equity capital.
- **Transaction Cycles:** (1) revenue (customer acceptance, credit, shipping, sales, cash receipts, receivables, allowances for doubtful accounts, sales warranties, etc.); (2) expenditures (purchases, payrolls, cash disbursements, accounts payable, accrued expenses, etc.); (3) production or conversion (inventory, cost of sales, property and related depreciation, etc.); (4) financing (investments, debt, leases, equity capital); and (5) financial reporting.<sup>2</sup>
- **Groupings of Business Functions:** (1) financial reporting (controllershship, general accounting); (2) EDP; (3) financial management (cash receipts and disbursements, cash balances and investments, debt, leases, and equity capital); (4) sales and credit (order entry, credit, shipping, billing, receivables and collections); (5) inventory and production costs (production planning and operations, cost accounting, inventory recordkeeping, and inventory custody); (6) productive assets (planning and authorization for capital assets, accounting for property and related depreciation, maintenance, and asset custody); (7) purchases and payables (purchasing, receiving, invoice processing, and disbursements); and (8) employee compensation and benefits (personnel, employee supervision, payroll preparation and recording, and disbursements).

### Formats of Checklist Questionnaires

.10 Checklist questions are usually worded so a "yes" answer indicates that the client uses a particular procedure or technique. "No" answers serve as signals that the client may have an internal control weakness unless the client has other procedures that accomplish the same objectives as would the absent procedure. "No" answers pose an especially important documentation problem because they require consideration of the following:

- Should the absent procedure be dismissed as not applicable because it is not relevant in the client's circumstances?
- Does the client have other procedures that accomplish the objective of the absent procedure so that the answer does not indicate a weakness?

---

<sup>2</sup> The financial reporting cycle would include general accounting and preparation of such reports as financial statements, tax returns and reports to regulatory bodies. For nonpublic companies which work closely with their auditors in preparing such reports, review of internal accounting control for the financial reporting cycle may be a moot point.

- Does the weakness require modification of the audit program for substantive tests or are the tests adequate despite the weakness?
- Is the weakness a material weakness requiring communication in accordance with SAS No. 20 (AU section 323)?
- How should other weaknesses be communicated to the client?

Because of these considerations, the formats of questionnaires usually call for information in addition to simply checking yes and no answers. Some questionnaires provide an additional column for “not applicable” and a wide column for additional comment on conclusions about other compensating procedures and the needs for program modifications and/or written communication to the client.

.11 Some questionnaire formats provide additional columns for information such as the following:

- Name of client’s employee or group of employees who perform the procedure.
- Specific cross-reference to flowcharts and/or narratives included in the auditor’s working papers.
- Specific cross-reference to working papers on compliance tests.
- Specific cross-reference to compensating procedures for absent items; compensating procedures may be represented by other checklist items or noted in complementary memoranda or procedures not anticipated in the questionnaire.
- Specific cross-reference to memoranda on internal accounting control weaknesses and their effect on the audit program and development of management letter comments.

.12 Some questionnaires provide for the auditor to initial and date each item. Others provide entry of the date and auditor’s signature after each group of questions for a particular transaction cycle or functional grouping. Some questionnaires also include blank formats with preprinted captions on which the auditor may prepare annotations about specific internal accounting control weaknesses, conclusions about findings, and proposed amendments (if any) to the audit program. These preprinted captions for example, may include the following:

- Explanation of a specific weakness or new strength (generally cross-referenced to a specific item in the body of the checklist).
- Cross-reference to a specific compensating internal accounting control procedure, if any.

- Whether amendment of the audit program is needed concerning:
    - (a) Further restriction of audit procedures.
    - (b) Extension of audit procedures.
    - (c) Modification of the extent or timing of audit procedures.
- 

»»→ *The next page is 4301.* ←««

**AAM Section 4300*****Illustrative Internal Accounting Control Questions—Small Business***

.010 The following is a list of illustrative internal accounting control questions an auditor might raise concerning a small manufacturing operation owned by one person who also serves as the general manager and has only a few employees involved in the accounting function. These illustrative questions are numbered merely for organization purposes; the numbers are in no way intended to infer completeness or a preferred sequence. This list will require modification for other types of entities. Because this list is merely illustrative, some auditors may find it not extensive enough, while others may find it too detailed. Others may prefer a different organization or sequence for the inquiries. A firm that believes the questionnaire approach is appropriate for its practice should develop its own internal accounting control questionnaires based on its own needs and preferences. In any event, users of checklists and questionnaires should recognize that important matters in a particular set of circumstances may not be covered in a standard checklist.

.020

**I. General**

1. Is a complete and current chart of accounts used?
2. Is a double entry bookkeeping system in use which includes a general ledger, books of original entry and suitable subsidiary records?
3. Do the records provide for efficient accumulation of entries and avoidance of unnecessary or duplicate work?
4. Are standard journal entries used to the extent practicable?
5. Are journal entries understood and authorized by the owner?
6. Does the owner reasonably understand the form and content of the financial statements and such required reports as tax returns?
7. Does the owner use operating budgets and cash projections?  
If so,
  - a. Do the budgets and projections lend themselves to effective comparison with actual results?
  - b. Are material variances reviewed and explained?
8. Are monthly comparative financial reports prepared which are sufficiently informative to highlight abnormalities?

9. Are the books of original entry posted promptly and the general ledger and subsidiary ledgers kept current and balanced periodically (monthly)?
10. Is there adequate control including a reporting schedule and assigned responsibility for preparation of required financial statements and government regulatory reports?
11. Are the personal funds of the owner including his personal income and expenses completely segregated from the business?
12. Is the bookkeeper required to take annual vacations and does someone else perform the bookkeeping duties during that time?
13. Are there adequate safekeeping facilities for custody of the accounting records such as fireproof storage areas and restricted access cabinets?
14. Is there adequate fidelity bond coverage of employees who handle cash, securities, other valuable assets and accounting records?
15. Is the adequacy of insurance coverage periodically reviewed?
16. Is there a suitable records retention plan?
17. Is the owner satisfied that all employees are competent and honest?

## **II. Revenue Cycle (Revenue, Receivables & Cash Receipts)**

### **.030 A. Revenue and Accounts Receivable**

1. Is credit approved by the owner or a designated credit manager?
2. Are credit files maintained on a current basis for significant customers?
3. Are commission rates set or approved by the owner?
4. Are sales orders or work orders approved by the owner or a responsible employee for:
  - a. Price?
  - b. Terms of sale, including delivery dates?
  - c. Credit?
  - d. Account balance limits?
5. Are all sales orders (or work orders) recorded on pre-numbered forms and are all numbers accounted for?
6. Are shipping documents:
  - a. Prepared for all shipments?
  - b. Pre-numbered and all numbers accounted for?



- c. Based on approved sales orders and matched with sales invoices?
- d. Processed promptly?
- 7. Are all sales invoices :
  - a. Pre-numbered and all numbers accounted for?
  - b. Compared to shipping documents?
  - c. Checked for price and terms?
  - d. Checked for clerical accuracy?
  - e. Recorded promptly?
- 8. Are all credit memos pre-numbered and all :
  - a. Numbers accounted for?
  - b. Approved?
  - c. Recorded promptly?
- 9. Is there a proper cut-off of sales at month end?
- 10. Are monthly statements of account for all trade receivable balances :
  - a. Reviewed by the owner before mailing?
  - b. Mailed by the owner or a responsible employee other than the bookkeeper?
- 11. Is the accounts receivable subsidiary ledger balanced monthly to the general ledger control account?
- 12. Is an aging schedule or schedule of past due customers' accounts prepared monthly?
- 13. Does the owner or credit manager review monthly listings of past due customer accounts and investigate delinquent accounts and unusual items?
- 14. Are write-offs and other adjustments to customers' accounts authorized by the owner?

**.040 B. Cash Receipts**

- 1. Does the owner or a responsible employee other than the bookkeeper or person who maintains accounts receivable detail :
  - a. Open the mail and prelist all cash receipts before turning them over to the bookkeeper?
  - b. Stamp all checks with the restrictive endorsement "for deposit only" before turning them over to the bookkeeper?
  - c. Subsequently compare the daily prelisting of cash receipts with :
    - (i) The cash receipts journal?
    - (ii) The duplicate deposit slip?

2. Are cash receipts deposited intact on a daily basis?
3. Are cash receipts posted promptly to the accounts receivable subsidiary records?
4. Are discounts taken checked for conformity with an authorized policy?
5. Are cash sales controlled by cash registers or prenumbered cash receipt forms?
6. If cash registers are used does a responsible employee other than the cash register operator (cashier)—
  - a. Have custody at all times of the key to the cash register tape compartment?
  - b. Take periodic readings of the register and compare such with the cashier's record of cash receipts?

### III. Expenditures Cycle

#### .050 A. Purchases and Accounts Payable

##### *Purchasing*

1. Does the owner or a designated person other than the book-keeper do the purchasing?
2. Are all purchases over a predetermined dollar amount approved by the owner?
3. Are purchases of services, property and equipment, investments and other non-routine items approved by the owner?
4. Are all purchases based on purchase orders which present descriptions, quantities and prices which are approved before issuance?
5. Are all purchase order forms prenumbered and is custody of unissued forms adequate to prevent their misuse?
6. Are issued purchase orders listed in detail showing order numbers, vendors' names, quantities and prices to control their issuance and disposition? (This may be in the form of a register, log, or file of copies of issued purchase order forms.)
7. Are open purchase orders periodically reviewed for delivery period so that past due orders may be brought to the owner's attention?

##### *Receiving*

8. Are all materials inspected for condition and independently counted, measured or weighed when received?

9. Are receiving reports used and prepared promptly? (Note: copies of purchase orders with the quantities blanked out may serve this purpose.)
10. Are receiving reports subjected to the following:
  - a. Prenumbering and accounting for the sequence of all numbers? (This may be coordinated with accounting for all purchase orders—see items 5 and 6 above.)
  - b. Promptly provided (by copies) to those who perform the purchasing and accounting (accounts payable) functions?
  - c. Controlled so that the liability may be determined for materials received but not yet invoiced?

### ***Accounts Payable***

11. Are vendor's invoices:
  - a. Matched with applicable purchase orders?
  - b. Matched with applicable receiving reports?
  - c. Reviewed for correctness of:
    - (i) Quantities received?
    - (ii) Prices charged?
    - (iii) Clerical accuracy (extensions & footings)?
    - (iv) Account distribution?
12. Are all available discounts taken?
13. Is there written evidence that invoices have been properly processed (for example, a block stamp, attachment of a voucher form, annotations) before payment?
14. Are duplicate invoices conspicuously stamped or destroyed as a precaution against duplicate payment?
15. Are approved debit memos used to notify vendors of goods returned to them and other adjustments of their accounts?
16. Are there procedures which provide that direct shipments to customers, if any, are properly billed to them?
17. Does the owner verify that the trial balance of accounts payable agrees with the general ledger control account?
18. Does the owner verify that other key accounts agree with the subsidiary records?
19. Are vendors' statements reconciled with accounts payable detail?
20. Are vendors' statements checked by the owner periodically for overdue items?

21. Are expense accounts :
  - a. Submitted promptly?
  - b. Adequately supported?
  - c. Approved before payment?

.060 B. Payrolls

1. Are all employees hired by the owner?
2. Are individual personnel files maintained?
3. Is access to the personnel files limited to the owner or a designee who is independent of the payroll or cash functions?
4. Are wages, salaries, commission and piece rates approved by the owner?
5. Are proper authorizations obtained for all payroll deductions?
6. Is gross pay determined using authorized rates and :
  - a. Adequate time records for employees paid by the hour?
  - b. Piece work records for employees whose wages are based on production?
  - c. Are piece rate records reconciled with production records, or are counts spot checked?
  - d. Salesmen's commission records reconciled with sales records?
7. If employees punch time clocks, are the clocks located so they may be watched by someone with authority?
8. Are time records for hourly employees approved by a foreman or supervisor?
9. Would the owner be aware of the absence of any employee?
10. Is the clerical accuracy of the payroll checked?
11. Are payroll registers reviewed by the owner?
12. Is an imprest bank account used for payroll, and does the owner compare deposits to the account with the payroll register?
13. Does the owner approve, sign and distribute payroll checks?
14. If employees are paid in cash, does the owner compare the cash requisition to the net payroll?
15. Does the owner maintain control over unclaimed payroll checks?

.070 C. Cash Disbursements

1. Are all disbursements except from petty cash made by check?
2. Are checks prenumbered and all numbers accounted for?
3. Are all checks recorded when issued?

4. Are all unused checks safeguarded (i. e., is access limited to the owner)?
5. Is a mechanical check protector used to inscribe amounts as a precaution against alteration?
6. Are all voided checks retained and mutilated?
7. Are all checks signed by the owner?
8. If a signature plate is used, is it under sole control of the owner?
9. Are supporting documents (processed invoices, receiving reports, purchase orders, etc.) presented with the checks and reviewed by the owner before he signs the checks?
10. Are supporting documents for checks properly cancelled to avoid duplicate payment?
11. Are checks payable to cash prohibited?
12. Are signed checks mailed by someone independent of the accounts payable function?
13. Are bank statements and paid checks :
  - a. Received directly by the owner?
  - b. Reviewed by the owner before they are given to the book-keeper?
14. Are bank reconciliations prepared :
  - a. Monthly for all accounts?
  - b. By someone other than the cashier or persons authorized to sign checks or use a signature plate if they are other than the owner?
15. Are bank reconciliations reviewed and adjustments of the cash accounts approved by the owner?
16. Are all disbursements from petty cash funds supported by approved vouchers which are prepared in ink and cancelled to prevent reuse?
17. Is there a predetermined maximum dollar limit on the amounts of individual petty cash disbursements?
18. Are petty cash funds on an imprest basis and :
  - a. Kept in a safe place?
  - b. Reasonable in amount so that the fund ordinarily requires reimbursement at least monthly?
  - c. Controlled by one person?
  - d. Periodically counted by someone other than the custodian?

#### **IV. Production or Conversion Cycle**

##### **.080 A. Inventories and Cost of Sales**

###### ***Physical Inventories***

1. Are physical counts made of all classes of inventory at least once a year?
2. Are physical inventory procedures supervised by the owner or a responsible employee?
3. Do written inventory procedures exist and, if so, are they determined or approved by the owner?
4. Do the inventory procedures adequately address the following matters:
  - a. Location and orderly physical arrangement of inventories?
  - b. Identification and description of the inventories by persons familiar with it?
  - c. Segregation and proper identification of goods that are not property of the client, such as customers' goods and goods held on consignment?
  - d. Method of determining quantities such as weight, count or measure?
  - e. Identification of stock counted to determine all items are counted and to preclude duplicate counting?
  - f. Cut-off of receipts and deliveries?
  - g. Control of physical inventory records, such as prenumbering of all count sheets, count tickets, and accounting for all numbered records issued and used?
  - h. Identification of slow moving, obsolete and damaged items?
5. Are inventories under physical control of a designated storekeeper who is responsible for quantities and who is also not the bookkeeper?
6. Are there reasonable safeguards against theft or pilferage such as fences or locked areas?
7. Are the inventories adequately insured?

###### ***Perpetual Inventory Records***

8. Are perpetual inventory records maintained and, if so,—
  - a. Are the perpetual records controlled by general ledger accounts and adjusted to periodic physical inventories at least once a year?
  - b. Are the perpetual records kept by someone other than the person(s) who have custody of the physical stock?

- c. Are differences between physical counts and perpetual records investigated?
- d. Are adjustments to the perpetual records approved by the owner?

**Costs**

- 9. Do the accounting records provide for properly classified accumulation of the costs of raw materials, direct labor, and overhead (including indirect labor)?
- 10. Do the accounting records accumulate quantities or units of finished products sold and units of raw materials used in production in sufficient detail and with proper cut-off to provide for adequate determination of cost of goods sold and cost of inventories?
- 11. Does the client's production process lend itself to accumulation of costs by job order or units processed, and if so, is an appropriate cost accounting system used?
- 12. Is the cost accounting system tied in with or reconciled to the general ledger?
- 13. Are production cost budgets and production reports prepared periodically?
  - a. Do the budgets lend themselves to comparison with actual costs?
  - b. Are differences between budget and actual costs investigated and explained?
  - c. Are production cost budgets and comparisons with actual costs reviewed by the owner?

**Receipts, Usage and Shipments**

- 14. Do receiving personnel verify the quantity and quality of materials purchased and prepare formal receiving reports?
- 15. Are signed requisitions required for release of all materials from the storeroom and, if so, are the requisitions prenumbered and all numbers accounted for?
- 16. Are all shipments of finished goods based on approved shipping advices?
- 17. Are shipping and receiving areas separate from inventory storage areas?

**.090 B. Property, Plant and Equipment**

- 1. Are all additions authorized by the owner?
- 2. Does the owner understand and approve the estimated lives and methods of depreciation for depreciable property?

3. Does the owner authorize all retirements?
4. Are there detailed records of property, plant and equipment which—
  - a. Identify specific assets including their costs and acquisition dates?
  - b. Show related depreciation?
  - c. Are balanced periodically (at least annually) with the general ledger control accounts?
5. Are there adequate detailed records for leased property under capital leases?
6. Are periodic physical inventories or inspections made of property, plant and equipment?
7. Are depreciable lives periodically reviewed for adequacy in relation to unanticipated use or obsolescence based on actual experience?

## **V. Financing Cycle**

### **.100 A. Notes Receivable and Investments**

1. Does the owner authorize all notes receivable?
2. Are all investment purchases and sales authorized by the owner?
3. Is a detailed record of notes and investments maintained including related income?
  - a. Is the record kept current?
  - b. Is the record reconciled to the general ledger control accounts?
4. Are investments registered in the name of the company?
5. Does owner have sole access to notes and investment certificates?
6. Are investments kept in a safe place?
7. Are investments counted or confirmed periodically?

### **.110 B. Notes Payable, Debt, and Other Term Obligations (such as Leases)**

1. Does the owner negotiate all borrowings?
2. Does the owner understand the terms, conditions and finance cost (interest) of all debt and lease obligations of a financing nature?
3. Are detailed, up to date, records maintained of notes payable, long-term debt and other term obligations such as leases?
4. Are the company files adequate regarding copies of outstanding notes, bonds, mortgages and leases?



5. Are paid bonds and notes effectively cancelled and retained in the company?

**.120 C. Owner's Equity**

1. If doing business as a corporation :
    - a. Are the owner's records safeguarded and in order regarding the certificate or articles of incorporation, bylaws, unissued stock certificates (if any), and relevant correspondence with legal counsel?
    - b. Does the general ledger include appropriate capital accounts?
    - c. Are minute books maintained and properly safeguarded?
  2. If doing business as a sole proprietorship, does the general ledger include appropriate capital accounts?
- 

➤→ *The next page is 4401.* ←➤



**AAM Section 4400*****Illustrative Specific Internal Accounting Control Objectives and Related Questions—Medium to Large Business***

.010 This section lists specific internal accounting control objectives and related questions that an auditor might raise concerning a medium to large business with enough employees to be able to achieve a reasonable segregation of duties. These illustrative objectives and related questions are organized into a general category and four broad transaction cycles which are further divided into various subheadings. This is to provide some additional illustration of the concepts discussed in AAM section 4200.09 on organization of checklist questionnaires and other generalized aids.

.020 As discussed in AAM section 4200.05-.07, auditors develop various generalized materials as aids for studying and evaluating internal accounting control. Many of these aids consist of questions or statements about particular procedures or techniques but do not include specific internal accounting control objectives. Some recently developed materials, however, include statements of specific internal accounting objectives in addition to the traditional questions or statements on procedures and techniques. The common aspect of these various sets of specific objectives is that they are derived from the discussion of internal accounting control in SAS No. 1, section 320.28-48. The number and degree of detail of the sets of objectives included in these materials vary. For example, they range in number from about 40 to over 100. These variations depend on the needs and preferences of the auditors who developed the materials.

.030 The illustrative material in this section includes 62 specific internal accounting control objectives accompanied by related questions concerned with how the objectives may be accomplished. In a number of instances the questions require a comment rather than a simple yes or no answer; these instances should be self evident. Because some procedures and techniques may accomplish more than one objective, there are instances when a group of questions is associated with two or more objectives. Likewise, there is some repetition among the various groups of questions associated with different

specific objectives. Some of the questions are of a general nature and are accompanied by examples of more specific procedures and techniques.

.040 A firm should develop or adopt guidance material which is appropriate for its own needs and preferences. In any event, users of this illustrative material or other such material must use professional judgment and be alert for important matters in a particular set of circumstances which may not be covered in the illustrative material. For example, some companies may have developed additional specific internal accounting control objectives to meet special circumstances. Also, some of the specific internal accounting control objectives included in generalized material may not be applicable to some companies because of the absence of certain types of transactions.

## **I. General**

### **.050 A. Organization**

#### *Objectives*

- Definitions of responsibilities and authority assigned to specific individuals permit identification of whether persons are acting within the scope of their authority.
- Reports prepared for management planning and control purposes permit systematic comparison of actual with expected results to deter and detect errors and irregularities.

#### *Questions*

1. Does the entity have a current organization chart and related materials such as job descriptions and lists of particular individuals which clearly identify:
  - a. The responsibilities and authority assigned to senior management personnel?
  - b. Individuals specifically authorized to initiate and execute transactions?
  - c. Individuals with specific responsibility for custody of various classifications of assets?
  - d. Individuals with specific responsibility for financial control functions?
2. Are financial reports prepared for management at reasonable intervals (for example, monthly) which permit comparison of recorded transactions and account balances with expected

- results based on such sources of information as budgets, standard costs, engineering estimates, prior experience, and the personal knowledge of management?
3. If operating budgets and cash projections are used:
    - a. Do the budgets and projections lend themselves to effective comparison with actual results?
    - b. Are material variances reviewed and explained?
  4. If an internal audit function is present:
    - a. Are the internal auditors independent of the activities they audit?
    - b. Do they perform studies and evaluations of internal accounting control including performance of compliance tests?
    - c. Do they perform substantive tests of the details of transactions and account balances?
    - d. Do they document the planning and execution of their work by such means as preparation of programs and working papers?
    - e. Do they render written reports on their findings and conclusions?
    - f. Are their reports submitted to the board of directors or to a committee thereof?
  5. Are there regular meetings of the board of directors (or comparable bodies) to set policies and objectives, review the entity's performance and take appropriate action, and are minutes of such meetings prepared and signed on a timely basis?
  6. For positions of trust such as those involving direct and indirect access to cash, securities and other assets convertible into cash:
    - a. Are appropriate investigations made of applicants' backgrounds before hiring?
    - b. Is fidelity bond coverage considered?

#### **.060 B. General Accounting**

##### ***Objectives***

- Accounting policies and procedures, including selection among alternative accounting principles, are determined in accordance with management's authorization.
- Access to the accounting and financial records is limited to minimize opportunities for errors and irregu-

larities and to provide reasonable protection from physical hazards.

- Accounting entries are initiated and approved in accordance with management's authorization.
- All accounting entries are appropriately accumulated, classified and summarized in the accounts.

### **Questions**

1. Does the entity have adequate written statements and explanations of its accounting policies and procedures?

(Written accounting policies and procedures may include such matters as:

- (i) Chart of accounts accompanied by explanations of the items to be included in the various accounts.
  - (ii) Identification and description of the principal accounting records, recurring standard entries, and requirements for supporting documentation. For example, this may include information about the general ledger and journal, and the subsidiary transaction registers, accounts, and detail records for each of the various significant classes of transactions.
  - (iii) Expression of the assignment of responsibilities and delegation of authority including identification of the individuals or positions that have authority to approve various types of recurring and non-recurring entries.
  - (iv) Explanations of documentation and approval requirements for various types of recurring and non-recurring transactions and journal entries. Documentation requirements, for example, would include the basis and supporting computations required for adjustments and write-offs.
  - (v) Instructions for determining an adequate cutoff and closing of accounts for each reporting period.)
2. Is responsibility assigned for initiation and approval of revisions in the accounting policies and procedures?
  3. Are the entity's accounting policies and procedures adequately communicated to appropriate personnel (for example, by distribution of written instructions and manuals to persons who need them)?
  4. Does the principal accounting officer of the entity have adequate authority over accounting employees and principal accounting records at all locations?

(Accounting employees of an operating division or subsidiary may report to the operating manager in charge of the division or subsidiary. In these situations it is especially important that those responsible for accounting and reporting at the divisional or subsidiary level be fully advised of the accounting and reporting policies they are expected to follow.)

5. Is maintenance of the general ledger performed by persons whose duties do not include:
  - a. Direct access to assets such as handling cash receipts, custody of marketable securities, receiving of purchased goods, and shipping of finished product?
  - b. Performance of functions which provide indirect access to assets such as signing checks, approving invoices, approving purchase orders, authorizing production, extending credit and approving sales orders?
  - c. Maintenance of subsidiary ledgers and records?
6. Is access to the general ledger and related records restricted to those who are assigned general ledger responsibilities?
7. Are there adequate facilities for custody of the general ledger and related records?

(Examples of such facilities include fire resistant locked cabinets, vaults, physical barriers, separate rooms, limited access to work areas, alarms and other detection devices.)
8. Is appropriate insurance coverage maintained in accordance with management's authorization?

(Such insurance may include loss of records coverage and fidelity bonding of employees in positions of trust.)
9. Are all journal entries reviewed and approved by designated individuals at appropriate levels in the organization?

(The levels at which journal entries are reviewed and approved will usually vary depending on whether the entries are recurring or non-recurring, routine or unusual, accumulations of routine expected transactions or adjustments of balances requiring estimates and judgments.)
10. Are all journal entries adequately explained and supported?

(Explanation and support for an entry should be sufficient to enable the person responsible for its review and approval to reasonably perform this function.)
11. Are the individuals designated to review and approve journal entries independent of initiation of the entries they are authorized to approve?

12. Do all journal entries include indication of approval in accordance with management's general or specific authorization?
13. Are all accounting entries subject to the controls over completeness of processing?  
(Examples of controls over completeness of processing include prenumbering of journal vouchers and accounting for all numbers used, accumulation of control totals of dollar amounts debited and credited, and standard identification numbers for recurring standard accounting entries.)
14. Do all journal entries include adequate identification of the accounts in which they are to be recorded?
15. Are there adequate detailed records to support entries regarding:
  - a. Amortization of prepaid expenses, deferred charges and intangible assets?
  - b. Revenue recognition of deferred income?
  - c. Liability accruals and provisions relating to such matters as product warranties?
  - d. Provisions and liabilities for income taxes and other taxes?
  - e. Liability accruals and provisions for such long-term agreements as pension plans, and deferred compensation arrangements?
16. Are adequate accounts and records maintained so that adjustments and write-offs made to account balances do not impair accountability for actual amounts?

(Examples are use of contra (allowance) accounts to accumulate valuation adjustments of asset balances, and use of memorandum accounts to control bad debts which have been written off.)

#### **.070 C. Preparation of Financial Statements**

##### ***Objectives***

- The general ledger and related records permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements and reports.
- Individuals at appropriate levels in the organization consider sufficient, reliable information in making the estimates and judgments required for preparation of financial statements including related disclosures and other externally reported financial information.



- Financial statements including related disclosures are prepared and released in accordance with management's authorization.

**Questions**

1. Are the general ledger accounts arranged in orderly groupings which are conducive to efficient statement preparation?
2. Are financial reports of consolidated divisions, subsidiaries and affiliates prepared in prescribed formats which are conducive to efficient combination and consolidation?
3. Are there adequate instructions and procedures for statement preparation?

(Instructions and procedures, for example, may include the following :

- (i) Written financial statement closing schedule with assignment of specific preparation and review responsibilities.
  - (ii) Standard forms and accompanying instructions that identify for such entities as branches, divisions and subsidiaries the data they are to report (for example, consistent groupings and identification of intercompany amounts).
  - (iii) Accumulation of information on intercompany transactions.
  - (iv) Accumulation of information for disclosure in notes to financial statements.)
4. Are there adequate detailed records and procedures (for preparation and review) for—
    - a. Entries to develop consolidated financial statements such as eliminations and recording of goodwill and/or minority interest?
    - b. Reclassification entries?
  5. Are policies and procedures adequate for informing appropriate levels of management on a timely basis of—
    - a. Significant, unusual, or non-recurring transactions or events and considerations concerning their accounting recognition?
    - b. Requirements of existing and new accounting rules, and of the rules and regulations of appropriate regulatory bodies?
  6. Are estimates of net realizable value of assets and related adjustments to provide valuation allowances, and/or to write down asset balances, reviewed and approved by designated individuals at appropriate levels in the organization who are independent of the persons originating such estimates and adjustments?

7. Are procedures adequate for the review and comparison of financial statement working papers to source data and a comparison of elimination, and reclassification entries to those made in prior periods?
8. Are financial statements subjected to overall review, including comparisons with the prior period and budgeted amounts, by appropriate levels of management before the statements are approved for issuance?

## II. Revenue Cycle

### A. Revenue and Receivables

#### .080 Sales Orders

##### *Objectives*

- The types of goods and services to be provided, the manner in which they will be provided, and the customers to which they will be provided are in accordance with management's authorization.
- The prices and other terms of sale of goods and services are established in accordance with management's authorization.

##### *Questions*

1. Do policies and procedures for acceptance and approval of sales orders appear clearly defined and adequately communicated for:
  - a. Standard goods and services?
  - b. Nonstandard goods and services?
  - c. Unusual delivery arrangements?
  - d. Export sales?
  - e. Sales to related parties?
2. Is responsibility clearly assigned for approval of sales orders (customer acceptance, credit clearance, and other terms of sale) before shipment or performance?
3. Are sales orders approved in accordance with management's general or specific authorization before shipment or other performance concerning:
  - a. Customer?
  - b. Description and quantities?
  - c. Price?
  - d. Other terms of sale (for example, discounts, warranties, time commitments)?

e. Credit (account balance limits)?

(In some instances, these matters may be recorded in computer stored master files. In these instances, consideration should be given to controls over the integrity and timely updating of the files.)

4. Are all approved sales orders recorded on appropriate forms (shipping orders, work orders, etc.) which include indication of proper approval and are subject to:

a. Prenumbering?

b. Accounting for all forms used?

c. Recording in detail?

(For example, listing in a register or log, or retention of copies of all sales orders issued in a file.)

d. Timely communication to persons who perform the shipping or service function?

5. Are there appropriate procedures for approval of “No charge” services and services performed under a warranty?

6. Are unfilled sales commitments periodically reviewed?

7. Is current information on prices, and policies on such matters as discounts, sales taxes, freight, service, warranties and returned goods clearly communicated to sales and billing personnel?

(For example, such information may be communicated through approved sales catalogs, sales manuals or authorized price lists.)

8. Is there timely communication of salesmen’s commission rates to persons performing the sales and accounting functions?

(For example, approved commission schedules.)

#### **.090 Credit**

##### ***Objective***

- Credit terms and limits are established in accordance with management’s authorization.

##### ***Questions***

1. Do policies on acceptance of credit risk appear clearly defined and adequately communicated?
2. Is the credit of prospective customers investigated before it is extended to them?
3. Is there periodic review of credit limits?

4. Are persons who perform the credit function independent of sales, billing, collection and accounting functions?
5. Do persons who perform the credit function receive timely information about past due accounts?
6. Is there timely communication of credit limits and changes of credit limits to persons responsible for approving sales orders?

#### **.100 Shipments**

##### ***Objectives***

- Goods delivered and services provided are based on orders which have been approved in accordance with management's authorization.
- Deliveries of goods and rendering of services result in preparation of accurate and timely billings.

##### ***Questions***

1. Are goods shipped or services rendered based on documented sales or work orders which include indication of approval in accordance with management's authorization?
2. Are shipping documents prepared for all shipments?
3. Are shipping documents subjected to:
  - a. Prenumbering?
  - b. Accounting for all shipping documents issued?
  - c. Recording in detail? (For example, listing in a register or log, or retention of copies of all shipping documents issued in a file.)
  - d. Timely communication to persons who physically perform the shipping function?
  - e. Timely communication to persons who perform the billing function?
  - f. Timely communication to persons who perform the inventory control function?(In some systems, copies of the sales order may serve as shipping documents.)
4. Do shipping documents provide indication of:
  - a. Adequate cross-reference to the applicable properly approved sales order?
  - b. Customer identity?
  - c. Location to which shipment is made?
  - d. Description and quantities of goods shipped?

- e. Date of shipment?
  - f. Means of shipment (carrier, etc.)?
  - g. Indication of receipt?
5. Are persons who perform the shipping function independent of the sales, billing, cash and accounting functions?
  6. Is access to finished goods and merchandise restricted so that withdrawals of inventory are based only on properly approved sales orders?
  7. Are quantities of goods shipped verified, for example, by double counting or comparison with independent counts by common carriers?
  8. Are shipping and performance documents reviewed and compared with billings on a timely basis to determine that all goods shipped or services rendered are billed and accounted for?

#### **.110 Billings and Records**

##### ***Objectives***

- Sales and such related transactions as commissions and sales taxes are based on deliveries of goods or rendering of services and recorded at the correct amounts and in the appropriate period and are properly classified in the accounts.
- Sales related deductions and adjustments are made in accordance with management's authorization.

##### ***Questions***

1. Are sales invoices prepared for all shipments of goods or services rendered (including purchases which are shipped directly to customers)?  

(In some situations, it is practical to have posting of sales orders include simultaneous preparation of such related forms as shipping orders, billings, and if applicable, salesmen's commission advices.)
2. Are billing and invoice preparation functions performed by persons who are independent of the selling (soliciting and receiving orders from customers), credit, and cash functions?
3. Are all sales invoices:
  - a. Prenumbered?
  - b. Accounted for to determine all invoices are recorded?
  - c. Matched with properly approved sales orders?

- d. Matched with shipping documents?
  - e. Traced to authorized current source information on prices and terms (for example, price lists, schedules, catalogues, or computer stored master files)?
  - f. Checked for clerical accuracy by recomputation of extensions and footings?
  - g. Recorded promptly?
4. Are sales invoices listed in detail?  
(For example, the listing may be a sales journal, file of invoice copies, or computer prepared transaction file.)
5. Are there suitable chart of accounts, standard journal entries, control accounts and subsidiary records for recording, classifying and summarizing revenues, receivables, collections and such related items as commissions, and provision of allowances for doubtful accounts and product warranties?
6. Is there a proper cut off of sales and sales adjustments at month end?  
(For example, adjustments for shipments not invoiced to customers, sales invoices not recorded, and sales returns or credit adjustments not recorded.)
7. Are all credit memos (for example, adjustments, allowances and returns):
- a. Prenumbered and all numbers accounted for?
  - b. Matched when applicable with receiving reports for returns?
  - c. Approved by a responsible employee other than the person initiating preparation of the credit memo?
  - d. Recorded promptly?
8. Are commissions based on rates which are in accordance with management's general or specific authorization?
9. Is the accounts receivable subsidiary ledger reconciled monthly to the general ledger control account?
10. Are monthly statements and specific billings sent for trade receivables:
- a. Reviewed by a responsible employee who is independent of the accounts receivable and cash functions?
  - b. Mailed by a responsible employee who is independent of the accounts receivable and cash functions?

11. Is an aging schedule or schedule of past due accounts prepared monthly by someone independent of the billing and cash receipts functions?
12. Does the credit manager review monthly aging schedules or listings of past due customer accounts and investigate delinquent accounts and unusual items on a timely basis?
13. Is there documentation of review and analysis of accounts receivable balances to determine valuation allowances (for doubtful accounts) and any specific balances to be written-off?
14. Are valuation allowances and write-offs approved by a responsible employee?
15. Are written-off accounts receivable subject to memorandum control and follow-up by an employee independent of the cash receipts function?
16. Are written-off accounts receivable turned over to lawyers or collection agencies?

## B. Cash Receipts <sup>1</sup>

### .120 Processing Collections

#### *Objectives*

- Access to cash receipts and cash receipts records, accounts receivable records, and billing and shipping records is controlled to prevent or detect, on a timely basis, the taking of unrecorded cash receipts or the abstraction of recorded cash receipts.
- Detail transaction and account balance records are reconciled, at reasonable intervals, with applicable control accounts and bank statements for timely detection and correction of errors.

#### *Questions*

1. Is the mail opened by a person(s) whose duties do not involve any shipping, billing, accounts receivable detail, general ledger, invoice processing, payroll and cash disbursement functions?
2. Does the person(s) who opens the mail:
  - a. Place restrictive endorsements on all checks as received so they are for deposit only to the bank accounts of the company?

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<sup>1</sup>The illustrative internal accounting control objectives and related questions for the cash receipts sections of the revenue cycle (AAM section 4400.120-.130) are duplicated in AAM section 4400.430-.440 because some accountants may prefer to consider them as part of a financing (treasury) cycle.

- b. List or otherwise obtain control (for example, by photocopying) over all remittances and prepare totals at least daily?
- c. Forward all remittances to the person who prepares and makes the daily bank deposit?
- d. Forward the total of remittances to persons independent of physical handling of remittances and accounts receivable detail functions for subsequent comparison with the authenticated duplicate deposit slip and control over postings to subsidiary records?

(In lock box arrangements, customers would mail their remittances to a post office box controlled by the company's bank which would have responsibility for functions 2a-2d.)

3. Are receipts of currency controlled by cash registers and/or prenumbered cash receipt forms?
  - a. If cash registers are used, is a copy of the tape given to the customer as a receipt, and:
    - (1) Is the key to the cash register tape compartment in the custody at all times of a responsible employee other than the cash register operator(s)?
    - (2) Are readings of the register periodically taken and compared with the cashier's records of receipts by a responsible employee other than the cash register operators?
  - b. If prenumbered receipts are used for currency collections:
    - (1) Is a copy given to the payor as a receipt?
    - (2) Are all prenumbered receipts accounted for by a person(s) other than the person(s) handling cash received and balanced with the daily cash received?
  - c. If cash collections are for payments on account, is adequate information given for accurate posting to accounts receivable detail?
  - d. If significant cash sales are made (as in a retail store) are spot checks made to determine that cashiers are following prescribed procedures?
4. Are currency receipts forwarded daily to the person who prepares the daily bank deposit?
5. Is a summary listing of daily currency receipts forwarded to a person(s) independent of physical handling of remittances and accounts receivable detail functions?
6. Do areas involving physical handling of cash appear reasonably safeguarded?

(For example, protective windows, vaults, cashier cages, etc.)



7. Are each day's receipts (by mail, and over the counter) except for post dated items deposited intact daily?
8. Are post dated items segregated on daily detail listings of remittances to aid in control of total items received?
9. Are all employees who handle receipts adequately bonded?
10. Are banks instructed not to cash checks and other instruments (for example, drafts, money orders, etc.) drawn to the order of the company?
11. Does company policy prohibit the cashing of any accommodation checks (for example, personal and payroll checks) out of collections?
12. Are local bank accounts used for branch office collections subject to withdrawal only by the home office?
13. Are banks instructed to deliver charged back deposit items (such as checks returned because of insufficient funds) directly to an employee independent of physical handling of cash receipts and posting of accounts receivable detail?
14. Are bank chargebacks received directly from the bank and investigated by a person independent of:
  - a. Physical handling of collections?
  - b. Posting accounts receivable subsidiary detail?
15. Are entries to the cash receipts journal compared with:
  - a. Duplicate deposit slips authenticated by the bank?
  - b. Deposits per the bank statements?
  - c. Listings prepared (initial control) when mail is opened?
16. Are the comparisons described in item 15 above made by a person(s) whose duties do not include cash receipts and accounts receivable functions?

### .130 Recording Collections

#### **Objective**

- All cash receipts are recorded at the correct amounts in the period in which received, and are properly classified and summarized.

#### **Questions**

1. Is information captured from remittances (by mail and over the counter) adequate for accurate posting of credits to individual accounts receivable subsidiary records or to classifications concerning such other sources as investment income, rents, sales of property or scrap, and proceeds of financing?

(This information, for example, may be included on the listing prepared when the mail is opened, remittance advices which accompany customers' checks, detachable stubs from billings, photocopies of checks, copies of prenumbered receipts issued for currency collections, etc.)

2. Are details of daily collections balanced with the total credits to be distributed to appropriate general ledger accounts and to the total collections for the day before posting to the subsidiary records?
3. Do postings of the general ledger control accounts and subsidiary records include the date on which the remittance was received?
4. Are postings to the general ledger control accounts made by a person(s) independent of:
  - a. Physical handling of collections?
  - b. Posting accounts receivable subsidiary detail?
5. Are details of collections posted to subsidiary accounts receivable records by a person(s) independent of:
  - a. General ledger functions?
  - b. Physical handling of collections?
  - c. Receipt and investigation of bank chargebacks?

### III. Expenditures Cycle

#### A. Purchases and Accounts Payable

##### .140 Purchases

##### *Objectives*

- The types of goods, other assets, and services to be obtained, the manner in which they are obtained, the vendors from which they are obtained, the quantities to be obtained and the prices and other terms are initiated and executed in accordance with management's general or specific authorization.
- Adjustments to vendor accounts and account distributions are made in accordance with management's general or specific authorization.

##### *Questions*

1. Are all purchases based on requisitions which have been approved in accordance with management's authorization?

(For example, management's authorization may be general in that requisitions for certain types of purchases may be based on automatic reorder points which were previously approved. Management's authorization may be specific in that only specific employees may be authorized to approve requisitions for certain types of purchases.)

2. Are purchases made in accordance with management's prescribed guidelines for vendor acceptability?

(For example, guidelines for vendor acceptability may be based on such considerations as past performance, reputation, and credit standing; ability to meet delivery, quality, and service specifications; price competitiveness; legal restrictions; and policies on related party transactions. Lists of approved vendors may be developed based on such acceptability guidelines. Competitive bids may be required for items over predetermined dollar amounts from a list of several designated major vendors.)

3. Are written purchase orders used for all commitments and do those orders include the vendor description, quantity, quality, price, terms and delivery requirements for the goods or services ordered?
4. Are all purchase orders, before issuance, approved by specific individuals or classes of individuals designated by management?
5. Are all purchase orders prenumbered?
6. Are all purchase orders routinely accounted for?
7. Are all purchase orders listed in detail?  
(Examples include a register, log, computer tabulation, or file of copies of issued order forms.)
8. Is there a record of open purchase commitments?  
(Examples include periodic routine listings of open items prepared from a register, a file of open order copies, a computer master file of open orders.)
9. Is the purchasing function independent of receiving, shipping, invoice processing and cash functions?
10. Is custody of unissued purchase order forms adequate to prevent their misuse?
11. Are open purchase orders periodically reviewed and investigated?

#### .150 Receiving

##### *Objectives*

- All goods, other assets and services received are accurately accounted for on a timely basis.

- Only authorized goods, other assets and services are accepted and/or paid for.

### *Questions*

1. Are all goods received inspected for condition and independently counted, weighed or measured to provide for comparison with the applicable purchase order?
2. Is there evidence that all services received are evaluated for quality and completeness?
3. Are procedures adequate for timely communication concerning shortages or damaged goods?
4. Are receiving reports prepared promptly for all goods received? (For example, copies of purchase orders with the quantities blanked out may serve this purpose. Receiving reports may also be used to record such matters as receipt of pieces of leased equipment.)
5. Do receiving reports provide for recording of:
  - a. Description, quantity and acceptability of goods or services received?
  - b. Date on which the goods or services are received?
  - c. Signature of the individual approving the receipt?
6. Are receiving reports subjected to the following:
  - a. Prenumbering?
  - b. Listing in detail?  
(For example, a complete set of file copies in numerical or chronological sequence, a receiving log, etc.)
  - c. Accounting for all receiving reports used?
  - d. Distribution of copies for timely matching with purchase orders and vendor's invoices and, if applicable, timely maintenance of perpetual inventory records?
7. Are receiving functions performed by designated employees who are independent of the purchasing, shipping, invoice processing and cash functions?
8. Is there a separate inspection function?

### **.160 Invoice Processing**

#### *Objectives*

- Only authorized goods, other assets and services received are paid for.

- Amounts payable for goods and services received are accurately recorded at the correct amounts in the appropriate period and are classified in the accounts to:
  - (1) Permit preparation of reports and statements in conformity with generally accepted accounting principles or other criteria.
  - (2) Maintain accountability for costs incurred.
- Access to purchasing, receiving, and accounts payable records is suitably controlled to prevent or detect within a timely period duplicate or improper payments.

### *Questions*

1. Are vendors' invoices processed by designated employees who are independent of the purchasing, receiving, shipping and cash functions?
2. Are all vendors' invoices received directly by the designated employees (accounts payable department) who perform the invoice processing function?
3. Is control established over all invoices received?  
(For example, control may be established over invoices received by prompt matching with a prenumbered internally prepared document such as a purchase order and assignment of that number to the invoice. Another approach may consist of assignment of a voucher number and entry into a register.)
4. Are duplicate invoices conspicuously stamped or destroyed as a precaution against duplicate payment?
5. Are there a suitable chart of accounts and established guidelines for assigning account distributions to processed invoices?
6. Are vendors' invoices, prior to payment, compared in detail to:
  - a. Purchase orders?
  - b. Receiving reports?
  - c. Evidence of direct shipment to customers?  
(For example, copy of vendor's shipping document or acknowledgment of receipt by the customer)
  - d. Debit memoranda?
  - e. Evaluation reports on services rendered?
7. Are vendors' invoices, prior to payment, reviewed for correctness of:
  - a. Clerical accuracy (extensions and footings)?
  - b. Freight charges?
  - c. Account distribution?

8. Is there documented evidence that invoices have been subjected to prescribed processing routines, assigned specific account distributions and approved before payment?

(Examples include use of a block stamp which has been initialed or signed, attachment of a completed voucher form, attachment of copies of the purchase order and receiving report, and routine annotations on the invoice.)

9. Are all available discounts taken?
10. Are processed invoices and supporting documents approved by designated employees before payment?
11. Are there procedures for periodic review and investigation of unprocessed invoices, unmatched purchase orders and unmatched receiving reports which provide for appropriate follow-up and appropriate financial statement accruals?
12. Are approved debit memos used to notify vendors of goods returned and other adjustments of their accounts?
13. Are processed invoices listed in detail to facilitate timely determination of accounts payable and related account distribution of filled purchase commitments?  
(For example, entries in a voucher register and periodic preparation of unpaid voucher listings, computer prepared listings of transaction detail and master files for vendor accounts, files of unpaid processed invoices, etc.)
14. Are accumulation of processed invoices and follow-up of unmatched purchase orders and receiving reports adequate to result in a proper cut-off for financial reporting purposes?
15. Is accounts payable detail periodically reconciled with the control accounts at reasonable intervals?
16. Are vendors' statements reviewed for overdue items and reconciled with accounts payable detail?
17. Is there independent follow-up of such matters as overdue items on vendors' statements, payment requests, and complaints?
18. Are employee expense accounts
- Prepared in accordance with criteria set by management?
  - Submitted promptly?
  - Adequately supported?
  - Approved before payment?

## B. Payroll

### .170 Authorization of Wages, Salaries, Withholdings and Deductions Objectives

#### *Objectives*

- Employees are hired and retained only at rates, benefits and perquisites determined in accordance with management's (board of directors, if appropriate) general or specific authorization.
- Payroll withholdings and deductions are based on evidence of appropriate authorization.

#### *Questions*

1. Are all new hires, rates of pay and changes thereto, changes in position, and separations based on written authorizations in accordance with management's criteria?  
(Management's criteria, for example, may include—
  - (i) support for such authorizations by written personnel requisitions which have been initiated and approved at designated levels of management,
  - (ii) conformity of pay rates with previously approved wage and salary schedules, and
  - (iii) appropriate investigation of the job candidate's background.)
2. Are methods for determining premium pay rates for such matters as overtime, night shift work, and production in excess of certain quotas based on written authorization in accordance with management's criteria?  
(Such written authorization may, for example, consist of a schedule based on a labor agreement and/or management policy statements.)
3. Are all employee benefits and perquisites granted in accordance with management's authorization?  
(Employee benefits may be generally authorized as, for example, under a pension plan applicable to a number of employees or specifically authorized as in a deferred compensation agreement with a particular individual authorized by the board of directors.)
4. Are appropriate written authorizations obtained from employees for all payroll deductions and withholding exemptions?
5. Are personnel files maintained on individual employees which include appropriate written authorizations for rates of pay, payroll deductions and withholding exemptions?

6. Are the following reported promptly to employees who perform the payroll processing function :
  - a. Wage and salary rates resulting from new hires, rate changes, changes in position, and separations?
  - b. Changes in authorized deductions and withholding exemptions?

#### .180 Preparation and Recording

##### *Objectives*

- Compensation is made only to company employees at authorized rates and for services rendered (hours worked, piecework, commissions on sales, etc.) in accordance with management's authorization.
- Gross pay, withholdings, deductions and net pay are correctly computed based on authorized rates and services rendered and properly authorized withholding exemptions and deductions.
- Payroll costs and related liabilities are correctly accumulated, classified and summarized in the accounts in the appropriate period.
- Comparisons are made of personnel, payroll and work records at reasonable intervals for timely detection and correction of errors.

##### *Questions*

1. Do employees who perform the payroll processing function receive timely notification of:
  - a. Wage and salary rates resulting from new hires, rate changes, changes in position and separations?
  - b. Changes in authorized deductions and withholding exemptions?
2. Is gross pay determined using authorized rates and:
  - a. Time or attendance records for employees paid by the hour or by salary?
  - b. Piece work records for employees whose wages are based on production?
  - c. Adequate detail records of sales for commission salesmen?
3. Are there a suitable chart of accounts and established guidelines for determining account distributions for wages and salaries and controlling liabilities for payroll deductions and taxes withheld?
4. Do records of individual employee time, piecework, and/or commissions on sales—



- a. Permit computation of gross pay in accordance with management's criteria?
  - b. Include adequate information for distribution of payroll costs or reconciliation with payroll costs charged to particular cost centers in accordance with management's criteria?
  - c. Receive written approval of applicable supervisors or foremen before submission to persons who prepare the payroll?  
(Management criteria for determination of gross pay may include such additional considerations as formulas for overtime premium, shift differential premiums and incentive bonuses. In some situations, records of employee time or production may involve charges to several job order or departmental cost centers. Management criteria may also include additional approvals of time or production increments which result in pay over and above certain base amounts.)
5. Are total production hours used for determination of gross pay reconciled with production statistics used for cost accounting purposes?
  6. Are piece rate records reconciled with production records, or are counts spot checked?
  7. Salesmen's commission records reconciled with recorded sales?
  8. Are clerical operations in the preparation of payrolls verified by reperformance or reconciliation with independent controls (such as predetermined totals for gross pay and/or net pay) over source data?
  9. Is a reconciliation prepared of:
    - a. Payroll cost distributions to gross pay?
    - b. Net pay, deductions and withholding to gross pay?
  10. Are comparisons made at reasonable intervals of pay rates per the payroll with rates per the written authorizations in the personnel files by responsible persons whose duties are independent of the personnel, payroll processing, disbursement, and general ledger functions?
  11. Are such data as hours worked, piecework and commission sales used to determine gross pay compared at reasonable intervals with applicable production and sales records by responsible persons whose duties are independent of personnel, timekeeping, payroll processing, disbursement and general ledger functions?
  12. Are the results of comparisons made per items 10 and 11 above reviewed by a responsible official and appropriate action taken?

.190 Disbursements (Payroll) <sup>2</sup>**Objective**

- Net pay and related withholdings and deductions are re-mitted to the appropriate employees and entities respectively, when due.

**Questions**

1. Are payrolls approved in writing by responsible employees before issuance of payroll checks or distribution of cash for net pay?
2. Is net pay distributed by persons who are independent of personnel, payroll preparation, time-keeping and check preparation functions?
3. For payrolls paid by check, are checks drawn on a separate imprest account, and are deposits equal to the amount of net pay?
4. For payrolls paid in cash :
  - a. Are adequate security precautions taken?
  - b. Does the cash requisition equal the amount of net pay to be distributed as cash?
  - c. Is distribution made by persons independent of payroll preparation functions?
  - d. Are receipts obtained from employees?
5. Is responsibility for custody and follow-up of unclaimed wages assigned to a responsible person independent of personnel, payroll processing and cash disbursements functions?
6. Are procedures adequate to result in timely and accurate preparation and filing of payroll tax returns and payment of accumulated withholdings and related accrued taxes?

(Examples of procedures include use of a tax calendar or tickler file, instructions and tables for tax return preparation, use of competent tax information services, and appropriate account classifications and subsidiary records to accumulate required information.)

7. Are procedures adequate to result in timely and accurate remittance of accumulated payroll deductions for fringe benefits?  
(Examples include timely availability of information on benefit plans and amendments, use of a payment calendar or tickler file, appropriate account classifications and subsidiary records to accumulate required information.)

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<sup>2</sup> See AAM section 4400.210-.230 (or 4400.450-.470) for additional objectives and questions on cash disbursements.

## .200 Segregation of Functions and Physical Safeguards

### *Objectives*

- Functions are assigned so that no single individual is in a position to both perpetrate and conceal errors or irregularities in the normal course of his duties.
- Access to personnel and payroll records is limited to minimize opportunities for errors and irregularities.

### *Questions*

1. Is there adequate separation of duties among employees who perform the following functions:
  - a. Written authorization of new hires, pay rates and changes thereto, benefits, changes in position, and separations?
  - b. Maintenance of personnel records?
  - c. Timekeeping and accumulation of piecework and/or commission information
  - d. Preparation of payrolls
  - e. Approval of payrolls
  - f. Cash disbursements
  - g. General ledger
2. Do the personnel and payroll records appear reasonably safeguarded?  
(Examples include locked file cabinets, work areas with limited access.)

## C. Cash Disbursements <sup>3</sup>

### .210 Assignment of Functions

#### *Objective*

- Functions are assigned so that no single individual is in a position to both perpetrate and conceal errors or irregularities in the normal course of his duties.

#### *Questions*

1. Is the cash disbursements function performed by persons who are independent of the following functions:
  - a. Purchasing?
  - b. Receiving?

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<sup>3</sup>The illustrative internal control objectives and questions for the cash disbursements sections of the expenditures cycle (AAM section 4400.210-.230) are duplicated in AAM section 4400.450-.470 because some accountants may prefer to consider them as part of a financing (treasury) cycle.

- c. Invoice processing?
  - d. Payroll preparation and approval?
  - e. Shipping?
  - f. Accounts receivable?
  - g. Cash receipts?
  - h. General ledger?
2. Is there adequate separation of duties within the cash disbursement function among persons who perform the following:
- a. Control access to unissued checks?
  - b. Prepare checks?
  - c. Sign checks and inspect support?
  - d. Mail checks?
  - e. Maintain custody of petty cash?
  - f. Maintain the cash disbursement journal?
  - g. Reconcile the bank accounts?

#### .220 Processing Disbursements

##### *Objectives*

- Disbursements are made only for expenditures incurred in accordance with management's authorization.
- Adjustments to cash accounts are made only in accordance with management's authorization.
- Disbursements are recorded at correct amounts in the appropriate period and are properly classified in the accounts.
- Access to cash and cash disbursements records is restricted to minimize opportunities for irregular or erroneous disbursements.

##### *Questions*

1. Are all bank accounts authorized by the board of directors?
2. Are all check signers authorized by the board of directors?
3. Are banks promptly notified of any changes in authorized check signers?
4. Are banks instructed not to cash checks and other instruments (for example, drafts, money orders, etc.) drawn to the order of the company?
5. Are all bank accounts and cash funds subjected to general ledger control?
6. Are all disbursements and bank transfers based on vouchers and check requests which have been approved by responsible employees designated by management?

7. Are all disbursements except from petty cash made by check?
8. Are properly approved supporting documents (processed invoices, purchase orders, receiving reports, etc.) presented with the checks and reviewed by the check signer(s) before signing the checks?
9. Is a mechanical check protector used to inscribe amounts on checks as a precaution against alteration?
10. Are supporting documents for checks properly cancelled to avoid duplicate payment?
11. Are signed checks independently mailed directly after signing without being returned to persons involved in the invoice processing and check preparation functions?
12. Is access to unissued checks limited to designated responsible employees who are independent of the check signing function, including operation of mechanical check signing machines?
13. Are checks prenumbered and all numbers accounted for?
14. Are all voided checks retained and mutilated?
15. Are all checks promptly recorded when issued and listed in detail (cash disbursements journal, check register, etc.)?
16. Are details of individual disbursements balanced with the totals to be posted to appropriate general ledger account distributions and to total disbursements to be posted to the general ledger control accounts for cash?
17. Is there a written policy which prohibits:
  - a. Drawing checks payable to cash or bearer?
  - b. Signing or countersigning of blank checks?
18. If dual signatures are required:
  - a. Are the two signers independent of one another?
  - b. Does each signer determine that the disbursement is supported by approved documentation?
19. If a check signing machine is used:
  - a. Are checks approved before mechanical signing by designated responsible employees who are subject to the same segregation of duties as if they were authorized check signers?

(Use of a check signing machine allows an entity to delegate authority for approving checks to a greater number of persons than those registered with the bank as authorized signers. However, approval procedures should be sufficient to assure the official whose name is on the signature plate

that all mechanically signed checks would have met his approval if he had reviewed and manually signed them himself.)

- b. Are the keys and signature plate, and operation of the signing machine under control at all times of the official whose signature is on the plate?
- c. Are the employees who have custody of the keys and plate, and operate the check signing machine independent of voucher and check preparation functions and denied access to blank checks?
- d. Are the checks issued to the machine operator(s) counted in advance and reconciled with the totals of the counting device on the check signing machine by someone other than the machine operator?

(Control may be strengthened by having a locked compartment on the machine which receives the signed checks and can be opened only by someone independent of the machine operator.)

20. Are cash funds on an imprest basis and :
  - a. Kept in a safe place?
  - b. Reasonable in amount?
  - c. Controlled by one custodian who is independent of invoice processing, check signing, general accounting and cash receipts functions?
  - d. Periodically counted by someone other than the custodian?
21. Are all disbursements from cash funds :
  - a. Supported by vouchers which are prepared in ink?
  - b. Approved in accordance with management's authorization?
  - c. Cancelled to prevent reuse?
  - d. Subject to a predetermined maximum dollar limit for any individual disbursement?
22. Are reimbursements of cash funds :
  - a. Subject to the same review and approval as processed invoices?  
(See AAM section 4400.160 on invoice processing)
  - b. Remitted by checks drawn payable to the order of the custodian of the cash fund?

### .230 Bank Reconciliations

#### *Objective*

- Comparison of detail records, control accounts and bank statements are made at reasonable intervals for detection and appropriate disposition of errors or irregularities.

#### *Questions*

1. Are the bank accounts reconciled monthly by an employee(s) who is independent of invoice processing, cash disbursements, cash receipts, petty cash and general ledger functions?
2. Are bank statements, related paid checks, debit and credit memos received directly from the bank by the employee(s) performing the reconciliations?
3. Does the bank reconciliation procedure include:
  - a. Reconciliation of the balance per bank to balance per the general ledger control account and subsidiary detail records?
  - b. Comparison in detail of deposits per the bank statement with deposits per cash receipts detail records?
  - c. Comparisons in detail of disbursements per bank with the cash disbursements journal (check register) as to date drawn, payee and amount?
  - d. Comparison of payees with endorsements?
  - e. Follow up of reconciling items and initiation of entries to record such transactions as checks returned for insufficient funds, and bank charges?
4. Are old outstanding checks investigated and subjected to proper disposition (in compliance with applicable escheat laws if present)?

## **IV. Production (Conversion) Cycle**

### **A. Production Costs and Inventories**

#### **.240 Authorization of Production Activities, Planned Inventory Levels and Service Capabilities**

#### *Objective*

- All production activity (including planned inventory levels and service capabilities) and accounting therefor, is determined in accordance with management's general or specific authorization.

*Questions*

1. Are the types and quantities of goods to be manufactured and/or services to be provided determined in accordance with management's authorization?

(Some examples of how management may record and communicate its authorization include approval of:

- (i) Production goals and schedules based on accompanying sales forecasts.
  - (ii) Overall production and inventory control plans.
  - (iii) Establishment of a production control function.
  - (iv) Definitions and policy statements on services to be provided.)
2. Are the methods and materials to be used determined in accordance with management's authorization?

(Some examples of how management may evidence its authorization include approval of:

- (i) Product engineering plans and specifications.
  - (ii) Acquisitions and use of property and equipment.
  - (iii) Procedural instructions for services to be provided.)
3. Are planned inventory levels or service capabilities to be maintained, determined in accordance with management's authorization?

(Some examples of how management may evidence its authorization include approval of:

- (i) Budgeted inventory levels.
  - (ii) Policies on whether to produce for specific customer orders, for stock, or a combination of both.
  - (iii) Predetermined reorder points.
  - (iv) Policies on identification and disposition of excess or obsolete inventory.
  - (v) Planned personnel rosters of individuals with specific knowledge, experience and skills relating to services to be provided.)
4. Is the scheduling of goods to be produced and/or services to be provided determined in accordance with management's authorization?

(Some examples of how management may evidence its authorization include approval of:

- (i) Production schedules and forecasts.
- (ii) Forecasts of time requirements.



- (iii) Policies and procedures for budgeting individual job or project orders.)
5. Are all adjustments to inventory and cost of sales made in accordance with management's authorization?
  6. Are all dispositions of obsolete or excess inventory or scrap made in accordance with management's authorization?

**.250 Recording Resources Used in Production and Completed Results**

**Objective**

- Resources obtained and used in the production process and completed results are accurately recorded on a timely basis.

**Questions**

1. Are receiving reports prepared which include adequate information for posting detailed inventory records and allow for summarization into a source for posting inventory control accounts? (See AAM section 4410.130, Expenditures Cycle—Receiving, for further illustrative questions on receiving reports.)
2. Are all releases from storage of raw materials, supplies, and purchased parts inventory based on approved requisition documents which:
  - a. Include adequate information to be used as a reliable and consistent source for posting detailed inventory records?  
(For example, descriptions, quantities and inventory cost.)
  - b. Allow for summarization into a source for maintaining inventory control accounts?
  - c. Provide a means (such as prenumbering or batching) of accounting for all requisitions issued?
3. Is authority to approve inventory requisitions assigned to responsible employees whose duties do not include the following:
  - a. Physical custody of raw materials, supplies and purchased parts inventories?
  - b. Maintenance of detailed inventory records?
  - c. Maintenance of inventory control accounts?
4. Is labor effort (time, cost or both) reported promptly and recorded in sufficient detail to be identified with applicable classifications such as job orders or allocation to units in process, and to provide for:
  - a. Accumulation into reliable and consistent sources for maintaining detail production control and cost accounting records?

- b. Summarization into a source for posting inventory control accounts?
- c. Reconciliation with payroll costs charged to the production process?
- d. A means (such as prenumbering or batching) of accounting for all labor reports issued?

(See AAM section 4410.150-.180, Expenditures Cycle—Payrolls, for further illustrative questions on payroll.)

- 5. Are transfers of completed units from production to custody of finished goods inventory based on approved completion reports which authorize such transfer and:
  - a. Include adequate information to be used for reliable and consistent maintenance of detailed finished goods inventory and reconciliation with applicable materials and labor put into the production process?
  - b. Allow for summarization into a reliable and consistent source for maintaining general ledger control accounts?
  - c. Provide a means (such as prenumbering or batching) of accounting for all completion reports issued?
- 6. Do completion reports include indication of approval by designated individuals in accordance with management's criteria?  
(Such criteria may concern completion of prescribed production steps and conformity with prescribed quality standards.)
- 7. Are there adequate procedures for reporting defective units and scrap resulting from the production process?
- 8. Are perpetual inventory records maintained of both quantities and dollar amounts for:
  - a. Raw materials?
  - b. Supplies?
  - c. Work in process?
  - d. Finished goods?
  - e. Scrap?
  - f. Inventory held by outside parties?  
(For example, bonded warehouses, consignees, subcontractors, suppliers.)
  - g. Inventory held for outside parties?  
(For example, goods billed but not yet shipped, goods held on consignment, materials being processed as a subcontractor, etc.)?

- 9. Are the perpetual records of inventory detail:

- a. Controlled by general ledger accounts?
  - b. Based on documentation of inventory movement and adjustments which has been approved in accordance with management's authorization?
  - c. Adjusted to periodic physical inventories taken annually or on a cycle basis at least once a year?
  - d. Reconciled with the inventory control accounts at reasonable intervals?
  - e. Kept by persons whose duties do not include the following:
    - (1) Custody of the physical stock
    - (2) Maintenance of the general ledger control accounts
    - (3) Authority to requisition withdrawals or other movement of inventory.
10. Is documentation of inventory movement accounted for to determine complete and adequate recording thereof?
  11. Are there adequate procedures for identifying and reporting excess, slow-moving and obsolete inventories?
  12. Do the duties of the persons engaged in production, inventory planning, and inventory custody exclude the following functions:
    - a. Maintenance of detail inventory records?
    - b. Cost accounting?
    - c. General accounting?

#### **.260 Recording Transfers to Customers and Other Inventory Dispositions**

##### ***Objective***

- Transfer of finished production to customers and other dispositions such as sales of scrap are accurately recorded on a timely basis.

##### ***Questions***

1. Are releases of finished goods inventory for delivery to customers based on shipping documents which have been approved in accordance with management's authorization?  
(See Revenue Cycle—Shipments for further illustrative questions on shipping documents.)
2. Are releases of excess, obsolete, defective or scrap inventory for disposition based on documented instructions which have been approved in accordance with management's authorization?

3. Is authority to approve instructions for the release of inventory assigned to responsible employees whose duties do not include the following:
  - a. Physical custody and handling of inventories including preparation of goods for shipment?
  - b. Maintenance of detailed inventory records?
  - c. Maintenance of general ledger control accounts?
4. Do shipping documents and release documents for such other dispositions as sales of scrap—
  - a. Include adequate information for recording reductions in the detailed inventory records, charges to cost of sales, and cross-reference or connection with source documents used to recognize revenue and the related receivable?

(If practicable, the same document may serve as the source for recognition of revenue and the related receivable and of cost of sales and the related reduction of inventory.)
  - b. Allow for summarization into a source for maintaining the inventory control accounts?
  - c. Provide a means (such as prenumbering or batching) of accounting for all shipping documents and other release documents issued?

#### **.270 Accumulation and Classification of Production and Inventory Costs and Costs of Sales**

##### ***Objective***

- Inventory, production costs and costs of sales are accumulated and classified in the accounts to—
  - (1) permit preparation of statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements.
  - (2) maintain accountability for costs incurred.

##### ***Questions***

1. Do the chart of accounts and standard journal entries provide adequate general ledger control accounts and subsidiary detail for the following:
  - a. Accumulation and classification of costs of materials, direct labor, and overhead (including indirect labor)?
  - b. Accumulation of information such as the following in sufficient detail and with proper cutoff to provide for adequate determination of inventory costs and cost of goods sold:

- (1) Quantities of raw materials and supplies used in production?
- (2) Labor hours and/or machine hours expended?
- (3) Quantities or units of product produced?
- (4) Quantities or units of product transferred to customers?  
(Accounts and records vary extensively among companies because of such variables as industry, company size and nature of the production or service process. Examples of techniques to consider in addressing a company's needs include:
  - (i) Identification and allocation of costs directly to units or jobs produced and to overhead; application of overhead to units or jobs using a burden rate and a factor such as direct labor hours incurred or units produced.
  - (ii) Use of a job order or process cost system or combination of both, or an allocation of costs incurred to units produced based on units sold and the units in the physical inventories as of the closing and opening of a period.
  - (iii) Identification of costs incurred with departments or cost centers responsible for incurring the particular costs.
  - (iv) Use of departmental or costs center burden rates to apply overhead to production.
  - (v) Use of a standard cost system with investigation of variances.
  - (vi) Account classifications which provide for preparation of reports and statements in conformity with generally accepted accounting principles and, if appropriate, such other criteria as direct costing practices selected by management for internal purposes and statutory accounting practices required by regulatory bodies.)
2. If a cost accounting system is used, is it reconciled at reasonable intervals with the general ledger?
3. If perpetual records are maintained, are they reconciled at reasonable intervals with the:
  - a. General ledger?
  - b. Cost accounting system?
4. Are requisitions for materials, supplies, finished goods and physical transfers of inventory subjected to the following:
  - a. Review to determine that requisitions are completed and approved in accordance with management's authorization?

- b. Accounting for all requisitions used? (For example, by accounting for all numbers preassigned to particular types of requisition forms).
  - c. Summarization of requisitions at reasonable intervals for consistent and timely maintenance of control accounts?
  - d. Accurate and timely recording in the subsidiary detail records?
5. Are reports of direct and indirect labor effort (for example: job tickets, time cards, etc.) subjected to the following:
- a. Review to determine that the reports are completed and approved in accordance with criteria authorized by management?
  - b. Accounting for all reports issued?  
(For example, by accounting for all numbers preassigned to particular types of reporting forms.)
  - c. Reconciliation with account distribution of payroll for consistent and timely maintenance of the control accounts?
  - d. Accurate and timely recording in the subsidiary detail records?
6. Are the detailed inventory records and control accounts adjusted for reports of excess, slow-moving and obsolete inventories in accordance with management's general or specific authorization?
7. Are burden rates and amounts of overhead applied to production compared at reasonable intervals with actual overhead costs incurred and updated in accordance with management's authorization?
8. For standard cost systems:
- a. Are standard rates and volume compared at reasonable intervals with actual costs and activity and revised accordingly for changes in underlying conditions?  
(For example, comparison of raw material costs with vendors' invoices, standard labor rates with actual rates, standard materials usage and machine hours with product engineering changes, standard labor hours with time studies, etc.)
  - b. Are significant variances investigated and the resulting explanation brought to management's attention on a timely basis?
9. Do the duties of persons who maintain the detailed inventory and cost accounting records exclude the following functions:
- a. Physical custody and handling of inventories?
  - b. Maintenance of the general ledger control accounts?

10. Is access to the detailed inventory records and control accounts limited to persons responsible for their maintenance, oversight and internal audit?
11. Are the inventory detail records and control accounts adjusted to physical counts at least annually?

### .280 Inventory Safeguarding

#### *Objectives*

- Inventory is protected from unauthorized use or removal.
- Access to inventory, property, cost and production records is limited to designated individuals in accordance with management authority so that unauthorized dispositions may be prevented or detected within a timely period.

#### *Questions*

1. Do physical safeguards of inventory appear reasonably adequate in relation to the materiality of the inventory and its susceptibility to theft?  
(Examples include:
  - fenced areas
  - restricted-access storerooms or vaults
  - guards
  - detection and scanning devices (for example, alarms, television cameras)
  - inspection of personnel
  - independent storeroom clerks
  - maximum visibility by supervisors and security personnel of work and storage areas.)
2. Does inventory appear reasonably protected from physical deterioration?  
(Examples include:
  - shelters and buildings
  - maintenance of environment at appropriate temperature and humidity
  - containers and storage facilities.)
3. Are persons responsible for custody of inventory independent of inventory recording, cost accounting and general accounting functions?
4. Is insurance coverage of the inventory maintained and reviewed in accordance with management's authorization?

**.290 Physical Counts of Inventory****Objective**

- Recorded balances of inventory are substantiated and evaluated at reasonable intervals by comparison with and evaluation of actual quantities on hand. (For example, physical counts and review for excess, slow moving and obsolete stock.)

**Questions**

1. Is inventory subjected to physical count at least annually?
2. If the complete physical count is made at other than the fiscal year end are the controls over physical movement (receipts, internal transfers, and shipments) of inventory, accuracy of recording cut-offs and segregation of duties satisfactory for such timing?
3. If counts are made on a cycle basis rather than as complete counts, are all of the following conditions present for classes of inventory subjected to cycle counts?
  - a. Complete and accurate perpetual records which are maintained on a timely basis?
  - b. The nature of the inventory items allows for practicable comparison with perpetual records?
  - c. Adequate control over physical movement of inventories (receipts, internal transfers, and shipments) and accurate recording of cut-offs to provide timely and accurate source data for maintaining the perpetual records and clear identification of classes or groups of items to be counted?
  - d. Sufficient segregation of duties so that errors of omission or commission are prevented or detected promptly?
4. Do detailed written inventory procedures and instructions exist which have been approved in accordance with management's authorization before issuance and use?
5. Do the inventory procedures adequately address the following matters:
  - a. Location and orderly physical arrangement of inventories?
  - b. Identification and description of the inventories by persons familiar with it?
  - c. Segregation and proper identification of goods that are not property of the client, such as customers' goods and goods held on consignment?
  - d. Method of determining quantities such as weight, count or measure?



- e. Recording of items on count sheets or tickets including complete descriptions, identifying codes (serial numbers, model numbers), as well as quantities counted?
  - f. Special considerations for work in process such as identifying stage of completion?
  - g. Identification of stock counted to determine all items are counted and to preclude duplicate counting?
  - h. Cut-off of receipts, internal transfers, and shipments.
  - i. Control of physical inventory records, such as prenumbering of all count sheets, count tickets, and accounting for all numbered records issued and used?
  - j. Identification of slow moving, obsolete and damaged items?
  - k. Substantiation of inventories held by others?
  - l. Pricing, extension and summarization of the physical counts?
  - m. Investigation and disposition of differences between physical counts and detailed inventory records?
6. Are physical count procedures supervised by a responsible official whose duties do not include physical custody of inventories and performance of purchasing, receiving, and shipping functions?
  7. Are inventory instructions adequately communicated to and understood by persons who perform the physical counts?
  8. Are physical counts performed by persons whose duties do not include the following:
    - a. Physical custody of inventories?
    - b. Detailed inventory record keeping (maintaining perpetual records)?
    - c. Maintenance of inventory control account(s)?
  9. Is inventory movement adequately controlled during the count so that items are not missed or double-counted because of:
    - a. Receiving activity?
    - b. Internal inventory movement?
    - c. Shipping activity?
  10. Are controls over purchases and receiving activity sufficient to result in recording of liabilities for any items included in inventory which have not been paid for?
  11. Are controls over sales and shipping activity sufficient to result in exclusion from the physical inventory of any items which have been sold and billed but not yet shipped?

12. Are inventory counts subject to adequate verification such as recounts by persons other than those who made the initial counts or spot checks by others, such as internal auditors?
13. Are pricing, extension and summarization of the physical counts performed by persons whose duties do not include the following:
  - a. Physical custody of inventories?
  - b. Detailed inventory record keeping?
  - c. Maintenance of the inventory control accounts?
14. Are pricing, extension and summarization of the physical counts subject to adequate verification such as reperformance by persons other than those who initially performed the tasks on a complete or test basis?
15. Are differences between physical counts and detailed inventory records investigated in accordance with management's authorization before the records are adjusted?
16. Is there documentation of review and analysis of the physical inventory to:
  - a. Conform with the lower of cost or market principle,
  - b. Identify items which are excessive, slow-moving, defective or obsolete,
  - c. Determine the need for adjustments or valuation allowances?
17. Are adjustments of the inventory detail records and control accounts given prior approval in accordance with management's authorization?
18. Are dispositions of obsolete or excess inventories and scrap made in accordance with criteria authorized by management?

## **B. Property and Equipment**

### **.300 Initiation and Execution of Property and Equipment Transactions**

#### **Objective**

- Additions and related accumulation of depreciation or amortization, retirements, and dispositions of property and equipment (owned and leased) are made in accordance with management's authorization.

#### **Questions**

1. Is advance approval in accordance with management's criteria required for all property and equipment transactions?  
(For significant additions (purchases or leases) approval authority may be kept at such levels as the board of directors.

In some closely held entities, authority for such approval may be reserved by the stockholders or partners. Some entities, however, may have a framework of policies and procedures within which general authority for property and equipment transactions within certain dollar limits may be delegated to management levels below the board of directors. It is desirable that such policies be clearly expressed and documented.)

2. Are requests for additions, transfers, major maintenance and repair, retirement and disposition of property and equipment—
  - a. Initiated by designated individuals in accordance with management's authorization?  
(These individuals generally are responsible employees or officials in the department which would use the asset.)
  - b. Formally documented, including an adequate description of the proposal, its reasons, and the estimated amount of the transaction?  
(Some entities may use standardized forms to document requests for property and equipment transactions including signatures of employees who initiated and approved the request.)
  - c. Reviewed for key considerations in accordance with management's criteria?  
(Key considerations may include such issues as:
    - (i) Whether to make or buy the asset.
    - (ii) Selection of vendors, prices and terms including consideration of soliciting competitive bids.
    - (iii) Selection among financing alternatives such as use of internally generated funds, entering debt or lease agreements, and issuing preferred or common stock.
    - (iv) Accounting matters, such as whether the transaction should be capitalized or expensed, classification of leases, determination of estimated useful life, salvage value, and methods of depreciation or amortization.)
  - d. Approval at a higher level than the department or official who initiated the request?
3. Are authorizations to execute property and equipment transactions adequately documented?  
(Following are some examples of such documentation:
  - (i) Decisions recorded in meetings of the board of directors or finance committee accompanied by relevant detailed

proposals and cost-benefit analyses which may be part of the minutes by reference.

- (ii) Work order forms approved by designated individuals in accordance with clearly stated management criteria.
  - (iii) Contracts and agreements signed by individuals in accordance with appropriately documented designation by the board of directors.)
4. Are procedures adequate for determining that components and services for property and equipment are received or performed? (Examples include status or completion reports prepared by architects and engineers and approved in accordance with management's authorization; or transactions processed through the company's normal purchasing procedures. See AAM section 4400.120-.140, expenditures cycle, for additional illustrative inquiries on purchase orders, receiving reports and vendors' invoices.)
  5. Are procedures adequate for determining that all dispositions of property and equipment have been executed and proceeds, if any, received in accordance with management's authorization?

### **.310 Recording Property and Equipment and Related Depreciation and Amortization**

#### ***Objective***

- Transactions involving property and equipment and related depreciation and/or amortization are accurately recorded, accumulated and classified in detail and in control accounts to—
  - (1) permit preparation of statements in conformity with generally accepted accounting principles or other criteria applicable to such statements,
  - (2) maintain accountability for assets.

#### ***Questions***

1. Are detailed records maintained for the classes of property and equipment (owned and leased) which present:
  - a. Description of specific assets, their location, and if applicable, such specific identification as serial or other control numbers?
  - b. Cost, acquisition date, and date placed in service (if different from acquisition date)?
  - c. Depreciable or amortizable life and method of depreciation or amortization?
    - (1) For financial reporting purposes?
    - (2) For tax purposes if different from financial reporting?

- d. Estimated salvage value and amount subject to depreciation or amortization?
- e. Amount of related accumulated depreciation or amortization?
2. Are general ledger control accounts maintained for the appropriate classes of owned and leased property and equipment and related depreciation and amortization?
3. Are responsibilities for maintaining the detailed property records segregated from those of—
  - a. Maintaining the general ledger control accounts?
  - b. Custody of property and equipment?
4. Do persons who maintain the detail records and control accounts receive timely and adequate information about—
  - a. Additions, transfers, retirement from service and dispositions of property and equipment?
  - b. Depreciable (or amortizable) lives and methods of depreciation or amortization as prescribed in accordance with management's authorization?
5. Are the detailed property and equipment records reconciled at reasonable intervals with the control accounts and differences, if any, investigated and resolved in accordance with management's authorization?
6. Are depreciable and amortizable lives reviewed at reasonable intervals for adequacy in relation to use or obsolescence based on actual experience?

### **.320 Safeguarding Property and Equipment**

#### ***Objective***

- Property and equipment is reasonably safeguarded from loss.

#### ***Questions***

1. Is property and equipment insured in accordance with management's authorization based on appraisals made at reasonable intervals?
2. Are items of property and equipment (owned and leased) subject to reasonably adequate physical protection techniques? (Examples of such techniques include fire alarms and extinguishers, fences, security guards, burglar alarms, limited access and requisitioning procedures for use of portable equipment, etc.)
3. Is responsibility for physical custody of property and equipment assigned to employees whose duties are independent of:

- a. Maintaining detailed property records?
  - b. General ledger functions?
4. Are items of property and equipment (owned and leased) physically inspected at reasonable intervals and compared with the detailed property records?  
(This may be done in coordination with appraisals made to determine insurable values.)
  5. Are documents of title and property rights, such as deeds and leases, in the custody of a responsible employee whose duties do not include maintenance of the detailed property records or physical custody of the assets?
  6. Are documents of title and property rights compared with the detailed property records at reasonable intervals by persons whose duties do not include the following:
    - a. Custody of such documents?
    - b. Maintenance of the detailed property and equipment records?

## **V. Financing (Treasury) Cycle**

### **A. Investments**

#### **.330 Authorization of Investment Transactions**

##### **Objective**

- The nature and terms of investment transactions (marketable securities, notes receivable, and long-term debt or equity investments) are made in accordance with management's authorization.

##### **Questions**

1. Are investment transactions initiated and approved in accordance with management authorization?  
(If investments are infrequent and significant, management may deal with each purchase or sale on a case by case basis with approval exercised by the board of directors or a finance committee. If investment transactions are relatively frequent, management may establish standard policies and procedures for initiation and approval of investment transactions.)
2. Are investment transactions approved before execution by responsible officials other than those who proposed the transactions?  
(For example, a transaction may be proposed by the chief executive officer and executed after authorization and approval by the board of directors. Another example would be purchases of treasury bills by the chief financial officer pursuant to authorization by the board of directors.)

3. Are investment transactions initiated and approved by persons whose duties do not include:
  - a. Accounting for investment transactions?
  - b. Custody of investment securities?
4. Are initiation and approval of investment transactions adequately documented?
5. Are brokers advices and other evidence of execution of transactions promptly compared with documented authorizations and differences brought to the timely attention of management?

### **.340 Recording and Classifying Investment Transactions**

#### ***Objective***

- Investment transactions, including accrual and collection of related income, are recorded at the correct amounts in the accounting periods in which they were executed or earned, and properly classified in the accounts.

#### ***Questions***

1. Are adequate general ledger control accounts maintained for various investment classifications and related income?
2. Are adequate detailed investment records maintained currently including control of related income?
3. Are procedures adequate to determine that investment income (interest, dividends) is properly accrued and promptly collected? (Examples of these procedures include comparison of interest accrued with terms of the securities or loan agreements and interest income received, or comparison of dividend income with published dividend records or reports by the investee.)
4. Are the detailed investment records reconciled with the general ledger control accounts, including related income, by persons whose duties do not include:
  - a. Maintenance of the detailed investment records?
  - b. Maintenance of the general ledger?
  - c. Physical custody of the investment securities?
5. Are investments and related collateral reviewed and appraised or valued at market at reasonable intervals for comparison with cost valuations and—
  - a. Reporting of the findings to management?
  - b. Determination of need for any valuation allowances?

**.350 Physical Safeguards and Custodial Accountability****Objective**

- Documents evidencing ownership of investments and related collateral, and other investment records are subjected to reasonably adequate physical safeguards and effective custodial accountability procedures.

**Questions**

1. Are investment securities and related collateral subject to reasonably adequate physical safeguards?  
(Examples include use of safe deposit boxes and/or vaults which require two individuals to gain access; custodial accounts with banks and trust companies, and accounts with brokers.)
2. Are investment securities, except for bearer securities, registered in the name of the company or nominees designated in accordance with management's authorization?
3. If an independent custodian is used, has the custodian been approved by the board of directors?
4. Is custody of investment securities held by the company assigned to designated bonded employees whose duties do not include:
  - a. Maintenance of detailed investment records?
  - b. Maintenance of general ledger control accounts?
  - c. Cash receipts and disbursement functions?
5. Is authority to withdraw investment securities from custody limited to written authorization and joint signatures of responsible officials whose duties do not include:
  - a. Custody of investment securities?
  - b. Maintenance of detailed investment records?
6. Are investment securities examined at reasonable intervals and compared with detailed investment records by responsible persons whose duties do not include:
  - a. Custody of the investment securities?
  - b. Maintenance of the detailed investment records?
  - c. Maintenance of the general ledger control accounts?
  - d. Cash functions?



## B. Borrowing (Debt and Leases)

### .360 Authorization of Debt and Other Borrowing Arrangements

#### *Objective*

- All debt and other borrowing arrangements (such as leases) are initiated and executed in accordance with management's authorization.

#### *Questions*

1. Are debt and other borrowing arrangements initiated and approved in accordance with management authorization?
2. Are authorizations for specific debt and other borrowings recorded?

(Authorizations may be recorded, for example, as decisions in the minutes of board of directors' meetings, finance committee meetings, or partners' meetings.)

3. Do the authorizations specify:
  - a. The officials authorized to negotiate debt and leases?
  - b. The maximum commitments such officials can make?
  - c. Property which may be pledged to collateralize debt?
  - d. Covenants which may be made to obtain the loan or lease?  
(Some entities may require that all loan and other borrowing agreements be reviewed by legal counsel before signing.)
4. Are the signatures of two authorized officials required to execute debt instruments or leases?
5. Do procedures appear adequate for initiating proposed debt and lease transactions?

(In some entities, debt and lease transactions may be infrequent and of such significance that management participates directly in the proposal and approval process on a case by case basis using specialized assistance where appropriate. In other entities, there may be regular procedures concerning matters such as:

- (i) Study of alternatives such as debt, lease or equity financing.
- (ii) Review of corporate charter, bylaws and covenants of existing debt and lease agreements and obtaining appropriate advice from legal counsel.
- (iii) Review of financial forecasts, tax and financial reporting considerations and obtaining appropriate professional advice.)

6. If an agent (generally a bank or trust company) is used for the interest disbursing and redemption functions, have the agent and arrangements been authorized by the board of directors?

### .370 Recording and Classifying Debt and Other Borrowings

#### *Objective*

- Transactions and obligations concerning debt and other borrowing arrangements are promptly and accurately recorded and classified in detail records and control accounts to—
  - (a) permit preparation of financial statements including required disclosures in conformity with generally accepted accounting principles or other criteria applicable to such statements, and
  - (b) provide timely and accurate information as a basis for conforming with payment obligations and other covenants in the applicable agreements.

#### *Questions*

1. Are detailed, timely records maintained of such debt and other borrowings as notes payable, long-term debt and capitalized leases that include such information as:
  - a. Date of inception?
  - b. Type of obligation?
  - c. Face amount?
  - d. Interest rate?
  - e. Maturity?
  - f. Timing and amount of payments?
  - g. Proceeds initially received?
  - h. Payments of principal?
  - i. Outstanding principal balance?
  - j. Accrued interest expense?
  - k. Payments of interest?
  - l. Outstanding balance of accrued interest payable?
  - m. Premium or discount at inception?
  - n. Amortization of premium or discount?
  - o. Balance of unamortized premium or discount?
  - p. Summarized information or collateral and/or restrictive covenants connected with the obligation (such as minimum current ratios and/or debt to equity ratios; restrictions on paying dividends, purchasing property and equipment, and/or entering lease agreements?)

2. Does the chart of accounts provide adequate control accounts for principal amounts and related interest expenses of debt and other borrowings?
3. Are the detailed records maintained by responsible person(s) whose duties do not include:
  - a. Maintenance of the general ledger control accounts?
  - b. Physical custody of agreements connected with borrowings and unissued debt instruments?
  - c. Cash functions?
4. Do persons who maintain the detail records and control accounts receive timely and adequate information about debt and other borrowing obligations (for example, copies or abstracts of the debt and lease agreements)?
5. Are detailed records reconciled with the control accounts at reasonable intervals by persons whose duties do not include:
  - a. Maintenance of the detailed records on debt and other borrowings?
  - b. Custody of agreements connected with borrowings and unissued debt instruments?
6. Are adequate reports developed from the detailed records and actual debt and lease agreements which provide timely and accurate information as a basis for:
  - a. Payments of principal and interest in conformity with the agreements?
  - b. Monitoring compliance with terms and covenants in the agreements?

(See AAM section 4400.190, Expenditure Cycle—for illustrative objectives and questions on cash disbursements.)
7. Are detailed records compared with debt and lease agreements at reasonable intervals by responsible persons whose duties do not include:
  - a. Maintenance of the detailed records?
  - b. Custody of the debt and lease agreements?
  - c. Maintenance of the general ledger control accounts?
  - d. Cash functions?
8. If independent agents are retained for the interest paying and redemption functions, are the agents' reports promptly reconciled with the control accounts and subsidiary records?

**.380 Safeguarding Records, Documents and Unissued Debt Instruments****Objective**

- Access to records, documents and instruments concerning debt and other borrowing arrangements is permitted only in accordance with management's authorization.

**Questions**

1. Does a responsible individual maintain adequate files of copies of notes payable, long-term debt, mortgage agreements and leases?
2. Are unissued debt instruments such as notes and bonds adequately safeguarded and in the custody of a responsible employee whose duties do not include—
  - a. Maintenance of detailed records on borrowings and other term obligations?
  - b. Maintenance of general ledger control accounts?
  - c. Cash functions?
3. Are unissued debt instruments subject to preassigned numerical control and are all such instruments accounted for at reasonable intervals?
4. Are paid bonds and notes effectively cancelled to preclude their further use?

**C. Equity Capital****.390 Authorization of Equity Capital Transactions****Objective**

- Equity capital transactions are—
  - (a) appropriately authorized and approved in conformity with the entity's governing document (corporate charter, partnership agreement, etc.)
  - (b) initiated and executed in accordance with management's authorization.

**Questions**

1. Are capital transactions (issuance, reacquisition and redemption of stock, dividends, granting of options, rights, conversion privileges, etc.) authorized and approved in conformity with the entity's governing document?

(The entity's governing document (corporate charter, partnership agreement, etc.) may clearly specify the groups or disig-

nated officials who have authority concerning the initiation and approval of specific types of capital transactions.)

2. Are authorizations and approvals for specific capital transactions appropriately recorded?

(For example, if the corporate charter provides that capital transactions be initiated by the board of directors subject to approval of the stockholders, such authorizations and approvals would be recorded in the respective minutes of board of directors' meetings and stockholders' meetings.)

3. Are two officials specifically authorized by the board of directors required to sign and countersign stock certificates?
4. Are all stock certificates prepared and approved before issuance in accordance with management's authorization?

(Prescribed procedures would include, for example, compliance with tax and other statutory requirements before signing and issuing certificates. For transfers and retirements of certificates, prescribed procedures would include cancellation and disposition of the certificates received.)

5. If a registrar, transfer agent and/or dividend paying agent is retained, have they been authorized by the board of directors?

#### .400 Recording and Classifying Equity Capital Transactions

##### *Objective*

- Transactions and obligations concerning equity capital are promptly and accurately recorded and classified in detailed records and control accounts.

##### *Questions*

1. Does the general ledger include appropriate control accounts for equity capital?
2. Are appropriate control records maintained for each class of stock on such information as number of shares authorized, issued and outstanding, and number of shares subject to options, warrants, and conversion privileges?
3. Are timely detailed records maintained on the specific stock certificates issued and outstanding for each class of capital stock and the identity of holders of record and number of shares for each certificate?

(In a closely held corporation with a limited number of shareholders and outstanding certificates, properly completed stubs in capital stock certificate books may serve this purpose. Re-

tired certificates would normally be cancelled and reattached to the related stubs. Other situations may require a data base that permits timely rendering of listings of each certificate by number and/or of each shareholder and number of shares held.)

4. Are detailed stock certificate records reconciled at reasonable intervals with the control records and the general ledger?  
(If the corporation retains independent agents for the registrar and transfer functions, for example, the agents' periodic reports would be promptly reconciled with the general ledger.)
5. Are reconciliations of detailed records with the control records and general ledger performed by persons whose duties do not include:
  - a. Custody of unissued stock certificates?
  - b. Maintenance of the detailed records?
  - c. Cash functions?

#### **.410 Physical Safeguards and Custodial Procedures**

##### ***Objectives***

- Access to records, agreements, and such negotiable documents as stock certificates concerning equity capital is permitted only in accordance with management's authorization.
- Records, agreements and negotiable documents are subjected to reasonably adequate physical safeguards and custodial procedures.

##### ***Questions***

1. Are unissued stock certificates, reacquired certificates and detailed stockholder records subject to reasonable physical safeguards?  
(Examples include fire-resistant files, vaults, and use of safe deposit boxes.)
2. Are stock certificates subject to controls such as prenumbering which provides that all certificates (unissued, issued, and retired) may be accounted for?
3. Are unissued and retired stock certificates examined and all certificate numbers accounted for at reasonable intervals by a person(s) whose duties do not include:
  - a. Physical custody of unissued stock certificates?
  - b. Maintenance of stockholder detail records?
  - c. Cash functions?
  - d. General ledger functions?

4. Are retired stock certificates—
  - a. Examined for proper endorsement and effectively cancelled by a person(s) whose duties do not include maintenance of the detailed stockholder records?
  - b. Matched and recorded promptly in the detailed records of certificates (reattached to related stubs in the certificate book)?
5. Are treasury stock certificates registered in the name of the company and recorded to be readily distinguished from other outstanding shares?

#### **.420 Dividends Disbursements**

##### ***Objective***

- Dividends are disbursed accurately and in conformity with decisions of the board of directors.

##### ***Questions***

1. Are dividends declared recorded in the minutes of the board of directors meetings regarding class of stock, amount per share, total amount, record date and payment date?
2. Do procedures result in an accurate cutoff and accurate listing of stockholders as of the record date?
3. Are dividend checks prepared based on appropriate stockholder listings and subjected to the following:
  - a. Approval and signature in accordance with management's authorization.
  - b. Mailing by a person(s) whose duties do not include maintenance of detailed records of stockholders, custody of unissued and retired stock certificates, and check preparation functions?
4. Are total dividends disbursed reconciled to total outstanding shares as of the record date?

#### **D. Cash <sup>4</sup>**

#### **.430 Processing Collections**

##### ***Objectives***

- Access to cash receipts and cash receipts records, accounts receivable records, and billing and shipping records is con-

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<sup>4</sup>The illustrative internal accounting control objectives and related questions for these cash sections are the same as those for the cash receipts sections of the revenue cycle (AAM section 4400.120-.130) and cash disbursements sections of the expenditures cycle (AAM section 4400.210-.230). They are duplicated here in AAM section 4400.430-.470 because some accountants may prefer to consider them as part of a financing (treasury) cycle.

trolled to prevent or detect, on a timely basis, the taking of unrecorded cash receipts or the abstraction of recorded cash receipts.

- Detail transaction and account balance records are reconciled, at reasonable intervals, with applicable control accounts and bank statements for timely detection and corrections of errors.

### **Questions**

1. Is the mail opened by a person(s) whose duties do not involve any shipping, billing, accounts receivable detail, general ledger, invoice processing, payroll and cash disbursement functions?
2. Does the person(s) who opens the mail:
  - a. Place restrictive endorsements on all checks when received so they are for deposit only to the bank accounts of the company?
  - b. List or otherwise obtain control (for example, by photocopying) over all remittances and prepare totals at least daily?
  - c. Forward all remittances to the person who prepares and makes the daily bank deposit?
  - d. Forward the total of remittances to persons, who are independent of physical handling of remittances and accounts receivable detail functions, for subsequent comparison with the authenticated duplicate deposit slip and with control total over postings to subsidiary records?  
(In lock box arrangements, customers would mail their remittances to a post office box controlled by the company's bank which would have responsibility for functions 2a-2d.)
3. Are receipts of currency controlled by cash registers and/or prenumbered cash receipt forms?
  - a. If cash registers are used, is a copy of the tape given to the customer as a receipt, and:
    - (1) Is the key to the cash register tape compartment in the custody at all times of a responsible employee other than the cash register operator(s)?
    - (2) Are readings of the register periodically taken and compared with the cashier's records of receipts by a responsible employee other than the cash register operator(s)?
  - b. If prenumbered receipts are used for currency collections:
    - (1) Is a copy given to the payor as a receipt?
    - (2) Are all prenumbered receipts accounted for by a person(s) other than the person(s) handling cash received and balanced with the daily cash received?



- c. If cash collections are for payments on account, is adequate information given for accurate posting to accounts receivable detail?
- d. If significant cash sales are made (as in a retail store) are spot checks made to determine that cashiers are following prescribed procedures?
4. Are currency receipts forwarded daily to the person who prepares the daily bank deposit?
5. Is a summary listing of daily currency receipts forwarded to a person(s) independent of physical handling of remittances and accounts receivable detail functions?
6. Do areas involving physical handling of cash appear reasonably safeguarded?  
(For example, protective windows, vaults, cashier cages, etc.)
7. Are each day's receipts (by mail, and over the counter) except for post dated items deposited intact daily?
8. Are post dated items segregated on daily detail listings of remittances to aid in control of total items received?
9. Are all employees who handle receipts adequately bonded?
10. Are banks instructed not to cash checks and other instruments (for example, drafts, money orders, etc.) drawn to the order of the company?
11. Does company policy prohibit the cashing of any accommodation checks (for example, personal and payroll checks) out of collections?
12. Are local bank accounts used for branch office collections subject to withdrawal only by the home office?
13. Are banks instructed to deliver charged back deposit items (such as checks returned because of insufficient funds) directly to an employee independent of physical handling of cash receipts and posting of accounts receivable detail?
14. Are bank chargebacks received directly from the bank and investigated by a person independent of:
  - a. Physical handling of collections?
  - b. Posting accounts receivable subsidiary detail?
15. Are entries to the cash receipts journal compared with:
  - a. Duplicate deposit slips authenticated by the bank?
  - b. Deposits per the bank statements?
  - c. Listings prepared (initial control) when mail is opened?

16. Are the comparisons described in item 15 above made by a person(s) whose duties do not include cash receipts and accounts receivable functions?

#### **.440 Recording Collections**

##### ***Objective***

- All cash receipts are recorded at the correct amounts in the period in which received, and are properly classified and summarized.

##### ***Questions***

1. Is information captured from remittances (by mail and over the counter) adequate for accurate posting of credits to individual accounts receivable subsidiary records or to classifications concerning such other sources as investment income, rents, sales of property or scrap, and proceeds of financing?

(This information, for example, may be included on the listing prepared when the mail is opened, remittance advices which accompany customers' checks, detachable stubs from billings, photocopies of checks, copies of prenumbered receipts issued for currency collections, etc.)

2. Are details of daily collections balanced with the total credits to be distributed to appropriate general ledger accounts and to the total collections for the day before posting to the subsidiary records?
3. Do postings of the general ledger control accounts and subsidiary records include the date on which the remittance was received?
4. Are postings to the general ledger control accounts made by a person(s) independent of:
- a. Physical handling of collections?
  - b. Posting accounts receivable subsidiary detail?
5. Are details of collections posted to subsidiary accounts receivable records by a person(s) independent of:
- a. General ledger functions?
  - b. Physical handling of collections?
  - c. Receipt and investigation of bank chargebacks?

#### **.450 Assignment of Disbursement Functions**

##### ***Objective***

- Functions are assigned so that no single individual is in a position to both perpetrate and conceal errors or irregularities in the normal course of his duties.

### *Questions*

1. Is the cash disbursements function performed by persons who are independent of the following functions :
  - a. Purchasing?
  - b. Receiving?
  - c. Invoice processing?
  - d. Payroll preparation and approval?
  - e. Shipping?
  - f. Accounts receivable?
  - g. Cash receipts?
  - h. General ledger?
2. Is there adequate separation of duties within the cash disbursement function among persons who perform the following :
  - a. Control access to unissued checks?
  - b. Prepare checks?
  - c. Sign checks and inspect support?
  - d. Mail checks?
  - e. Maintain custody of petty cash?
  - f. Maintain the cash disbursement journal?
  - g. Reconcile the bank accounts?

### **.460 Processing Disbursements**

#### *Objectives*

- Disbursements are made only for expenditures incurred in accordance with management's authorization.
- Adjustments to cash accounts are made only in accordance with management's authorization.
- Disbursements are recorded at correct amounts in the appropriate period and are properly classified in the accounts.
- Access to cash and cash disbursements records is restricted to minimize opportunities for irregular or erroneous disbursements.

#### *Questions*

1. Are all bank accounts authorized by the board of directors?
2. Are all check signers authorized by the board of directors?
3. Are banks promptly notified of any changes in authorized check signers?

4. Are banks instructed not to cash checks and other instruments (for example, drafts, money orders, etc.) drawn to the order of the company?
5. Are all bank accounts and cash funds subjected to general ledger control?
6. Are all disbursements and bank transfers based on vouchers and check requests which have been approved by responsible employees designated by management?
7. Are all disbursements except from petty cash made by check?
8. Are properly approved supporting documents (processed invoices, purchase orders, receiving reports, etc.) presented with the checks and reviewed by the check signer(s) before signing the checks?
9. Is a mechanical check protector used to inscribe amounts on checks as a precaution against alteration?
10. Are supporting documents for checks properly cancelled to avoid duplicate payment?
11. Are signed checks independently mailed directly after signing without being returned to persons involved in the invoice processing and check preparation functions?
12. Is access to unissued checks limited to designated responsible employees who are independent of the check signing function, including operation of mechanical check signing machines?
13. Are checks prenumbered and all numbers accounted for?
14. Are all voided checks retained and mutilated?
15. Are all checks promptly recorded when issued and listed in detail (cash disbursements journal, check register, etc.)?
16. Are details of individual disbursements balanced with the totals to be posted to appropriate general ledger account distributions and to total disbursements to be posted to the general ledger control accounts for cash?
17. Is there a written policy which prohibits:
  - a. Drawing checks payable to cash or bearer?
  - b. Signing or countersigning of blank checks?
18. If dual signatures are required:
  - a. Are the two signers independent of one another?
  - b. Does each signer determine that the disbursement is supported by approved documentation?

19. If a check signing machine is used:
- a. Are checks approved before mechanical signing by designated responsible employees who are subject to the same segregation of duties as if they were authorized check signers? (Use of a check signing machine allows an entity to delegate authority for approving checks to a greater number of persons than those registered with the bank as authorized signers. However, approval procedures should be sufficient to assure the official whose name is on the signature plate that all mechanically signed checks would have met his approval if he had reviewed and manually signed them himself.)
  - b. Are the keys and signature plate, and operation of the signing machine under control at all times of the official whose signature is on the plate?
  - c. Are the employees who have custody of the keys and plate, and operate the check signing machine independent of voucher and check preparation functions and denied access to blank checks?
  - d. Are the checks issued to the machine operator(s) counted in advance and reconciled with the totals of the counting device on the check signing machine by someone other than the machine operator?  
(Control may be strengthened by having a locked compartment on the machine which receives the signed checks and can be opened only by someone independent of the machine operator.)
20. Are cash funds on an imprest basis and:
- a. Kept in a safe place?
  - b. Reasonable in amount?
  - c. Controlled by one custodian who is independent of invoice processing, check signing, general accounting and cash receipts functions?
  - d. Periodically counted by someone other than the custodian?
21. Are all disbursements from cash funds:
- a. Supported by vouchers which are prepared in ink?
  - b. Approved in accordance with management's authorization?
  - c. Cancelled to prevent reuse?
  - d. Subject to a predetermined maximum dollar limit for any individual disbursement?

22. Are reimbursements of cash funds:
- Subject to the same review and approval as processed invoices?  
(See AAM section 4400.160 on invoice processing)
  - Remitted by checks drawn payable to the order of the custodian of the cash fund?

#### **.470 Bank Reconciliations**

##### ***Objective***

- Comparison of detail records, control accounts and bank statements are made at reasonable intervals for detection and appropriate disposition of errors or irregularities.

##### ***Questions***

1. Are the bank accounts reconciled monthly by an employee(s) who is independent of invoice processing, cash disbursements, cash receipts, petty cash and general ledger functions?
2. Are bank statements, related paid checks, debit and credit memos received directly from the bank by the employee(s) performing the reconciliations?
3. Does the bank reconciliation procedure include:
  - a. Reconciliation of the balance per bank to balance per the general ledger control account and subsidiary detail records?
  - b. Comparison in detail of deposits per the bank statement with deposits per cash receipts detail records?
  - c. Comparisons in detail of disbursements per bank with the cash disbursements journal (check register) as to date drawn, payee and amount?
  - d. Comparison of payees with endorsements?
  - e. Follow up of reconciling items and initiation of entries to record such transactions as checks returned for insufficient funds, and bank charges?
4. Are old outstanding checks investigated and subjected to proper disposition (in compliance with applicable escheat laws if present)?

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➤➤➤ → *The next page is 4501.* ← ➤➤➤

## AAM Section 4500

### *Flowcharts*

.01 A flowchart is a diagram which uses symbols to portray the flow of transactions and the various steps applied in that process.

.02 Use of flowcharts is widespread among persons involved in computerized information processing. Some auditors have also been using flowcharts as their preferred method of recording their understandings of their clients' systems of internal accounting control. Some firms, as an internal policy, urge their staff auditors to use flowcharting. Other firms require use of flowcharting on audits of clients over a given level of size or complexity.

.03 The decision to use flowcharts rests with the individual firm or auditor. Proponents of flowcharting believe the auditor can more easily read and analyze a flowchart than a narrative description of a system, especially when reviewing understandings which are developed by assistants. They also believe the discipline needed to prepare flowcharts encourages staff to obtain a clearer, more accurate understanding of the system being reviewed, particularly the control points in the system. Those with reservations about flowcharting are concerned that the potential benefits of flowcharting are not enough to justify the time and effort needed to prepare them. They also are concerned that staff may get lost in excessive detail or stray into extraneous areas. A decision to use flowcharts, therefore, implies a concurrent decision to develop adequate instructional material.

#### **Types of Flowcharts**

.04 Some users of flowcharts classify them into the following three types:

- Systems flowchart—provides a broad overview of a system.
- Program flowchart—concerned with the minute steps of a system, generally a computer program. Some users also describe computer program flowcharts as block diagrams.
- Internal accounting control flowchart—portrays the interaction of departments and/or individuals involved in the plan of organization and the procedures and records concerned with the safeguarding of assets and the reliability of financial records.

Some data processing people who tend to confront complex situations develop sets of charts in several layers with each layer oriented towards a different level of users; this is termed a hierarchical approach.

## Degree of Detail

.05 The question of how much detail an auditor should include in a flowchart is a difficult one. And the answer is elusive; it varies with the professional judgment of the auditor who has final responsibility for the engagement. A related difficult matter is how to help assistants avoid the pitfalls of including excess and/or extraneous detail in their flowcharts and the accompanying run-up of time. In deciding on an appropriate policy, the auditor should recognize that his working papers, taken as a whole, should be adequate to record his understanding of the client's internal accounting control and help support his evaluation of the system.

## Flowcharting Illustration—Small Business

.06 Use of flowcharts need not be limited to recording an understanding of complex information processing systems. An illustration is included below to show how an auditor might use flowcharts to record an understanding of purchases, receipt of stock, and cash disbursements for purchases for Kilroy Wholesale Grocery. John Kilroy owns and operates the business with two employees. One employee serves as both the stock clerk and truck driver. The other employee is the bookkeeper.

.07 A symbol legend is also included to explain the five different symbols used in the illustrative flowcharts. In practice, an auditor would probably use a standard set of flowchart symbols which would eliminate the need for preparing flowchart symbol legends for each set of working papers. The symbols used in the illustrative flowcharts are from the set of standard flowcharting symbols developed by the American National Standards Institute, Inc. (ASNI) which is sponsored by the Business Equipment Manufacturers Association.<sup>1</sup> Some accounting firms have developed or adopted other sets of symbols to meet their individual needs.

.08 The following illustrative transaction processing flowcharts of Kilroy Wholesale Grocery are presented as Exhibits 1 and 2:

- Purchases and Receipts of Stock (two pages)
- Cash Disbursements for Purchases (two pages)

.09 There are also various approaches to the layout of flowcharts. For example, the illustrations present the functions of more than one person (or department) on each sheet. An alternate approach would be to limit a page or set of pages to the functions of a single department or individual. In addition, the illustrative flowcharts present vertical flow lines that start at the top of the page. An alternate

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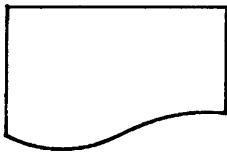
<sup>1</sup>ASNI, American National Standard Flow Chart Symbols and Their Usage in Information Processing. (1430 Broadway, New York, N. Y. 10018) 1971.



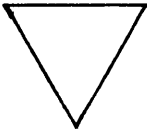
approach would be to present horizontal flow lines that start at the left side of the page. These alternate approaches depend on the preferences of the individual firm or the auditor who has final responsibility for the engagement.

.10

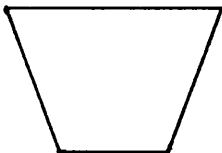
Kilroy Wholesale Grocery  
Symbol Legend - Transaction Processing  
Flowcharts



= Document



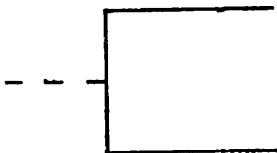
= File



= Manual operations. This symbol represents a process or work step performed by a person.



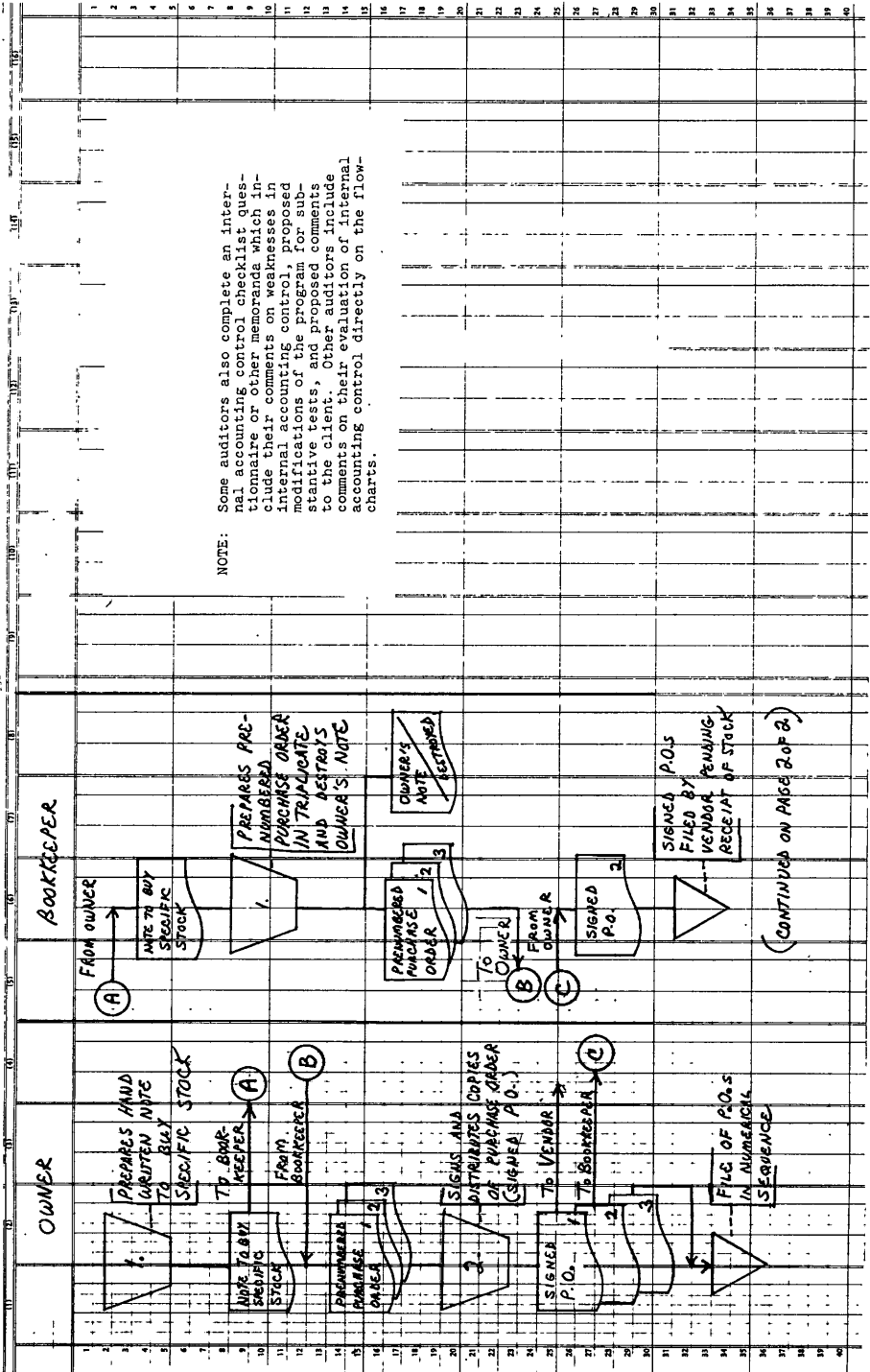
= Connector symbol. Used as a cross reference within a page or between pages.



= Comment or annotations symbol. This symbol is used to present comment or additional explanation which would not be able to fit within other symbols.

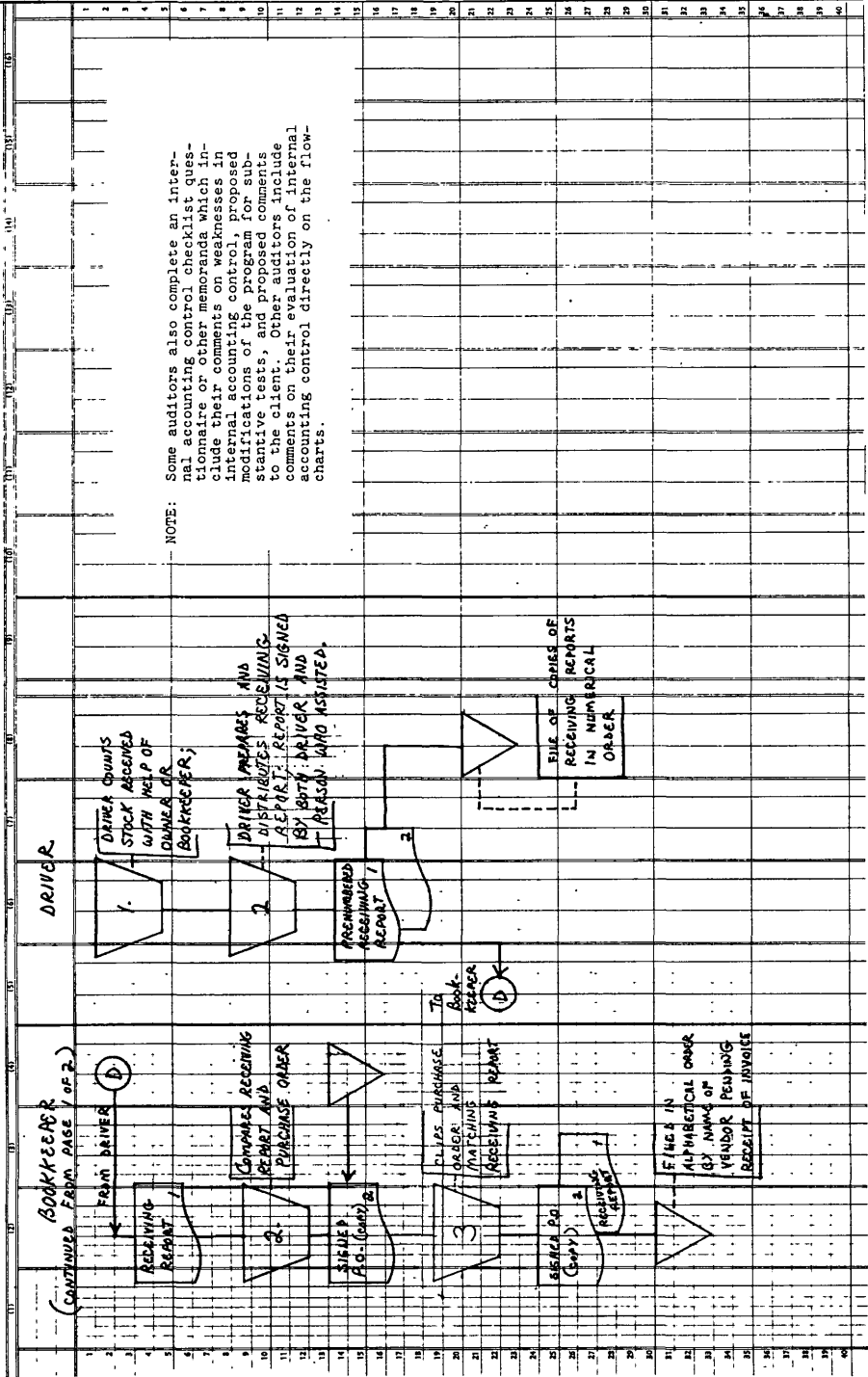
11 PURCHASES AND RECEIPT OF STOCK PAGE 1 OF 2  
TRANSACTION PROCESSING FLOW CHART

DESIGNED BY  
A.E. BISHOP  
APPROVED BY  
C. RAY BARR



.12 KILROY WHOLESALE GROCERY  
PURCHASES AND RECEIPT OF STOCK, PAGE 2 OF 2  
TRANSACTION PROCESSING FLOW CHART

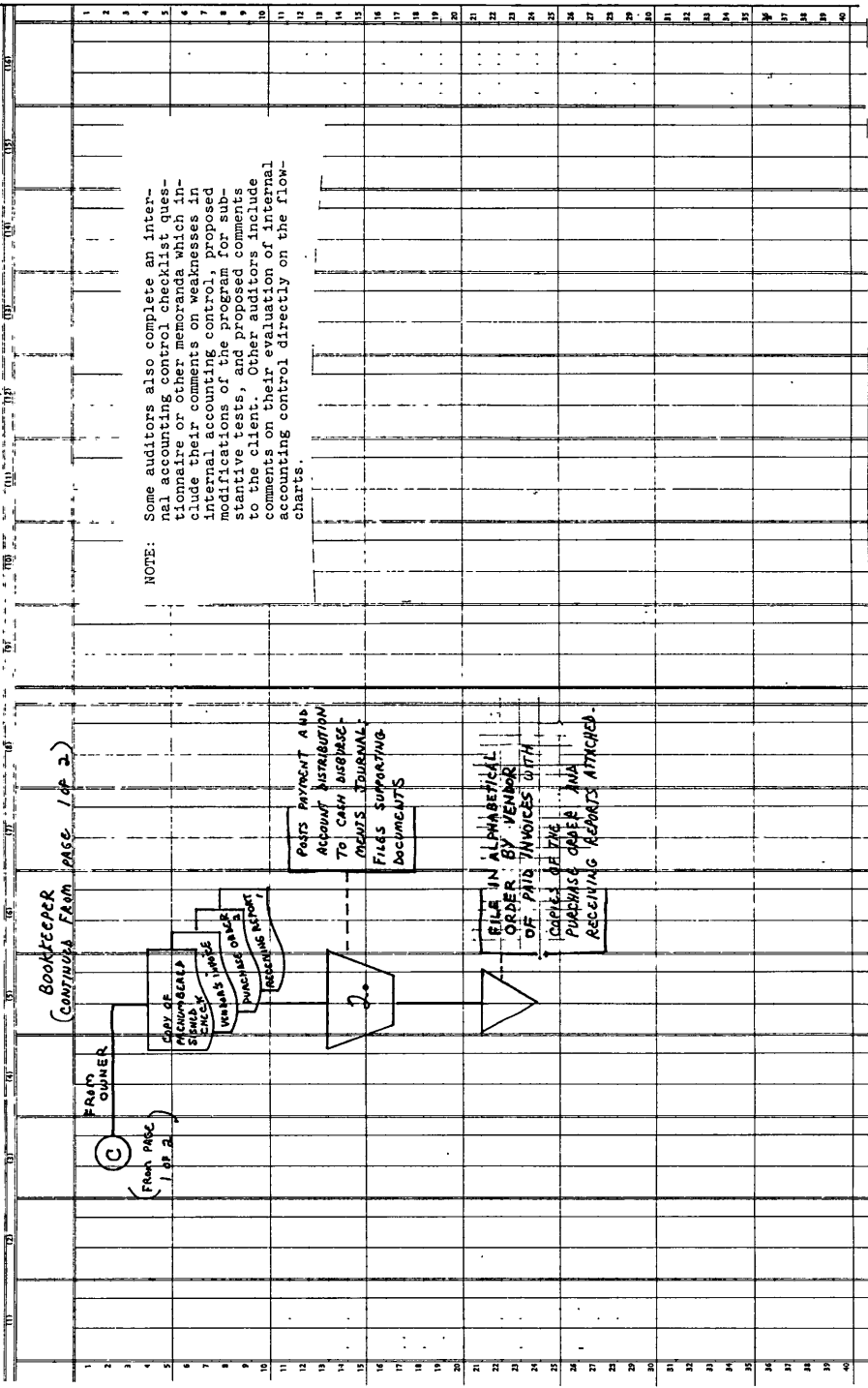
Revised	Date
Prepared By	
Approved By	



NOTE: Some auditors also complete an internal accounting control checklist questionnaire or other memoranda which include their comments on weaknesses in internal accounting control, proposed modifications of the program for substantive tests, and proposed comments to the client. Other auditors include comments on their evaluation of internal accounting control directly on the flowcharts.



**.14 KILROY WHOLESALE GROCERY  
CASH DISBURSEMENTS FOR PURCHASES, PAGE 2 of a  
TRANSACTION PROCESSING FLOW CHART**



## AAM Section 5000

## AUDIT APPROACH AND PROGRAMS

The material included in these sections on audit approach and programs is presented for illustrative purposes only. The comments, illustrative audit objectives and illustrative audit procedures are neither all inclusive nor are they prescribed minimums. The illustrative audit procedures are numbered merely to organize the materials; those numbers are not intended to imply completeness or a prescribed sequence. The nature, extent and timing of the auditing procedures to be applied on a particular engagement are a matter of professional judgment to be determined by the auditor based on the specific facts and circumstances.

This manual is a nonauthoritative kit of practice aids. Accordingly, these sections include minimal explanation and discussion of authoritative pronouncements. Users of this manual are urged to refer directly to applicable authoritative pronouncements when appropriate. Users should also note that this manual does not deal with specialized industry problems; reference should be made to applicable AICPA Industry Audit and Accounting Guides.



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*The next page is 5101.*




**AAM Section 5100*****Audit Approach***

.01 The approach to an audit may be broadly characterized by the following:

- (1) Obtain an understanding of the various assertions which the client will make in its financial statements and the nature of the client's business and industry.
- (2) Develop from the various assertions specific audit objectives which would, when accomplished, result in an examination made in accordance with generally accepted auditing standards.
- (3) Develop audit procedures designed to achieve the specific audit objectives developed from the assertions.

Because financial statement assertions vary with the circumstances of individual engagements, the development of specific audit objectives and audit procedures will also vary.

.02 SAS No. 22 (AU section 311<sup>1</sup>) provides guidance on planning an audit. It specifically requires the preparation of a written audit program which sets forth in reasonable detail the audit procedures that the auditor believes are necessary to accomplish the objectives of the examination (SAS No. 22, paragraph 5; AU section 311.05<sup>1</sup>). SAS No. 22 also notes that the form of the audit program and its content will vary; it does not prescribe how an audit program should be organized. It also states that as an examination progresses, changed conditions may make it necessary to modify planned audit procedures.

.03 The appendices to section 320 of SAS No. 1 (AU sections 320A and 320B<sup>1</sup>) provide guidance on the relationship of statistical sampling to auditing. These illustrative audit programs do not include any discussion of sampling techniques.

.04 These sections include various nonauthoritative working tools for audit programs including organization, extent of detail, sign-off provisions, and illustrative audit objectives and procedures.

.05 In developing audit programs, auditors should consider the requirements of authoritative accounting pronouncements. In particular, auditors might wish to review the requirements of statements on auditing standards that interpret the standards of field work (AU section 300<sup>1</sup>).

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»»→ ***The next page is 5201.*** ←««

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<sup>1</sup> Section reference in *AICPA Professional Standards*.



## AAM Section 5200

# *Audit Programs*

### **Organization**

.01 SAS No. 22 (AU section 311) notes that the form of the audit program and its content will vary; it does not prescribe how an audit program should be organized.

.02 An audit program is usually divided into logical units. Generally, these units correspond with the financial statement classifications. This eases comparison of the steps in the audit program to the workpapers which support a particular financial statement caption. It also makes it easier to assign different auditors to audit areas. Another approach is to divide the program on the basis of transaction cycles that may have been identified in the review of internal control. This might facilitate a comparison of planned audit steps to the evaluation of internal accounting control.

.03 Proper captioning of audit programs aids the auditor in considering whether all key areas of the audit have been adequately planned.

.04 The work steps within the various sections of the audit program are also subdivided in one or more ways. One of the most common divisions is by planned performance dates—such as planning stage, preliminary work, work at balance sheet date, and wrapping up the engagement. Within these sections, steps might be grouped along audit objective lines. For example, an audit program for inventory might be segregated into areas such as physical inventory procedures, pricing tests, review for obsolescence, etc.

### **Extent of Detail**

.05 SAS No. 22 (AU section 311) states that an audit program “should set forth in reasonable detail the audit procedures that the auditor believes are necessary to accomplish the objectives of the examination.” As previously noted, this Statement also indicates that the form of the program and the extent of detail will vary. This is a matter of the auditor’s judgment in the circumstances. Some auditors feel strongly that audit program steps should be very detailed to minimize misinterpretation by assistants. Other auditors, however, believe the program steps should be relatively general to avoid the possibility that assistants will execute steps by rote rather than use judgment. As a practical matter, the extent of detail in the program usually depends upon the skill and experience of the staff that is actually avail-

able to do the job. It also may depend upon how much continuity there is in the firm's experience with the client and how much detail the firm requires in its working papers. Some firms, for example, choose to require in their working papers comprehensive memoranda which present detailed narratives about the work steps performed in addition to analyses and schedules which include explanations of the work done. They believe such memoranda provide added assurance that the work done by assistants was adequately understood. The audit programs used by such firms would probably be less detailed. Other firms believe that a reasonably detailed audit program minimizes the need for such memoranda and enhances supervision.

### **Sign-Off Provisions**

.06 Addition of sign-off provisions makes an audit program a control device as well as a planning tool. When auditors initial and date specific steps in an audit program as the work is completed, the program may serve as a means of readily telling how much of the work has been performed and how much remains to be done. Initialling or signing off specific steps in the program also effectively reminds the auditor that he or she is assuming responsibility for performing those steps. Some auditors provide space for additional information on their audit program formats. For example, some auditors may want the workpaper reference entered on the program for a particular work step as well as the auditor's initials. Some auditors include provision for entering the budgeted or planned time and identity of the staff who the plan calls for performing the work step as well as the actual time, date and initials of the person who did the work. Including such information in a program may be advantageous, particularly in larger, more complex audits. On the other hand, it must be noted that many auditors believe that such information in the program is unnecessary and costly to accumulate accurately.

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➡ *The next page is 5401.* ←

**AAM Section 5400*****Illustrative Audit Objectives and Audit Procedures***

.010 Some audit procedures (for example, tracing the bank balance per the bank reconciliation to the confirmation received from the bank) lend themselves to routine language. To draft this type of routine language for each engagement is time consuming. As a result, some auditors maintain lists of illustrative audit objectives and audit procedures as sources of routine language to save time when developing audit programs for specific engagements. Other auditors may refer to copies of programs from previous or similar engagements for the same purpose. In either case, the source of routine language is a mere manuscript aid subject to the auditor's professional judgment. The auditor's professional judgment must be applied in deciding whether the program includes all of the procedures required in the particular circumstances. The manuscript aid serves solely as a timesaver. Users of manuscript aids must remain alert to needs such as the following:

- Developing steps for required procedures which are not covered by the manuscript aid.
- Excluding extraneous and unnecessary procedures which are covered by the manuscript aid.
- Editing or modifying the manuscript to suit the needs and preferences of the auditor in the circumstances.

.020 Following is a list of illustrative audit objectives and procedures which are numbered merely to organize the materials; the numbers are not intended to imply completeness or a prescribed sequence. This list is merely illustrative. Some auditors may find the items too wordy, others may find them too terse, and still others may prefer a different set of items organized in a different manner. Users of this material must use professional judgment and be alert for the important matters in a particular set of circumstances which may not be covered in the illustrative material.

**General Matters****.030 Pre-Fieldwork****Illustrative Procedures**

1. Review correspondence files, prior year's audit working papers, permanent files, financial statements, and auditor's reports.

2. Discuss matters that may affect the examination with firm personnel responsible for non-audit services to the entity.
3. Inquire about current business developments affecting the entity.
4. Read the current year's interim financial statements.
5. Discuss the type, scope, and timing of the examination with management of the entity, the board of directors, or its audit committee.
6. Consider the effects of applicable accounting and auditing pronouncements, particularly new ones.
7. Coordinate the assistance of entity personnel in data preparation.
8. Determine the extent of involvement, if any, of consultants, specialists, and internal auditors.
9. Establish the timing of the audit work.
10. Establish and coordinate staffing requirements.
11. Comply with firm policy on engagement letters.
12. Comply with firm policy on holding planning conferences with assistants assigned to the engagement.
13. Comply with firm policy on preparing a memorandum setting forth the preliminary audit plan.
14. Arrange with the client for such matters as adequate working space for the auditors and access to records.
15. Prepare or update a written audit program. (In practice, sections of the program may be prepared or updated at various times during the audit.)

#### **.040 Fieldwork**

1. Obtain copies of minutes for meetings of the stockholders, board of directors and important committees thereof such as the executive and finance committees; review and highlight matters of accounting significance.

NOTE: Examples of such matters include but are not limited to authorization or approval of the following:

- Related party transactions
- Bank accounts (opening and closing accounts, changes in authorized signatures)
- Financing agreements involving discounting of receivables
- Property and equipment (significant additions and retirements)
- Mergers and acquisitions
- Union agreements



- Officers' salaries
  - Employee benefit plans such as pension plans, profit sharing, group life and health insurance, etc.
  - Retention of legal counsel and/or discussion of pending, threatened, or completed litigation
  - Debt agreements (including short- and long-term debt, pledging of assets as collateral, acceptance of restrictive covenants, etc.)
  - Issuance or reacquisition of capital stock
  - Subjecting capital stock to options, rights, warrants, and other conversion privileges
  - Declaration of dividends
  - Returns of capital to shareholders
  - Leases
  - Royalty agreements
2. Obtain and review copies of new agreements and new amendments to existing agreements (for example, debt and lease agreements, contractual terms of preferred stock issued, labor contracts, pension and other benefit plan agreements, deferred compensation contracts, stock options, etc.); highlight matters for which disclosure will be required in the financial statements (and notes).
  3. Obtain (update) the understanding of the identity of related parties such as affiliates, principal owners, management and members of their immediate families, and entities for which the client's investments are accounted for on the equity method, and the business purpose of the significant types of related party transactions (see SAS No. 6; AU section 335). Provide audit personnel performing segments of the examination, or examining and reporting separately on the accounts of related components of the reporting entity, with the names of known related parties so that they may become aware of transactions with such parties during their examinations.
  4. For trial balances and other schedules and analyses prepared by the client, perform the following:
    - a. Trace amounts to the general ledger
    - b. Re-perform the footings and crossfootings (test basis may be appropriate)
    - c. Trace opening balances to final balances per the working papers for the preceding year (period).
  5. Communicate material weaknesses in internal accounting controls (see SAS No. 20; AU section 323).

6. Obtain written representation from management of the client (SAS No. 19; AU section 333).

NOTE: Many firms include other matters in the general sections of programs, such as disposition of proposed adjustments, report preparation and review, reconciliation of actual and estimated time, preparation of fee estimate for next year, evaluation of staff, etc.

## Internal Accounting Control

### .050 Revenue, Receivables, and Receipts

1. Review internal accounting control over sales orders, shipments, billings, accounts receivable and cash receipts. Prepare or update the recorded understanding in accordance with firm policy (narrative memoranda, completion of a questionnaire, flowcharts, etc.)
2. Consider selecting one or a few completed sales transactions representing each major type of sale; trace each selected transaction through the related documents and records from inception to ultimate disposition, noting the following:<sup>1</sup>
  - a. Authorization of the transaction(s) in accordance with prescribed procedure. (For example, approval of sales orders or job orders based on a customer's purchase order or executed job contract; prior approval of the customer's credit; comparison of prices with an authorized price list, etc.)
  - b. Evidence of completion and shipment of the customer's order. (For example, carrier's bill of lading, receipt signed by the customer, etc.)
  - c. Evidence of billing and recording of the sale and related charge to cost of sales. (For example, sales invoice recorded in the sales journal and accounts receivable subsidiary ledger; credit to inventory and charge to cost of sales recorded based on the completed job order.)
  - d. Evidence of collection as a cash receipt. [For example, trace transaction to the entry for the related remittance (as a collection on an individual transaction billing or monthly statement billing) recorded in the accounts receivable subsidiary ledger, cash receipts journal, and its inclusion in the daily deposit recorded on the bank statement.]
3. Make a preliminary evaluation of internal accounting control, and design and perform compliance tests (SAS No. 1, section 320.55-.63) of the specific prescribed procedures expected to be relied upon in determining the nature, extent and timing of substantive tests

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<sup>1</sup>This practice may be useful to clarify an understanding of prescribed internal accounting control procedures, and may be considered as a part of the tests of compliance.

of shipments, sales, discounts, sales returns, credits allowed, cash receipts and trade receivables. (For illustrative compliance tests, see items 5 through 11.)

4. Evaluate internal accounting control for shipments, sales, discounts, sales returns, credits allowed, cash receipts and trade receivables (see SAS No. 1, section 320.64-.68) and:
  - a. Record matters considered and conclusions reached in making the evaluation in accordance with firm policy (completion of questionnaires, checklists, preparation of required memoranda, etc.).
  - b. Based on the evaluation, make necessary modifications to applicable sections of the program for substantive tests.
  - c. Identify and note material weaknesses in internal accounting control to be brought to the client's attention (SAS No. 20; AU section 323).
  - d. Identify and note other internal accounting control matters to be brought to the client's attention.

**NOTE:** The evaluation of internal accounting control may affect substantive tests of revenues and receivables in, for example, the following aspects:

- Extent and method of selection of accounts for confirmation.
- Use of positive or negative forms of confirmation request, or a combination of both.
- Timing of confirmation procedures.
- Type of information needed on the confirmation request to facilitate responses.
- Anticipated scope of alternative procedures as to significant accounts which do not respond to confirmation requests.
- Nature and extent of tests to substantiate sales cut-off.
- Nature and extent of tests to substantiate deferral and realization of revenue in such situations as unearned subscription income or unearned finance charges on installment receivables.
- Approach to reviewing and evaluating adequacy of the allowance provided for doubtful accounts (review of allowances for specific accounts, comparison of experience relating to writeoffs with sales and receivables and the client's past and present credit policies and practices, etc.).

**Illustrative Compliance Tests**

5. Obtain the sales journal and for a selected period(s):
  - a. Trace totals from the sales journal to the general ledger control accounts for revenues, receivables and such other accounts as salesmen's commissions, provisions and allowances for product warranties, etc.
  - b. Trace selected individual items from the sales journal to such other subsidiary records as the salesmen's commissions detail, and entries to charge cost.
  - c. Reconcile the sales journal to the entries to charge cost of sales and credit inventory.
  - d. Test the arithmetic accuracy of the footings and crossfootings of the journals.
6. Select . . . . entries from the sales journal made at various times throughout the year, obtain the supporting documents and perform the following tests:
  - a. Compare the sales invoices with the entries in the sales journal for invoice date, invoice number, identity of customer, dollar amount and any related items such as sales tax, salesmen's commissions, etc.
  - b. Trace the sales invoice to the accounts receivable subsidiary (customers) ledger and to evidence of subsequent payment (remittance advice and cash receipts records).
  - c. Compare the sales invoice for customer identity, description of product, price, quantities, and amounts, to the applicable sales order, and customer's purchase order or job contract. Note evidence of approval of prices and credit as prescribed by management.
  - d. Compare customer identity, description of product, and quantities per the sales invoice to the documents evidencing shipment; test computations of related freight and insurance charges. Ascertain whether sales are recorded in the proper months.
  - e. Trace prices, discount and payment terms to such sources as price lists, job quotations, and job contracts.
  - f. Test arithmetic accuracy of extensions, footings and computation of discounts. Note evidence of performance of a clerical check by client staff, where applicable.
  - g. If the client charges cost of sales and credits inventory as items are sold, trace detail per the sales invoice to subsidiary records for cost of sales and inventory.

7. Review the numerical sequence file of shipping orders for a selected period and account for missing numbers.
8. Select . . . . shipping orders prepared at various times during the year. Obtain related sales invoices and trace them to the sales journal. Note whether billings are timely for shipments made.
9. Select . . . . credit memorandums issued at various times during the year; ascertain whether credits were authorized in accordance with prescribed procedure; review available supporting documentation; trace the memorandums to the sales journal or other appropriate journal and to the accounts receivable subsidiary ledger. If the credit is granted for return of goods, inspect evidence of return and ascertain whether accounting for the returned goods is consistent with reported condition of the returned goods.
10. Obtain the cash receipts journal and perform the following on a test basis for a selected period(s) :
  - a. Trace totals to the general ledger for both the cash account and applicable account distributions such as accounts receivable, cash sales, investment income, and additions to notes payable (re proceeds).
  - b. Test the arithmetic accuracy of the footings and crossfootings of the cash receipts journal; reconcile total receipts to total deposits per the bank statement.<sup>2</sup>
11. From the cash receipts journal, select . . . . cash receipts entered during the year; obtain the supporting remittance advices and perform the following:
  - a. Compare the remittance advices with applicable entries per the cash receipts journal and trace to deposits per the bank statement(s). Ascertain the promptness of the deposit and recording of the entries.
  - b. Trace detail posting of cash receipts to the accounts receivable, notes receivable, or other appropriate subsidiary ledger. Ascertain whether cash receipts and related credits to accounts receivable are recorded consistently in the proper period.<sup>2</sup>

#### **.060 Purchases, Accounts Payable and Disbursements**

1. Review internal accounting control over purchasing and receiving of goods and services and the processing and payment of vendors' invoices. Prepare or update the recorded understanding of inter-

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<sup>2</sup> Steps 10 and 11 above are duplicated as steps 8 and 9, respectively, under illustrative compliance tests for cash because some auditors prefer to group this type of test under that heading.

nal accounting control in accordance with firm policy (narrative memoranda, completion of a questionnaire, flowcharts, etc.).

2. Consider selecting one or a few processed invoices representing each major type of purchase transaction; trace each selected transaction through the related documents and records from inception to ultimate disposition, noting the following:<sup>3</sup>
  - a. Authorization in accordance with prescribed procedure. (For example, properly approved purchase orders or blanket purchase orders, executed term contracts such as leases and service agreements, properly approved requests for payment, etc.)
  - b. Evidence of receipt of the goods or services. (For example, receiving reports or such equivalents as receiving copies of purchase orders, approval of utility and service billings by designated operating management, advice of engineers or consultants on performance of services, etc.)
  - c. Evidence of processing the vendor's invoice and approval before payment. (For example, matching with an approved purchase order and with a receiving report, indication that extensions, discounts and footings were recomputed, indication of proper account distribution, date and signature or initials indicating approval for payment.)
  - d. Evidence on the processed invoice(s) indicating reference to the specific payment made and sufficiently prominent cancellation to avoid duplicate payment.
  - e. Evidence of payment. (Examine the paid check(s) and (i) compare check number, date, identity of payee, and amount to the processed invoice(s); (ii) trace the signatures on the check(s) to a list of authorized check signers; and (iii) compare the endorsement to the name of the payee for reasonableness (identity with name of payee or guarantee of endorsement by a bank).
  - f. Recording of paid check(s) in the cash disbursement journal as to check number, date, name of payee, amount and account distribution.
  - g. If an accounts payable or voucher register is used, evidence that the processed invoice(s) is correctly recorded in the voucher register as to voucher number, date, identity of payee, amount and account distribution.

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<sup>3</sup> This practice may be useful to clarify an understanding of prescribed internal accounting control procedures, and may be considered as a part of the tests of compliance.

3. Make a preliminary evaluation of internal accounting control and design and perform compliance tests (SAS No. 1, section 320.55-.63) of the specific prescribed procedures expected to be relied upon in determining the nature, extent and timing of substantive tests of accounts payable, cash disbursements, inventory costs, property and equipment purchases, and cost of sales, selling, general, administrative and other expenses. (For illustrative compliance tests see items 5 through 9.)
4. Evaluate internal accounting control for purchasing, receiving, processing and payment of vendors' invoices (see SAS No. 1, section 320.64-.68) and:
  - a. Record matters considered and conclusions reached in making the evaluation in accordance with firm policy (completion of questionnaires, checklists, preparation of required memoranda, etc.)
  - b. Based on the evaluation, make necessary modifications to applicable sections of the program for substantive tests.
  - c. Identify and note material weaknesses in internal accounting control to be brought to the client's attention (SAS No. 20; AU section 323).
  - d. Identify and note other internal accounting control matters to be brought to the client's attention.

NOTE: The evaluation of internal accounting control may affect substantive tests of purchases and accounts payable in, for example, the following aspects:

- Extent of analytical review and tests of details of transactions and balances regarding classification of costs or expenses and charges to accounts such as property and equipment and prepaid expenses.
- Time interval between receiving goods and services and invoicing by vendors (may affect design and extent of cut-off tests).
- Extent of testing of details of transactions and balances to substantiate recorded payables and search for unrecorded liabilities as of the balance sheet date.
- Need for and extent of confirmation of payables from vendors.

#### Illustrative Compliance Tests

5. Obtain the voucher register and for a selected period(s):
  - a. Trace totals to the general ledger for both accounts (vouchers) payable and the various account distributions.

- b. Trace postings to other subsidiary registers, if used (for example, property tax register).
  - c. Test the arithmetical accuracy of the footings and cross-footings of the voucher register for a test period(s).
6. Select . . . . entries from the voucher register for various months throughout the year, obtain supporting documents and perform the following tests :
- a. Compare the entry in the voucher register of the vendor's invoice as to date, payee, description and amount and test the clerical accuracy of the invoice.
  - b. Determine that the invoice is supported by (i) an approved purchase order or payment request form and, if applicable, a properly executed purchase requisition and (ii) a signed receiving report or other evidence of receipt of services or goods.
  - c. Determine that the account distribution in the voucher register is reasonable and in agreement with the purchase order.
  - d. Determine that purchase discounts have been properly recorded.
  - e. Determine that freight has been billed in conformity with the purchase order.
  - f. Examine the cancelled check issued in payment of the invoice for date, payee, amount, signature and endorsement. Trace to cash disbursements journal.
  - g. Inspect the voucher for evidence of clerical check, approval of payment as prescribed by management, and appropriate cancellation.
7. Review the numerical sequence files of receiving reports and of purchase orders and determine whether missing numbers are accounted for. (Failure by the client to do so increases the risk that unrecorded liabilities may exist.)
8. Obtain the cash disbursements journal and perform the following on a test basis :
- a. Trace postings for a selected period(s) to the general ledger for both the cash accounts and applicable account distributions.
  - b. Trace postings for a selected period(s) to other applicable subsidiary records, if present (for example, voucher or purchase journal, insurance and property tax registers, plant ledger, etc.).
  - c. For a selected period(s), foot and crossfoot the cash disbursements journal; reconcile total disbursements to the bank statement.<sup>4</sup>

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<sup>4</sup> Steps 8 and 9 are duplicated as steps 6 and 7 respectively under illustrative compliance tests for cash because some auditors prefer to group them under that heading.



9. Review the numerical sequence of checks issued for a selected period and account for missing numbers as void or included on the list of outstanding checks. Select . . . . checks drawn at various times during the year from the disbursements journal and obtain the paid checks and supporting detail for the disbursements:
  - a. Examine the paid checks and trace identity of signatures to the list of authorized check signers. (Consider requesting confirmations from banks of authorized check signers.)
  - b. Compare paid check and supporting detail to the cash disbursements journal for check number, date drawn, payee, amount, and account distribution.
  - c. Compare identity of payee to endorsement; review checks for unusual endorsements and schedule those found for further investigation.<sup>5</sup>

### **.070 Payrolls**

1. Review internal accounting control over payrolls, including account distribution of wages, salaries and commissions, payroll withholdings, deductions and net pay, and related payroll taxes. Prepare or update the recorded understanding in accordance with firm policy (narrative memoranda, completion of a questionnaire, flowcharts, etc.).
2. Consider selecting one or a few employees from the payroll registers representing each major type of payroll transaction (for example, employees compensated on an hourly basis, on a piecework basis, on a salary basis subject to overtime, and salesmen compensated on a commission basis; also, officers salaries, employees paid by check and paid by cash, etc.). Trace each selected transaction through the related documents and records from inception to ultimate disposition noting the following:<sup>6</sup>
  - a. Authorization of rate of pay. (For example, memoranda in the personnel files evidencing approval as prescribed by management, union contracts, approved rate or salary schedules, authorization of officer's salaries per minutes of board of directors meetings.)
  - b. Evidence in support of payment. For example:
    - Time cards or records, which have been approved as prescribed, for employees paid on an hourly basis and for employees paid for overtime.

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<sup>5</sup> See footnote 4.

<sup>6</sup> This practice may be useful to clarify an understanding of prescribed internal accounting control procedures, and may be considered as a part of the test of compliance.

- Production reports, which have been approved as prescribed, for employees paid on a piece-work basis.
  - Attendance records for salaried employees.
  - Sales and commission registers, and evidence that advance drawings for commission salesmen had been approved as prescribed.
- c. Evidence in support of payroll withholdings. (For example, signed W-4 forms and other proper authorizations.)
  - d. Evidence in support of payment. (For example, canceled payroll checks, noting date, check number, name of payee and comparing net pay to the payroll register, signature to list of authorized check signers, and endorsement to the signed W-4 forms; for employees paid by cash, comparing amount on the receipt signed by employee with the payroll register and signature to the signed W-4 form.)
  - e. Evidence of review of payroll for clerical accuracy, reasonableness, and account distribution, as prescribed by management.
  - f. Evidence of individual payroll records. (For example, the individual payroll entry to the records used to accumulate year to date employee compensation for such purposes as preparation of payroll tax returns and W-2 forms.)
3. Make a preliminary evaluation of internal accounting control and design and perform compliance tests (SAS No. 1, section 320.55-.63) of the specific prescribed procedures expected to be relied upon in determining the nature, extent and timing of substantive tests of payroll. (For illustrative compliance tests, see items 5 through 7.)
  4. Evaluate internal accounting control for payroll, including cost and expense account distributions, liabilities for payroll withheld and deducted and related payroll taxes (see SAS No. 1, section 320.64-.68) and:
    - a. Record matters considered and conclusions reached in making the evaluation in accordance with firm policy (completion of questionnaires, checklists, preparation of required memoranda, etc.)
    - b. Based on the evaluation, propose necessary modifications to applicable sections of the program for substantive tests.
    - c. Identify and note material weaknesses in internal accounting control to be brought to the client's attention (SAS No. 20; AU section 323).
    - d. Identify and note other internal accounting control matters to be brought to the client's attention.

**NOTE:** The evaluation of internal accounting control may affect substantive tests of payroll in, for example, the following aspects:

- The extent to which analytical procedures are applied to payroll costs and expenses and the extent to which fluctuations are investigated.
- Whether, and to what extent, gross pay is reconciled to individual earnings records.
- Whether, and to what extent, a payoff is made.
- The extent to which labor charges to property and equipment and to inventory are tested.
- The extent to which payroll taxes withheld and accrued are tested.

**Illustrative Compliance Tests**

5. Obtain the payroll register for a selected period(s):
  - a. Trace totals per the register through applicable payroll summaries to the paid check used to transfer cash for net pay to the payroll bank account, and to postings in the general ledger (and cost accounting records if applicable) for wage and salary cost and expense distributions, and liabilities for payroll withheld and deducted.
  - b. Trace payroll withheld through applicable subsidiary records to the payroll tax returns. Review the payroll tax returns; examine the check remitting withholdings to the governments (federal and state) and trace to the general ledger liability accounts.
  - c. Determine whether payroll was approved in accordance with prescribed procedures. (For example, approval might be a signature on a payroll summary and request for the deposit of net pay to the payroll bank account; the signature on the check used to transfer money to the payroll bank account; approvals directly on the registers, etc.)
  - d. Test the arithmetical accuracy of the footings and crossfootings of the payroll register.
6. Select . . . . entries from the payroll register made at various times throughout the year, and perform the following procedures:
  - a. Examine authorization for rate of pay and evidence in support of payment (for example, time records, piece work production reports or other documentation which has been approved as prescribed by management) and on a test basis recompute gross pay.

- b. Examine proper authorizations for payroll withholdings such as signed W-4 forms and on a test basis recompute amounts withheld.
  - c. Test arithmetical accuracy of net pay based on gross pay less deductions.
  - d. Examine cancelled checks noting date, check number, name of payee and comparing net pay to the payroll register, signature to list of authorized check signers, and endorsement to the signed W-4 forms.
  - e. Examine signed receipt for employees paid by cash, compare amount on the receipt with the payroll register and compare signature to the signed W-4 form.
  - f. Compare the individual payroll entry on the payroll register to the records used to accumulate year-to-date employee compensation for such purposes as preparation of payroll tax returns and W-2 forms.
7. Consider, based on the preliminary evaluation, whether to:
- a. Observe the distribution of payroll checks or cash, including control of unclaimed wages.
  - b. Physically observe selected employees in the performance of their duties.

#### **.080 Cash Balances**

1. Review internal accounting control of cash balances (in banks and on hand) and cash receipts and disbursements. Prepare (or update) the recorded understanding in accordance with firm policy (narrative memoranda, completion of a questionnaire, flowcharts, etc.).

NOTE: The understanding should include, among other matters, the following:

- Identity of all bank accounts used during the year, their approximate activity and balances, purpose (for example, general account, cash receipts depository, payroll account, branch office account, etc.), and authorized signatures for each account.
  - Location, custodian, approximate amount and purpose of all cash funds.
2. Make a preliminary evaluation of internal accounting control and design and perform compliance tests (SAS No. 1, section 320.55-.63) of the specific prescribed procedures expected to be relied upon in determining the nature, extent and timing of substantive tests of cash balances, receipts and disbursements (for illustrative compliance tests, see steps 4 through 10).

3. Evaluate internal accounting control of cash, and:
  - a. Record matters considered and conclusions reached in making the evaluation in accordance with firm policy (completion of questionnaires, checklists, preparation of required memoranda, etc.).
  - b. Based on the evaluation make necessary modifications to applicable sections of the program for substantive tests.
  - c. Identify and note material weaknesses in internal accounting control to be brought to the client's attention (SAS No. 20; AU section 323).
  - d. Identify and note other internal accounting control matters to be brought to the client's attention.

NOTE: The evaluation of internal accounting control may affect substantive tests of cash transactions and balances in, for example, the following aspects:

- The number of days following the balance sheet date for which cut off bank statements should be obtained.
- The extent to which (if any) tests of cash balances can be performed at interim dates.
- The extent to which testing of outstanding checks, deposits in transit, and other reconciling items can be restricted.
- The number of days before and after the balance sheet date which should be used for the testing of bank transfers.
- Whether all bank transfers during the selected period or only those over a selected dollar amount should be tested.
- Whether petty cash funds should be counted or confirmed with the custodian as of the balance sheet date.
- Whether petty cash funds should be counted on a surprise basis.
- The need for coordination of cash counts with inspection of marketable securities and other investments.

**Illustrative Compliance Tests**

4. Review the client's bank reconciliations; for a selected period(s) perform the following tests of the bank reconciliation(s) and related listings of outstanding checks:
  - a. Prove the arithmetic accuracy of the bank reconciliation, including the list of outstanding checks.

- b. Trace the bank balance to the bank statement and the book balance to the general ledger account.
  - c. Trace the paid checks accompanying the bank statement to the cash disbursements journal and outstanding checklist for the preceding month-end.
  - d. Trace deposits per the bank statement to the cash receipts journal and deposits in transit per bank reconciliations of the preceding month-end.
  - e. Trace deposits in transit to the bank statement for the following month; note whether the time interval between the dates per book and bank appear reasonable.
  - f. Trace outstanding checks to paid checks which accompanied the bank statement for the month(s) subsequent to the reconciliation tested; compare paid checks to the cash disbursements journal and inspect signature(s) and endorsements.
  - g. Trace other reconciling items to supporting documents and check subsequent disposition.
5. Consider preparing a proof of cash for a test period including the tests described in step 4 above and the following:
- a. Trace totals per the cash receipts and disbursements journals to the general ledger cash accounts; identify and obtain explanations for significant and unusual cash entries in the general ledger during the test period. Foot the receipts and disbursements journals and prove the arithmetic between the opening and closing general ledger cash balances for the test period.
  - b. Prove the arithmetic accuracy of the bank statement by footing the deposits and disbursements, adding the opening balance and deducting the closing balance and ascertaining that the resulting difference equals total disbursements.
  - c. Account for all deposits per books as deposits per bank or deposits in transit. Determine that deposits are made on a timely basis.
  - d. Review the numerical sequence of checks issued during the period, accounting for them as paid during the period, included on the list of outstanding checks, or void. Determine that void checks have been properly mutilated.

**NOTE:** The working paper format for step 5 would present reconciliations of total receipts and disbursements per the cash books to the respective total credits and charges per the bank statement(s) in addition to reconciliations of the bank and book balances at the beginning and end of the selected period. This working paper format may be

- used to reconcile total activity per the cash books and bank statements for various time periods such as a month or several months.
6. Obtain the cash disbursements journal and perform the following on a test basis (elements of this step are also included in step 5 above):
    - a. Trace postings for a selected period(s) to the general ledger for both the cash accounts and applicable account distributions.
    - b. Trace postings for a selected test period(s) to other applicable subsidiary records, if present (for example, voucher or purchase journal, insurance and property tax registers, plant ledger, etc.).
    - c. For a selected period(s) foot and cross foot the cash disbursements journal; reconcile total disbursements to the bank statement.<sup>7</sup>
  7. Review the numerical sequence of checks issued for a selected period and account for missing numbers as void or included on the list of outstanding checks. Select . . . checks drawn at various times during the year from the disbursements journal and obtain the paid checks and supporting detail for the disbursements:
    - a. Examine the paid checks and trace identity of signatures to the list of authorized check signers. (Consider requesting confirmations from banks of authorized check signers).
    - b. Compare paid checks and supporting detail to the cash disbursements journal for check number, date drawn, payee, amount and account distribution.
    - c. Compare identity of payee to endorsement; review checks for unusual endorsements and schedule those found for further investigation.<sup>7</sup>
  8. Obtain the cash receipts journal and perform the following on a test basis for a selected period(s) (elements of this step are also included in step 5 above):
    - a. Trace totals to the general ledger for both the cash account and applicable account distributions such as accounts receivable, notes receivable, cash sales, investment income, and additions to notes payable (re proceeds).
    - b. Test the arithmetic accuracy of the footings and crossfootings of the cash receipts journal; reconcile total receipts to total deposits per the bank statement.<sup>7</sup>

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<sup>7</sup> Steps 6 and 7 above are duplicated as steps 8 and 9 respectively under illustrative compliance tests for purchases, accounts payable and disbursements because some auditors prefer to group them under that heading. Likewise, steps 8 and 9 above are duplicated as steps 10 and 11 under illustrative compliance tests for revenues, receivables and receipts.

9. From the cash receipts journal, select . . . . cash receipts entered during the year; obtain the supporting remittance advices and perform the following:
  - a. Compare the remittance advices with applicable entries per the cash receipts journal and trace to deposits per the bank statement(s). Ascertain the promptness of the deposits and recording of the entries.
  - b. Trace detail posting of cash receipts to the accounts receivable, notes receivable or other appropriate subsidiary ledger. Ascertain whether cash receipts and related credits to accounts receivable are recorded consistently in the proper period.<sup>8</sup>
10. Select the paid check(s) to reimburse the petty cash fund(s) from the cash disbursements journal; examine the voucher and paid check for consistency with the disbursement journal and prescribed approval and account distribution, and perform the following tests:
  - a. Foot supporting evidence by account distribution and trace total to reimbursement voucher.
  - b. Trace reimbursement voucher to cash disbursements journal and petty cash book.
  - c. Examine petty cash vouchers for the following:
    - Prepared in ink
    - Approved
    - Cancelled after reimbursement
    - Dated
    - Payee
    - Amount
    - Signature
    - Account charged
    - Numbered consecutively
    - Reasonableness of amount and business purpose

#### **.090 Inventories and Cost of Sales**

1. Review and make a preliminary evaluation of internal accounting control over cost of production and inventory.<sup>9</sup> Prepare or update the recorded understanding in accordance with firm policy (narrative memoranda, completion of a questionnaire, flow charts, etc.)

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<sup>8</sup> See footnote 7.

<sup>9</sup> Procedures relating to inventories and cost of sales are closely related or the same as those reviewed for sales, purchases and payroll. Thus, while the auditor frequently observes the form of records used by the client, it is usually not necessary to trace inventory transactions, as such, through the records to clarify the understanding of the system.



NOTE: Matters to consider in making the review include, but are not limited to, the following:

- Nature of the client's operations and inventories.
  - Physical location of inventories.
  - How costs of material, direct labor, and overhead are accumulated; this may be coordinated with the study and evaluation of purchases and payroll and includes evaluation of the cost accounting system used (job order, process, standard costs, etc.).
  - Accounting principles followed in assigning costs to inventory (FIFO, LIFO, retail method, etc.).
  - Whether perpetual inventory records are used and, if so, how they are tested.
  - Frequency and method of physically counting the inventory and adjusting the records to the physical.
2. Based on the preliminary evaluation, design and perform compliance tests of the specific prescribed procedures expected to be relied upon in determining the nature, extent and timing of substantive tests of cost of sales and inventory. (See items 4 through 8 for illustrative compliance tests for inventory and cost of sales.)<sup>19</sup>
  3. Evaluate internal accounting control for cost of sales and inventory and:
    - a. Record the matters considered and conclusions reached in making the evaluation in accordance with firm policy (completion of questionnaires, checklists, preparation of required memoranda, etc.)
    - b. Based on the evaluation, make necessary modifications to applicable sections of the program for substantive tests.
    - c. Identify and note material weaknesses in internal accounting control to be brought to the client's attention (SAS No. 20; AU section 323).
    - d. Identify and note other internal accounting control matters to be brought to the client's attention.

NOTE: The evaluation of internal accounting control may affect substantive tests of cost of sales and inventory in, for example, the following aspects:

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<sup>19</sup> Some auditing procedures may serve to accomplish the purposes of both compliance and substantive tests. Certain steps that are listed here as illustrative compliance tests are also listed among illustrative substantive tests for inventory. They are listed here because they may serve to clarify and confirm the auditor's understanding of internal accounting control of inventory and cost of sales. They are listed as substantive tests because they provide evidence with respect to the client's accounting for cost of sales and cost of inventory.

- The extent to which physical inventories are observed and/or perpetual records tested.
- Whether physical inventories are taken at a preliminary date or at the balance sheet date.
- The extent to which consigned inventories are confirmed.
- The extent to which inventory prices are tested to supporting documentation.
- The extent to which analytical procedures are applied to cost of sales and the extent to which fluctuations are investigated.
- The extent to which cutoffs are tested.
- The extent to which inventories are tested for obsolete or excess stock.

#### **Illustrative Compliance Tests**

4. Tour the client's manufacturing or production facilities with a member of the client's organization familiar with production.
5. On a test basis, select transactions for additions and deletions of inventory from such sources as receiving reports, requisitions to place materials into production, and shipping documents. Note the reference or control number, date, description, quantity and dollar amount for each transaction selected. Trace the transactions to the perpetual inventory record and the cost accounting records, if any, used to determine unit or job costs. Perform similar tests selecting the transactions from the perpetual inventory records and/or cost accounting records and trace the transactions to receiving reports, requisitions and shipping documents.

NOTE: This testing may be coordinated with compliance tests for purchases, payables and disbursements, and for revenues, receivables and receipts.

6. Obtain an analysis of overhead costs charged to inventories and over- or under-absorbed overhead. Review the amounts included in the overhead pool for propriety and perform the following:
  - a. Determine that overhead costs are being charged to inventory in accordance with an appropriate policy (for example, as a percent of direct labor).
  - b. Identify disposition of variances, if any, between actual overhead costs incurred and overhead costs applied to production and inventory. Determine that variances are reasonable. Determine that no excessive costs for idle plant are being charged to inventory.

7. If a job order cost system is used, obtain the job order ledger (or tabulation), select a period(s) and perform the following:
  - a. Trace total costs incurred to the voucher register (or cash disbursements journal), the payroll distribution, and support for overhead applied.
  - b. Test the footings of the job order ledger by refooting the detail for selected subtotals and refooting the subtotals.
  - c. Select . . . . job orders for jobs in process and completed jobs and perform the following:
    - (1) Examine authorization for the job order.
    - (2) Trace materials used on a test basis at various times since inception of the job order to such supporting details as requisitions, purchase orders, receiving reports and processed invoices. (Consider coordination with compliance tests for purchases.)
    - (3) Trace direct labor costs to account distributions of the payroll registers and on a test basis to individual time reports or time cards. (Consider coordination with compliance tests for payroll.)
    - (4) Trace application of overhead costs to analyses used to accumulate overhead costs; test computations and review for reasonableness.
    - (5) Identify the status of the job (work in process, finished goods, or goods shipped) and trace through necessary summarization to the applicable general ledger account. Obtain explanation for any unreasonable time lag between completion and shipping dates for job orders performed for specific customers.
8. For process cost systems, obtain the cost of production reports for each department within the production process for a selected period(s) and:
  - a. Trace quantities and dollar amounts for units received for selected departments to the quantities and dollar amounts transferred out per the preceding department in the sequence of production.
  - b. For each selected department, review the computations of total and unit costs for production transferred to the next department; on a test basis recompute unit costs and ascertain that costs for units lost in process are properly reallocated to surviving units.
  - c. Trace materials costs charged to the selected departments to appropriate journals and on a test basis to individual requisitions.

- d. Trace labor costs incurred to account distribution analyses of the payroll registers.
- e. Review the allocation of overhead.

## **Illustrative Substantive Test Objectives and Procedures**

### **Cash**

#### **.100 Illustrative Audit Objectives**

To determine that :

- Cash exists and is owned by the entity.
- Cash balances reflect a proper cut off of cash receipts and disbursements.
- Cash balances as presented in the balance sheet properly reflect all cash and cash items on hand, in transit, or on deposit with third parties.
- Cash balances are properly classified in the financial statements and any restrictions on the availability of funds are properly disclosed.

## **Illustrative Substantive Test Procedures**

#### **.110 Cash in Banks**

1. Confirm bank balances (using standard bank confirmation forms) as of the balance sheet date for all banks used during the year.
2. Arrange to obtain cut-off bank statements and related paid checks directly from the banks for . . . . days following the balance sheet date.
3. Obtain or prepare a comparative listing of the component bank account and petty cash fund balances as of the closing and opening balance sheet dates for the year (period) being audited:
  - a. Refoot the schedule and trace totals to the financial statement assembly sheets.
  - b. Trace closing balances to the general ledger and working papers on bank reconciliations and petty cash funds.
  - c. Trace opening balances to the working papers for the preceding audit.
  - d. For bank accounts opened and closed during the year (period) trace to authorization in the minutes of the board of directors meetings.
4. Obtain copies of the bank reconciliations as of the balance sheet date and perform the following :

- a. Trace the book balance to the balance per the general ledger control account and to the working lead schedule or trial balance.
  - b. Compare the bank balance to the cut-off bank statement and to the bank confirmation.
  - c. Test the clerical accuracy of the reconciliation.
  - d. Review and explain unusual reconciling items and trace to appropriate subsequent disposition.
  - e. Trace deposits in transit to the cut-off bank statement(s) and ascertain whether the time lag is reasonable.
  - f. Inspect selected paid checks returned with the cut-off bank statement. Examine first cancellation date on the paid checks to identify any checks that were not recorded in the period under audit. Trace checks drawn prior to the end of the period under audit to the list of outstanding checks and to the cash disbursements journal as to date, payee and amount.
  - g. List and investigate any unusual checks including checks drawn to "bearer" or "cash."
  - h. List and investigate any outstanding checks of \$. . . . or over which did not clear the banks within a reasonable period to ascertain that the disbursements are proper.
5. Obtain or prepare an analysis of cash in savings banks and cash invested in certificates of deposit including identity of the individual banks and accounts or certificates, interest rates, maturities for certificates of deposit, opening and closing balances, activity during the year, and related interest income accrued and collected ; perform the following :
- a. Trace book balances and related income to the general ledger control account.
  - b. Test the footings and cross footings.
  - c. Obtain confirmations from the bank of balances at the close of the year (or period), related interest rates and methods of computation, and amounts.
  - d. Examine passbooks and certificates of deposit, comparing them to bank confirmations ; be alert for unrecorded passbook transactions or substituted certificates.
  - e. Recompute (all or on a test basis) amounts of interest earned and trace amounts to the related income accounts.
6. Prepare a bank transfer schedule providing column headings for the following :
- Name of disbursing bank
  - Check number or other reference

- Amount
- Date disbursed per books
- Date disbursed per bank
- Name of receiving bank
- Date deposited per books
- Date deposited per bank

Perform the following:

- a. Review the cash receipts and disbursements journals, bank statements and related paid checks (including the cut-off bank statements) for the last . . . . days before and first . . . . days after the closing date of the year (period) and list all bank transfers (or each transfer of \$. . . . or over) on the transfer schedule.
  - b. Review the schedule to determine that the deposit and disbursement side of each transfer is recorded in the proper period and that any time lag between book and bank entries appears reasonable. Trace incompleting transfers to the schedule of outstanding checks and/or deposits in transit.
7. If cut-off statements and related paid checks are not independently received by the auditor (or firm of auditors) directly from the bank, obtain the bank statements and related paid checks for the month following the balance sheet date and perform the following:
- a. Inspect bank statements for erasures and prove arithmetic accuracy of the statements (opening balance plus total deposits and other credits, less the closing balance equals total disbursements and other charges).
  - b. Examine paid date of each check and debit memo to ascertain it was paid by the bank during the period covered by the bank statements.
  - c. Foot the paid checks and debit memos to ascertain that the total agrees with total charges per the bank statements.
  - d. Request banks to confirm the balance at the end of the statement period.
8. On receiving the banks' responses to standard bank confirmation requests:
- a. Ascertain that all of the inquiries have been answered. If any inquiries have not been answered, telephone or correspond with the bank to obtain the missing information (in writing).
  - b. Trace the bank balances to the copies of applicable bank reconciliations included in the working papers; and accumu-

late the other responses for use in work on liabilities, commitments and contingencies.

9. Return the cut-off bank statements with related paid checks and other bank memoranda to the client and obtain a receipt.

### **.120 Cash Funds and Petty Cash**

1. Identify all funds, including locations, custodians, amounts, and purpose, and decide:
  - a. Which funds are to be counted and, if so, whether to count them simultaneously and whether simultaneous control and inspection of other assets, such as negotiable securities, is also necessary.
  - b. Timing of counts to be at a preliminary date, the balance sheet date or subsequent to the balance sheet date.
2. Count all undeposited cash, petty cash, unclaimed wages, stamps, etc., in the presence of the custodian. (A client's representative should be present at all times during the count) and:
  - a. List currency and coins counted by denomination.
  - b. List other items such as stamps, checks, and vouchers; examine vouchers as to date, amount, payee, authorization, signature, account charged, and documentation. Identify large or unusual amounts for possible follow-up.
  - c. Trace the fund balance per the count to the balance per the general ledger.
  - d. List all unusual items such as postdated checks or vouchers prepared in pencil for discussion with a responsible member of the client's staff.
  - e. If petty cash reimbursement checks are included in the fund, trace the amounts to cash book entries dated prior to the count.
  - f. Have the custodian sign a receipt at the conclusion of the count.
3. Consider whether to confirm funds at branch offices and other locations which are not scheduled for a physical count.

## **Investments**

### **.130 Illustrative Audit Objectives**

To determine that:

- The entity owns the investments as at the balance sheet date and has physical evidence of ownership (securities, receipts from responsible custodians, etc.).

- The market or other fair value of the investments has been determined as objectively as practicable.
- Related income from the investments is properly recorded and received.
- Restrictions, pledges or liens on any of the investments and related liabilities are identified and adequately disclosed in the financial statements.
- The financial statement presentation and disclosure of investments and related income (classification, amounts such as cost, market, share of equity) is in conformity with generally accepted accounting principles consistently applied.

**Some Matters to Consider**

1. Results of the study and evaluation of internal accounting control of investments and related income.
2. Plans for physical inspection, confirmation procedures, or a combination of both, including whether this should be done on a surprise basis, as of the balance sheet date, or both.
3. Need for control of investments and simultaneous control of such related items as cash funds and detail subsidiary records of investments when performing the inspections and confirmation selections and mailings.
4. Competent independent sources for market valuations.
5. Competent independent sources for substantiating declaration and remittance of investment income.

**.140 Illustrative Substantive Test Procedures**

1. Obtain or prepare detailed analyses of investments showing:
  - a. Classification between current and non-current portfolios and investments accounted for on the equity method.
  - b. Description of the security, including any interest rate and maturity of debt, the dividend rate on cumulative preference shares, etc.
  - c. Number of shares, par value, or face amounts held at the end of the preceding period, and the balance at cost and at market or equity if applicable, together with any unamortized premium or discount on bonds.
  - d. Additions including date, number of shares, par values or face amounts, and cost.
  - e. Sales and dispositions including date, number of shares, par value or face amounts, cost, proceeds and realized gain or loss.
  - f. Number of shares, par values, or face amounts held at the end of the period, and the balance at cost and at market or



- equity if applicable, together with any unamortized premium or discount on bonds.
- g. Related valuation allowances at the beginning and end of the period and changes therein.
  - h. Investment income (dividends, interest, etc.) for individual investments—accrued at the end of the previous period, earned during the current period, collected during the period and accrued at the end of the current period.
2. Foot and crossfoot the analyses.
  3. Trace ending totals to the general ledger and financial statement assembly sheets; trace opening balances to the prior period audit working papers.
  4. Inspect securities on hand in the presence of the custodian (including treasury stock and securities held as collateral) at the balance sheet date or at a date shortly before or after, and examine supporting evidence (for example, bank and broker advices) for transactions between the inspection date and balance sheet date.
    - a. Ascertain that certificates issued in nominee names are owned by the client.
    - b. Note certificate or serial numbers if useful.
    - c. If the investment is in the debt or equity of a nonpublic entity, consider obtaining confirmation from the issuer or trustee.
    - d. Obtain a signed receipt.
  5. Obtain positive confirmation as of the balance sheet date for investments held by independent custodians; consider whether inspection of investments held by custodians is necessary.
  6. Examine contractual terms of debt securities and preferred stocks.
  7. Determine that sales and purchases were properly approved; trace transactions to minutes of the Board of Directors or Finance Committee meetings.
  8. Examine bank or broker's advices and custodian's reports in support of purchases and sales.
  9. Determine that gain or loss on disposition of a security has been computed properly.
  10. Trace payments for purchases to cancelled checks and proceeds from sales to entries in cash book.
  11. By reference to published sources, by computation, and by examination of the cash receipts journal, determine that income from securities has been properly accrued or collected.

12. Determine that the amortization of premium and discount on bonds has been properly computed.
13. Determine that market value for both the current and non-current portfolios has been properly computed. Trace quoted market prices to competent published sources; obtain appraised values of infrequently traded securities.
14. For investments in nonpublic entities and investments carried on the equity method, compare carrying value to information in the most recently available audited financial statements. If necessary, use financial reports and statements issued later than the most recently available audited financial statements.
15. Compute the unrealized gain or loss on both the current and non-current portfolios for marketable equity securities.
16. Determine that the unrealized gain or loss on the current portfolio has been properly classified in the income statement and that the unrealized gain or loss on the non-current portfolio has been properly classified in the equity section of the balance sheet.
17. Determine that all transfers from the current to the non-current portfolios have been properly recorded in accordance with management's authorization and note pertinent information for the client representation letter.
18. Determine that any permanent impairment in value has been properly recognized and accounted for.

## **Trade Accounts and Notes Receivable**

### **.150 Illustrative Audit Objectives**

To determine that:

- The receivables exist, are authentic obligations owed to the entity, contain no significant amounts that should be written off, and that allowances for doubtful accounts are adequate and not excessive.
- Proper disclosure is made of any pledged, discounted or assigned receivables.
- Interest on accounts and notes receivable has been properly recorded.
- The presentation and disclosure of receivables is in conformity with generally accepted accounting principles consistently applied.

### **.160 Illustrative Substantive Test Procedures**

1. Based on the study and evaluation of internal accounting control, decide on the following:
  - a. Extent of confirmation procedures.

- b. Form of confirmation (positive, negative or a combination of both).
  - c. Timing of confirmation procedures (as of the balance sheet date or some other date).
  - d. Anticipated scope of alternative procedures.
  - e. Approach for reviewing and evaluating adequacy of allowances.
2. Review activity in the general ledger control accounts for trade accounts receivable for the period under examination and:
    - a. Note and investigate any significant entries which appear unusual in amount or source.
    - b. Compare the opening balance for the period with the final closing balances per the working papers and report for the preceding period.
  3. Analyze the relationship of receivables and sales (day's sales in accounts receivable) and compare with relationships for the preceding period(s).
  4. Obtain or prepare an aged trial balance of trade receivables as of the date selected for confirmation procedures<sup>11</sup> and:
    - a. Crossfoot the totals and refoot the total column and (selected or all) analysis columns.
    - b. Trace total to the general ledger control account and, if as of the balance sheet date, to the lead schedule or working trial balance.
    - c. On a test basis, trace entries for individual customers on the aging analysis (totals and aging detail) to the individual accounts in the accounts receivable subsidiary ledger and select individual accounts from the subsidiary ledger and trace totals and aging detail to the aged trial balance. Test footings of individual customer accounts in the subsidiary ledger.
  5. Select individual customer accounts for confirmation procedures from the aged trial balance (or trial balance) and arrange for the preparation of confirmation requests to be mailed under the auditor's control and tested as follows:
    - a. Trace individual confirmation requests as to balances and addresses to the subsidiary accounts receivable records. Send confirmations (using envelopes with the auditor's return address) and prepare confirmation statistics.

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<sup>11</sup> In some situations, it may not be practicable to obtain an aged trial balance until after the mailing of confirmation requests, especially when confirmation procedures are coordinated with the client's regular billing cycle. In such instances, obtain a trial balance (which may be an annotated tape) of trade receivables as of the confirmation date, test arithmetical accuracy of the footings, and perform steps 4b and 4c above.

- b. If client requests that any accounts be excluded from the confirmation process, obtain explanations; consider reviewing such records as correspondence files to substantiate the explanation and perform appropriate alternative procedures with respect to the amounts.
- c. Trace confirmation replies to the trial balance and investigate replies with differences.

NOTE: The auditor may prepare a control of exceptions such as copies of replies or a list and arrange for the client's staff to investigate the differences and accumulate supporting documentation for the auditor's review.

- d. Obtain new addresses for all confirmations returned by the post office and remail.
  - e. Send second requests for all unanswered positive confirmation requests. Consider sending third requests by registered or certified mail, and performing alternative auditing procedures.
  - f. Perform alternative auditing procedures for unanswered positive confirmation requests.
  - g. Summarize the results of the confirmation procedures.
  - h. Subsequent to the confirmation date, consider reviewing the customers' ledger and remittance advices for cash receipts.
6. For positive confirmation requests to which no reply was received, accounts which declined to provide confirmation information and accounts which the client requested not be confirmed:
    - a. Test items subsequently paid to remittance advices which identify the specific invoices paid.
    - b. Examine customer's purchase orders, related invoices and shipping documents for amounts that are not supported by remittance advices which identify the specific invoices paid.
    - c. Establish the existence of the customer by reference to such sources as Dun and Bradstreet Reference Book.
  7. If accounts receivable were confirmed as of a date other than the balance sheet date, obtain an analysis of transactions between the confirmation and balance sheet dates, trace amounts to books of original entry, and review the analysis and books for significant unusual entries.
  8. Obtain or prepare an analysis of trade notes receivable including the following information:
    - Maker
    - Date made/date due
    - Original terms of repayment
    - Collateral, if any

- Interest rate
  - Balance at the end of last period
  - Principal—additions, payments
  - Balance at the end of current period
  - Interest income—at the end of the preceding period, earned during the current period, received during the current period, and accrued at the end of the current period.
- a. Foot schedule and trace totals to applicable general ledger accounts.
  - b. Physically inspect all notes in possession of the client.
  - c. Request positive confirmations of the terms and balances of notes with makers (as of the balance sheet date or other date). Investigate any differences.
  - d. Confirm notes out for collection with collection agents.
  - e. Inspect collateral for notes, if any, making sure that items were not included in corresponding asset accounts of the company.
  - f. Recompute interest income, accrued interest and unearned discount; trace interest collections, if any, to the cash receipts journal. Ascertain that computations of interest and recognition of interest income is in conformity with APB Opinion No. 21.
9. Ascertain whether any accounts or notes have been assigned, pledged or discounted by reference to minutes, review of agreements, confirmation with banks, etc.
10. Ascertain whether any accounts or notes receivable are owed by employees or related parties such as officers, directors, shareholders and affiliates, and:
- a. Obtain an understanding of the business purpose for the transactions which resulted in the balances.
  - b. Ascertain that transactions were properly authorized.
  - c. Obtain positive confirmations of the balances (as of the balance sheet date or some other date) except for intercompany accounts with affiliated companies which the firm is concurrently examining.
  - d. Determine if any notes repaid prior to the balance sheet date have since been renewed.
11. Obtain or prepare an analysis of the allowance for doubtful accounts for the period, and:
- a. Review accounts written off during the period and determine that significant write-offs have been properly authorized. Examine supporting documentation, including correspond-

- ence with the customer. (Such correspondence may indicate a broader problem.)
- b. Review adequacy of the allowance and related provision by:
- (1) Review of the aged trial balance as of the balance sheet date with the client's credit manager or other responsible individual to identify accounts of a doubtful nature and allowances required; review correspondence files and other relevant data in support of client's representations. Items reviewed should include past due amounts and significant amounts whether or not past due.
  - (2) Examine credit reports for delinquent and large accounts.
  - (3) Review confirmation exceptions for indication of amounts in dispute.
  - (4) Consider whether accounts receivable that have been connected to notes receivable pose any unusual credit risk.
  - (5) Analyze and review trends for the following relationships:
    - (a) Accounts receivable to credit sales.
    - (b) Allowance for doubtful accounts to accounts receivable (in total and in relation to past due categories per aging analysis).
    - (c) Sales to returns and allowances.
    - (d) Expense provisions for doubtful accounts to net credit sales.
    - (e) Expense provisions for doubtful accounts to write-offs.
    - (f) Moving average relationship of write-offs to trade receivables.
- c. Identify differences, if any, between the book and tax basis for the allowance for doubtful accounts and related expense provision; summarize information required for determining income taxes currently payable and deferred.
- d. Review revenue, receivable and cash receipts transactions after the balance sheet date including discounts taken, credits allowed and write-offs for unusual transactions (especially concerning past due balances and large accounts).

## Inventories

### .170 Illustrative Audit Objectives

To determine that:

- The inventory exists and is the client's property.
- The client has taken reasonable care in determining the physical quantities and identifying the condition (normal, slow moving, obsolete) of its inventory.
- The inventories are summarized and priced with clerical accuracy, and the records have been adjusted to the physical inventory.
- Inventory classifications and carrying amounts are determined and presented in the financial statements in conformity with generally accepted accounting principles consistently applied (for example, assumptions about the cost flow such as FIFO and LIFO, and lower of cost or market considerations).
- Any encumbrances such as pledges or liens are identified and adequately disclosed in the financial statements.

#### Some Matters to Consider

1. Results of the study and evaluation of internal accounting control for inventories, production costs and cost of sales. (A particularly significant issue is whether accounting controls over inventory transactions and balances are of sufficient strength to allow performing the physical count sooner than the balance sheet date.)
2. Timely identification of the locations of the physical inventories and their relative materiality by location.
3. Timely review of the client's plans and instructions for taking the physical inventory and accumulating, pricing and summarizing the results. (For example, will prenumbered tags be used and accounted for? Will counts be independently checked? Who is responsible for summarizing the physical inventory?)
4. Whether involvement of specialists is required (see SAS No. 11, AU section 336).
5. Need for audit assistants based on timing of counts at various locations, materiality of the amounts involved, and degree of difficulty of the observation.
6. Whether any inventory is held by third parties such as public warehouses and consignees and, if so, whether to obtain positive confirmation or because of materiality observe its physical count (see SAS No. 1, section 331.14-15; AU section 331.14-15).
7. Information to be recorded during observation when noting test counts for subsequent tracing to summarization of the physical inventory.

8. Information to be recorded at time of the physical count for subsequent tracing to other records as a cut-off test.

## Illustrative Substantive Test Procedures

### .180 Before Observation of the Physical Inventory <sup>12</sup>

1. Tour the client's manufacturing or production facilities with a member of the client's organization familiar with production.
2. On a test basis, select transactions for additions and deletions of inventory from such sources as receiving reports, requisitions to place materials into production, and shipping advices. Note the reference or control number, date, description, quantity and dollar amount for each transaction selected. Trace the transactions to the perpetual inventory record and the cost accounting records, if any, used to determine unit or job costs. Perform similar tests selecting the transactions from the perpetual inventory records and/or cost accounting records and trace the transactions to receiving reports, requisitions and shipping advices.

**NOTE:** This testing may be coordinated with compliance tests for purchases, payables and disbursements, and for revenues, receivables and receipts.

3. Obtain an analysis of overhead costs charged to inventories and over- or under-absorbed overhead. Review the amounts included in the overhead pool for propriety and perform the following:
  - a. Determine that overhead costs are being charged to inventory in accordance with an appropriate policy (for example, as a percent of direct labor).
  - b. Identify disposition of variances, if any, between actual overhead costs incurred and overhead costs applied to production and inventory. Determine that variances are reasonable. Determine that no excessive costs for idle plant are being charged to inventory.
4. If a job order cost system is used, obtain the job order ledger (or tabulation), select a period(s) and perform the following:
  - a. Trace total costs incurred to the voucher register (or cash disbursements journal), the payroll distribution, and support for overhead applied.
  - b. Test the footings of the job order ledger by refooting the detail for selected subtotals and refooting the subtotals.

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<sup>12</sup> Some auditing procedures may serve to accomplish the purposes of both compliance and substantive tests. Certain steps that are listed here as illustrative substantive tests are also listed among illustrative compliance tests for inventory. They are listed here because they provide evidence with respect to the client's accounting for cost of sales and cost of inventory. They are listed as compliance tests because they may serve to clarify and confirm the auditor's understanding of internal accounting control of inventory and cost of sales.



- c. Select . . . . job orders for jobs in process and completed jobs and perform the following :
  - (1) Examine authorization for the job order.
  - (2) Trace materials used on a test basis at various times since inception of the job order to such supporting details as requisitions, purchase orders, receiving reports and processed invoices. (Consider coordination with compliance tests for purchases.)
  - (3) Trace direct labor costs to account distributions of the payroll registers and on a test basis to individual time reports or time cards. (Consider coordination with compliance tests for payroll.)
  - (4) Trace application of overhead costs to analyses used to accumulate overhead costs ; test computations and review for reasonableness.
  - (5) Identify the status of the job (work in process, finished goods, or goods shipped) and trace through necessary summarization to the applicable general ledger account. Obtain explanation for any unreasonable time lag between completion and shipping dates for job orders performed for specific customers.
5. For process cost systems, obtain the cost of production reports for each department within the production process for a selected period(s) and :
  - a. Trace quantities and dollar amounts for units received for selected departments to the quantities and dollar amounts transferred out per the preceding department in the sequence of production.
  - b. For each selected department, review the computations of total and unit costs for production transferred to the next department ; on a test basis recompute unit costs ; and ascertain that costs for units lost in process are properly reallocated to surviving units.
  - c. Trace materials costs charged to the selected departments to appropriate journals and on a test basis to individual requisitions.
  - d. Trace labor costs incurred to account distribution analyses of the payroll registers.
  - e. Review the allocation of overhead.

### **.190 Observation of the Physical Inventory**

1. Include the following in advance planning :
  - a. Review and evaluate the adequacy of the client's instructions for making the physical count.

- b. Consider attending the client's preparatory meetings for the physical count.
  - c. If a specialist is to be involved, review and evaluate the professional qualifications and reputation of the specialist; obtain an understanding of the nature of the work to be performed by the specialist.
  - d. Determine the nature and timing of confirmation requests needed from custodians of inventory such as public warehouses and consignees.
  - e. Review adequacy of audit staffing arrangements.
2. Tour the premises on arrival and ascertain whether the inventory arrangement is conducive to a satisfactory count; if the arrangement appears obviously unsatisfactory, recommend rearrangement.
  3. Ascertain that items on hand which are not property of the client are clearly identified, segregated and excluded from the count. Note such references as descriptions, quantities, serial numbers, and shipping advice numbers so that in subsequent tests of inventory summarization the auditor may determine whether the items were excluded from the physical count.
  4. Visit the shipping and receiving departments and record the control numbers for the last shipping advice and receiving report prepared prior to the physical count for subsequent tracing to accounting department records. Consider recording a few additional shipping advice and receiving report numbers for subsequent tracing.
  5. Ascertain that receiving and shipping departments are informed that receipts after and shipments before the inventory cutoff are to be excluded from the count. Ascertain that receiving reports for items not included in the count are prominently marked "after inventory."
  6. Observe and note client's provision for segregation and/or clear identification of slow moving, obsolete and/or damaged items; also be alert for such items among regular stock and, if present, bring to the client's attention and note for subsequent consideration.
  7. Inspect representative items of inventory and ascertain the source of its identification, description, status (work-in-process, finished goods, etc.), basis for count or measure (volume, weight, item tally, etc.). Inquire of both production personnel and personnel involved in the count about such items.
  8. Observe and ascertain that the client's inventory instructions and procedures are being followed.

9. Ascertain that prenumbered inventory tickets or count sheets are properly controlled including:
  - a. Accounting for all tickets or sheets issued to count personnel.
  - b. Accounting for return of all tickets or sheets issued including those unused and spoiled as well as those used, at completion of the inventory.
  - c. Note series of ticket or count sheet numbers used and those unused or spoiled for subsequent tracing in tests of summarization.
10. Observe the count process and make test counts ascertaining that the identifications, descriptions and quantities are being properly noted on the inventory tickets or count sheets. If inventory count sheets are used, select some items from the floor, make test counts and trace them to the sheets; select some entries from the sheets (include some items of greater dollar value) and trace them to items on the floor.
11. Prepare a worksheet listing some items (include some items of greater dollar value) test counted, for subsequent tracing into the client's inventory summarization. Include on the worksheet for each item the inventory ticket or count sheet number, location, description, quantity per client, quantity per your test count, and other particulars essential for subsequent tracing to the inventory summarization. Bring test count differences to the client's attention during the count so they may be resolved in a timely manner. If test count differences are not isolated, it may be necessary to request a recount of a particular area or department.
12. Observe that all items of inventory are clearly ticketed or marked when counted to avoid omissions and/or duplications of counts.
13. Observe whether any items are not being counted and obtain an adequate explanation for their omission.
14. Note any movement of inventory during the count; obtain explanation for the movement and record details from the applicable authorizing documents for consideration in review of the cutoff.
15. Prepare a memorandum on the observation of the physical inventory including:
  - a. Comment on the physical inventory arrangements.
  - b. Implementation of the client's inventory instructions.

#### **.200 Summarization—Physical Quantities**

1. Relate and trace information, noted during observations of the physical, about control numbers for count tickets or count sheets used, to the client's summarization of the physical for reasonable assurance that only tickets or sheets used for the physical are included in the summarization of quantities. (Summarization of

quantities may consist of the quantities per the final priced inventory or an intermediate tabulation of count tickets. In some instances the original count sheets may provide for entry of prices, extensions and summarization of dollar amounts.)

2. Trace test counts noted during the physical to the client's summarization of quantities.
3. Trace quantities confirmed by third parties to the summarization of quantities.
4. Depending on the extent of the work in step 2 above and on the internal accounting controls over inventory summarization, select quantities for particular items from the summarization and trace them to the count tickets or count sheets; select quantities for particular items from the count tickets or sheets and trace them to the summarization of quantities.
5. If the client uses perpetual inventory records and the perpetuals are to be used to determine the year end balance, trace items on a test basis to and from the physical inventory summaries; ascertain that the perpetuals were adjusted to the physical.
6. Trace notes made at the observation for slow moving, obsolete, and/or damaged items to the client's summarization of quantities and determine if they are clearly identified as such.
7. Test the cut-off information noted at the observation of the physical inventory as follows:
  - a. Select the last few shipping advices used before the count to the sales register; determine that the shipments were recorded as sales and charges to cost of sales as of the dates shipped.
  - b. Select a few shipping advices used after the count to the sales register and determine that the shipments were recorded as sales in the period after the date of the inventory.
  - c. Select the last few receiving reports used before the count and determine that the related liability was recorded prior to or as of the count date.
8. If the client uses a process cost system, trace selected quantities per the physical inventory to the departmental cost of production reports and determine that quantities have been adjusted to the physical inventory as of the date of the physical count.

#### **.210 Prices and Summarization—Monetary Units**

1. Ascertain the methods followed concerning the flow of costs (FIFO, LIFO, moving average, etc.) and compare with working papers of the preceding year to ascertain whether the methods have been consistently applied.

2. For purchased materials and supplies included in inventory, trace unit costs to prices per recent vendors' invoices and/or to prior year inventory if LIFO is used. Note dates per vendors' invoices and be alert for slow moving items. Ordinarily, sufficient invoices should be inspected to cover the quantities on hand.
3. Trace unit costs per the physical inventory for work-in-process and finished goods, on a test basis, to the cost accounting records and perform the following:
  - a. Obtain and review trial balances or tabulations of detailed components of production costs incurred for the year (period) and compare with the equivalent for the preceding year (period).
    - (1) Obtain and note explanations for apparent inconsistencies in classification and significant fluctuations in amounts.
    - (2) Ascertain that the cost classifications accumulated as production costs and absorbed in inventory are in conformity with generally accepted accounting principles.
  - b. Review computations of unit costs and costs credited against inventory and charged to cost of sales; update findings from tests made prior to observation of the physical count, and consider the need for further detail tests.
  - c. Review activity in the general ledger control accounts for raw materials, supplies, work-in-process and finished goods inventories; investigate any significant unusual entries or fluctuations.
  - d. Review labor and overhead allocations to inventory and cost of sales; compare to actual labor and overhead costs incurred and ascertain that variances appear reasonable in amount and have been properly accounted for.
4. Perform following tests for clerical accuracy of the summarized physical inventory:
  - a. Recompute extensions of quantities and unit costs on a test basis.
  - b. Refoot accumulation of dollar subtotals on a test basis.
  - c. Refoot dollar subtotals to test total dollar amounts per the physical inventory for the major classifications (i. e., raw materials, work-in-process, finished goods, supplies, etc.).
  - d. Review the inventory listings for significant quantities and amounts that appear unusual.
  - e. Ascertain that the general ledger control accounts have been adjusted to include the findings of the physical inventory. (This may consist of tracing the totals per the physical to an

analysis which supports journal entries, or an involved trail of tracing through the cost accounting records to the general ledger control accounts.)

5. Review the pricing, extensions and summarization of the physical inventory for items identified as slow moving, damaged, and/or obsolete to ascertain that the items are carried at dollar amounts in conformity with the lower of cost or market principle:
  - a. Examine documentation for the proceeds of recent scrap or salvage sales.
  - b. Review client's criteria for considering items as slow moving or obsolete and evaluate whether criteria appear reasonable and realistic. (For example, are a certain number of months used to determine when an item becomes slow moving? Are predetermined quantities used to determine that quantities on hand are not in excess of reasonable economic need?)

#### **.220 Lower of Cost or Market Considerations**

1. On a test basis select items of raw materials and supplies inventory including some items with relatively significant carrying amounts (because of high unit costs or large quantities on hand) and:
  - a. Compare the inventory unit prices with prices per recent vendors' invoices, vendor quotations, vendor price lists, and published market quotations.
  - b. Review purchase records and production requisitions for indications of whether items may be on hand in excess quantities, slow moving, or obsolete.
2. On a test basis select items or classifications of finished goods and work-in-process inventories including some items with relatively significant carrying amounts (because of high unit costs or large quantities on hand) and:
  - a. Review and note current selling prices and quantities sold for the items or classifications by reference to recent sales invoices, customer orders, and published market quotations, and supplementary discussion with the client's marketing and sales executives.
  - b. Compare inventory carrying amounts and recent selling prices for the selected finished goods items or classifications noted in terms of current relationships of sales to gross profit, selling and shipping expenses; ascertain that the carrying amounts of the selected finished goods items are not in excess of net realizable value.
  - c. For the selected work-in-process items, ascertain their stage of completion and estimated cost to complete by reference to

the cost accounting records, production reports and inquiry of the client's production supervisors. Apply the estimated costs to complete to the selected work-in-process items and apply steps a. and b. above.

- d. Compare quantities on hand for the selected items with quantities noted per recent sales invoices and customer orders; be alert that quantities on hand are not in excess of the client's requirements.
3. Compute the following ratios, compare them with similar ratios for prior years, and obtain explanations for unusual fluctuations:
  - a. Inventory turnover (cost of sales  $\div$  inventory)
  - b. Gross profit percentage (net sales  $\div$  gross profit)
4. Compare inventory balances as at the end of the year (period) with balances as at the beginning of the year (period) and obtain explanations for significant and unusual fluctuations.
5. Relate inventory balances as at the end of the year (period) to anticipated future sales.

### **.230 Other**

1. If the physical count was not taken as of the balance sheet date, analyze and reconcile the balance per the physically counted inventory to inventory per the balance sheet:
  - a. Review and analyze the general ledger control accounts for inventory from the date counted to the balance sheet date; trace additions to such sources as the purchase journal or voucher register, the cost accounting records, and charges to cost of sales.
  - b. Compare the current activity between the count date and balance sheet date to activity of the equivalent period in the preceding year. Investigate unusual fluctuations.
2. Review the sales journal and investigate the authenticity of any unusually large sales made in the period prior to the inventory count date.
3. Determine whether any inventory is pledged as collateral or subject to any liens; coordinate with work on debt payable.
4. Inspect the open purchase order file at the balance sheet date for significant commitments that should be considered for disclosure.

## **Property and Equipment, and Related Depreciation**

### **.240 Illustrative Audit Objectives**

To determine that:

- The property exists and is owned by the entity.

- Additions to property are authentic, recorded at cost and properly distinguished from maintenance and repairs expense.
- Retirements of property together with the proceeds from salvage and the related costs to remove are properly recognized.
- A proper amount of depreciation expense is allocated to the period based on the asset cost, estimated life and salvage, and use of acceptable methods consistently applied, and adequately presented in the financial statements.
- The net carrying value as presented in the financial statements is expected to be recoverable through the ordinary course of business.
- Any encumbrances and liens are identified and adequately disclosed in the financial statements.
- Significant amounts of idle property and equipment are properly stated, classified and described.
- Significant amounts of fully depreciated assets are considered for disclosure.

#### **.250 Illustrative Substantive Test Procedures**

1. Obtain (or update) an understanding of the client's policies concerning capitalization of assets and related depreciation methods and depreciable lives.
2. Consider a tour of the client's facilities for new staff assigned to the engagement, or for the entire audit team if significant changes have occurred.
3. Consider the extent to which it may be practicable to perform substantive tests prior to the balance sheet date.
4. Obtain or prepare the following schedules:
  - a. Summary schedule of property, plant and equipment and related depreciation (by major asset classification) including the following:
    - Beginning and ending asset balances at cost.
    - Asset additions at cost.
    - Asset retirements and dispositions.
    - Other changes.
    - Depreciation method and life.
    - Beginning and ending balances of the allowances for depreciation.
    - Additions to the allowances for depreciation accompanied by an analysis of amounts expensed, absorbed in inventory, and capitalized.
    - Reductions of the allowances for depreciation for retirements and dispositions.



- b. Additions at cost showing the description, date acquired, transaction reference (purchase order number, check number, work order number, etc.), estimated useful life, and cost for all additions of \$. . . . . or over. (Also see step 14 below).
- c. Retirements and dispositions showing the description, date of acquisition, date of retirement or disposition, cost, accumulated depreciation, net carrying value, proceeds of disposition and gain or loss on disposition. (Also see step 14 below).
- d. Analysis of maintenance expense showing each transaction of \$. . . . . or greater (or all transactions) for the year or period.
5. Trace opening balances per the summary schedules to closing balances per the prior year's working papers.
6. Trace amounts per the summary schedule to the general ledger, the detailed asset records, and to the schedules of additions, and retirements and dispositions; recompute the footings and cross footings of the schedules.
7. Perform the following tests of selected additions:
  - a. Determine the addition has been authorized by reference to such sources as minutes of the meetings of the board of directors or finance committee and/or capital asset budgets reviewed by the board of directors or finance committee or by evidence of approval by appropriate, responsible personnel, in accordance with prescribed policies.
  - b. Examine such supporting documents as purchase contracts, paid checks, vendors' invoices, purchase orders, receiving reports, work orders, engineers' reports, etc.
  - c. Trace transactions to appropriate entries in the detailed property records.
  - d. For construction in progress examine supporting work orders, documentation in support of costs incurred such as contractors' invoices, reports and correspondence from engineers and/or architects regarding completion, and trace transfers from the construction in progress accounts to other property accounts.
  - e. Physically inspect selected (or all) major additions.
  - f. Inquire about related dispositions.
  - g. Determine whether additions conform with the company's capitalization policy.
  - h. Determine that installment purchases, if any, are properly recorded.
  - i. By reference to purchase contracts and contractors' billings identify related liabilities to be recorded in connection with debt or other payables.

8. Perform the following tests of dispositions:
  - a. Determine disposition has been properly authorized.
  - b. Examine such supporting documents as bills of sale, contracts, delivery memoranda, etc.
  - c. Trace retirements to the detailed property records.
  - d. Determine that deductions from the asset accounts and related accumulated depreciation are correct.
  - e. Determine that gain or loss on disposition has been correctly classified and recorded.
9. For fully depreciated assets, determine whether the assets are still used and not retired from service.
10. Determine that assets retired from service, if material, have been removed from the property, plant and equipment accounts and related accumulated depreciation accounts, and are carried at amounts which are not in excess of realizable value.
11. Review lease agreements for new leases and determine whether leased assets which should be capitalized have been capitalized, and that related depreciation is being determined using an appropriate method and life.
12. Review provisions for depreciation and amortization and:
  - a. Determine whether the methods and depreciable lives used in the current year are consistent with the preceding year and are reasonable.
  - b. Test computations of depreciation and amortization.
  - c. Determine that amounts of depreciation capitalized in construction in progress are reasonable and appropriate.
  - d. Ascertain that obsolescence, if any, is being properly recognized by adjustment of depreciable lives.
  - e. Trace additions to the depreciation allowances to the applicable general ledger expense accounts.
13. Review maintenance expense and examine supporting documentation for selected transactions to determine that the amounts have been properly classified.
14. Obtain or prepare and test an analysis of qualified additions and early dispositions of qualified property in a format which provides for determination of the investment tax credit. (This may be incorporated into schedules for additions and dispositions).
15. Review the following relationships for the current and preceding year and obtain explanations for significant fluctuations:
  - a. Dispositions of property and equipment to replacements.
  - b. Accumulated depreciation to plant and equipment balances at cost.

- c. Current year depreciation and amortization to plant and equipment balances at cost.

## **Prepaid Expenses, Deferred Charges, Intangibles and Other Assets**

### **.260 Illustrative Audit Objectives**

To determine that :

- The balances represent costs which are properly allocable to future periods in conformity with generally accepted accounting principles.
- Additions are adequately supported.
- Amortization is determined by a rational and systematic method consistently applied.
- Any permanent impairment of balances is recognized by write downs charged to operations.
- Balances and related expenses are properly described and classified in the financial statements.
- Whether there are uninsured risks that should be considered for disclosure (see FASB Statement No. 5, paragraph 103 ; AC section 4311.103).

### **.270 Illustrative Substantive Test Procedures**

1. Obtain or prepare an analysis for each significant classification of prepaid expenses, deferred charges, other assets or intangibles. The analysis should include adequate description of significant components and the following :
  - Balance at the beginning of the year (or period).
  - Additions at cost.
  - Deductions charged to expense, and to other accounts.
  - Balance at the end of the year (or period).
2. Foot analysis and trace totals to general ledger; trace opening balance to the audit working papers for the preceding year (or period).
3. Examine supporting documents for material charges during the year.
4. Review and recompute amortization; determine that the amortization period is reasonable.
5. Determine that the carrying amount of the item does not exceed amounts properly allocable to future periods.
6. Trace amounts amortized during the period to the related general ledger expense accounts.
7. Confirm significant deposits and assets held by others.

8. Obtain or prepare an analysis of prepaid insurance and insurance expenses (including life insurance premiums); perform the following additional tests:
  - a. Examine all or selected policies noting identity of insurer, descriptions and amounts of coverage, premiums and period covered; compare particulars with the analysis.
  - b. Ascertain by review of the policy and related billing advices for the insurance premiums whether the premiums are being financed and/or the policy or cash surrender value has been pledged; determine that related liabilities and finance costs have been properly recorded.
  - c. Obtain confirmation of cash surrender values; consider confirmation of policies especially if premium financing is involved to determine that payments are current and coverage is still in force.
  - d. Ascertain whether all significant insurable risks have been considered.
  - e. Recompute amortization and trace amounts to the applicable expense accounts.
9. For property taxes, where significant, obtain or prepare an analysis which relates both prepayments and accruals as of the beginning and end of the period with tax expense. Examine tax billings and determine whether the timing of the period covered by the tax and the payment due dates result in a prepayment or an accrual as of the balance sheet date. Trace charges to expense to the proper expense account.
10. For intangible assets:
  - a. Trace authorization for major transactions to minutes of board of directors meetings.
  - b. Examine supporting documents.
  - c. Ascertain whether amortization has been properly computed in conformity with generally accepted accounting principles, and trace charges to related expense accounts.
11. Determine that there has been no permanent impairment of value for prepaid expenses, deferred charges, intangible assets, etc.
12. Determine that balances are properly classified in the balance sheet (current v. non-current, etc.).

## Accounts Payable

### .280 Illustrative Audit Objectives

To determine that:

- Accounts payable represent authorized current obligations.
- Amounts included in accounts payable are properly classified.

- Accounts payable include all significant current obligations.
- Adequate disclosure has been made of any pledged assets.

**Some Matters to Consider**

1. Results of the study and evaluation of internal accounting control of purchases, accounts payable and disbursements.  
In particular, this may affect both the extent of substantive procedures and whether they are performed at the date of the physical inventory, at the balance sheet date, or both.
2. Results of the study and evaluation of internal accounting control of payroll regarding liability for withheld payroll taxes.
3. Whether to request positive confirmation from vendors and, if so, when and to what extent.

NOTE: Some auditors send confirmations to major vendors to obtain independent outside evidence that all liabilities have been recorded. Other auditors believe that evidential matter can be obtained more efficiently through other procedures.

5. Potential efficiencies to be gained from coordination of accounts payable work with substantive tests of inventory when the physical is taken at the balance sheet date. (For example, tests of cut off, and using vouchers obtained from client's files in substantiating recent inventory prices as well as accounts payable work.)

**.290 Illustrative Substantive Test Procedures**

1. Obtain or prepare a schedule of accounts payable as of the balance sheet date.
  - a. Foot schedule and trace totals to the general ledger.
  - b. Trace selected individual accounts to accounts payable subsidiary ledger and vice versa.
  - c. Discuss with client old or disputed payables.
  - d. Investigate debit balances and, if significant, consider requesting positive confirmations and propose reclassification of the amounts.
  - e. Ascertain by review of minutes and agreements and by inquiry whether any assets are pledged to collateralize payables.
  - f. Identify inter-company accounts and:
    - (1) Arrange to have balances traced to corresponding receivables in the affiliate's books if affiliate is being currently examined by the firm.
    - (2) Obtain confirmation from the affiliate.
    - (3) Investigate and reconcile differences.

2. Consider confirmation procedures such as the following:
  - a. Obtain and review a list of major vendors, or identify major vendors by reviewing voucher registers or subsidiary accounts payable records.
  - b. Request vendors to provide a statement of the account balance as of the date selected (ordinarily, the physical inventory date and/or balance sheet date).
  - c. Investigate and reconcile differences.
3. Confirm balances due officers and employees; ascertain business purpose of the transactions and, if significant, trace to authorization in the minutes of the board of directors meetings.
4. Test selected unconfirmed balances by examination of vouchers, invoices, and receiving reports.
5. Perform a search for unrecorded liabilities,<sup>13</sup> including the following sources, and schedule findings to show effect of the potential adjustment on operations or financial position:
  - a. Examine files of receiving reports unmatched with vendors' invoices, searching for significant items received on or before the balance sheet date. Use this information to test client's schedule of goods received but not billed. (If vendors' invoices are not available, refer to the purchase order for prices.)
  - b. Inspect files of unprocessed invoices and vendors' statements for unrecorded liabilities.
  - c. Review the cash disbursements journal for disbursements after the balance sheet date; obtain and examine supporting detail for each disbursement of \$ — and over and determine that accounts payable as at the balance sheet date were properly recorded.
  - d. Review the voucher register for transactions recorded after the balance sheet date; obtain and examine supporting detail for each transaction of \$ — and over to identify items that should have been recorded at the balance sheet date and were not.
  - e. Inquire of responsible client staff about their knowledge of additional sources of unprocessed invoices, unrecorded commitments, or contingent liabilities.
7. Liabilities for payroll taxes withheld:
  - a. Trace liabilities to payments made subsequent to the balance sheet date; examine the payroll tax deposit receipts.

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<sup>13</sup> The search would cover entries recorded after the close of the year or period under examination to a date on or near the conclusion of fieldwork.

- b. Compare liability to accrued payroll taxes for reasonableness.
- c. Trace liabilities to summaries of the applicable payroll registers.

## **Accrued Liabilities Other Than Income Taxes**

### **.300 Illustrative Audit Objectives**

To determine that :

- Expense accounts include costs and expenses applicable to the period.
- All contingencies and estimated future expenses that should be accrued in the period have been accrued, classified and described in accordance with generally accepted accounting principles consistently applied.

### **Some Matters to Consider**

1. Results of the study and evaluation of internal accounting control for purchases, payables and disbursements, and payroll.
2. Coordination of work with review and comparisons of costs and expenses incurred for the current year (period) with the preceding year (period) and with budgeted amounts.

### **.310 Illustrative Substantive Test Procedures**

1. Obtain or prepare analysis of accrued liability accounts.
2. Examine documents or working papers supporting amounts accrued and:
  - a. Determine the basis and method of accrual
  - b. Recompute amounts provided
  - c. Review accrual for reasonableness
3. Trace amounts accrued during the year to related expense accounts.
4. Compare accrual to subsequent payments, where possible, to determine reasonableness.
5. Determine if any other accruals are required as a result of the search for unrecorded liabilities.
6. Investigate and explain any large fluctuations in accruals between the current and the preceding period.
7. For vacation accruals:
  - a. Examine union contracts and/or personnel manuals to determine vacation policies.
  - b. Test the client's computation of accrued vacation pay. (In some cases this might be a detailed calculation; in other cases, it may be more in the nature of an overall estimate.)

8. For accrued payroll taxes :
  - a. Compare accruals as of the balance sheet date to subsequent payments and determine that amounts were accrued in the proper period.
  - b. Consider reconciling wages per the payroll tax returns to the payroll registers.

## **Income Taxes Accrued and Provided**

### **.320 Illustrative Audit Objectives**

To determine :

- That the provision for income taxes is reasonable.
- That the liability for accrued income taxes is adequate and not excessive in relation to amounts reasonably expected to be payable.
- That deferred income taxes represent the effect of timing differences.
- That income tax provisions, accruals and deferrals are properly described and classified in conformity with generally accepted accounting principles consistently applied.

#### **Some Matters to Consider**

Carefully planned schedules and analyses for the audit working papers may also aid in accumulating information for income tax return preparation.

### **.330 Illustrative Substantive Test Procedures**

1. Obtain or prepare analyses of the various current and deferred income tax liabilities and receivables and related provisions showing :
  - Balances at the beginning of the year (period)
  - Amounts provided
  - Refunds received
  - Payments made, indicating date and nature
  - Balances at the end of the year (period)
2. Trace payments to cash books and general ledger; examine cancelled checks for evidence of timely payment.
3. Compare payments and refunds to copies of income tax returns.
4. Ascertain latest year that income tax returns have been examined and which periods, if any, are being contested. Examine recent Revenue Agent Reports; determine that adequate consideration has been given to items challenged in the past.
5. Determine that any assessments for tax deficiencies and related interest expenses have been properly recorded.
6. Schedule timing differences and permanent differences between income before taxes for financial reporting purposes and current



- income tax purposes; review and recompute the current and deferred income tax provisions for the year (period).
7. Determine that tax liability at the balance sheet date is adequate and not excessive.
  8. Reconcile the provision for income taxes and the tax liability.
  9. Update carryforward analyses of the composition of all income tax liability accounts.
  10. Update carryforward analyses of the composition of all deferred tax accounts.

## **Notes Payable, Long Term Debt and Debt Equivalents**

### **.340 Illustrative Audit Objectives**

To determine that :

- Notes payable, long term debt and debt equivalents are authorized, and properly classified and described in the financial statements.
- Liabilities are recorded in the proper period at the correct amounts.
- Related interest expense (including discount or premium) is accounted for in conformity with generally accepted accounting principles consistently applied.
- The financial statements include adequate disclosure of restrictive covenants of loan agreements, pledged assets, etc.

### **.350 Illustrative Substantive Test Procedures**

1. Obtain or prepare an analysis of notes payable, long term debt and capitalized lease obligations showing the following:
  - a. Description
    - (1) Date of origin
    - (2) Type of debt and maturity
    - (3) Face amount
    - (4) Interest rate
    - (5) Timing and amount of payments
  - b. Principal
    - (1) Balance at the beginning of the year (period)
    - (2) Additions
    - (3) Payments
    - (4) Balance at the end of the year (period)
  - c. Related Interest
    - (1) Accrued interest at the beginning of the year (period)
    - (2) Unamortized discount or premium at the beginning of the year (period)

- (3) Expense incurred during the year (period)
  - (4) Amount paid during the year (period)
  - (5) Accrued at the end of the year (period)
  - (6) Unamortized discount or premium at the end of the year (period)
2. Foot and crossfoot analysis, and trace totals to general ledger and subsidiary ledgers for notes payable, long term debt and capitalized lease obligations.
  3. Trace authorization for all new debt (including such debt equivalents as capitalized leases) to the minutes of the board of directors meetings.
  4. Examine supporting documentation for all debt (and debt equivalents) and related interest expense (for example, note and loan agreements, bond indentures, lease agreements, correspondence from legal counsel, etc.); obtain copies of debt agreements and highlight restrictive covenants. Note and investigate any apparent violations.
  5. Examine lease agreements; identify those which should be capitalized and determine whether they were capitalized at effective rates of interest determined in conformity with generally accepted accounting principles. (Users may wish to insert here references to the current pronouncements on accounting for leases). Obtain information needed for disclosures of lease obligations.
  6. Confirm outstanding balances, terms, conditions and compliance with covenants with the credit grantor or independent trustee.
  7. Examine cancelled or paid notes and bonds. Consider confirming large notes paid or cancelled during the year (period).
  8. Recompute interest expense and amortization of debt discount or premium.
  9. Reconcile interest expense with debt outstanding during the year (period).
  10. Review subsequent payment or renewal of substantial notes.
  11. Account for all unissued bonds.

## Stockholders' Equity

### .360 Illustrative Audit Objectives

To determine that:

- All transactions and commitments (options, warrants, rights, etc.) are properly authorized and classified.
- All transactions and commitments are recorded at correct amounts in the proper period.

- All transactions and balances are presented in the financial statements in conformity with generally accepted accounting principles consistently applied and accompanied by adequate disclosures.

## **Illustrative Substantive Test Procedures**

### **.370 Capital Stock and Additional Paid-In Capital**

1. For each class of stock, identify the number of authorized shares, par or stated value, privileges and restrictions.
2. Obtain or prepare an analysis of the activity in the accounts; trace opening balances to the balance sheet as of the close of the year (period) previously examined.
3. Examine minutes, bylaws and articles of incorporation for provisions relating to capital stock and support for all changes in the accounts including authorization per minutes of board of directors and stockholders meetings, and correspondence from legal counsel.
4. Account for all proceeds from stock issues (including stock issued under stock option and stock purchase plan):
  - a. Recompute sales price and applicable proceeds.
  - b. Determine that proceeds have been properly distributed between capital stock and additional paid-in capital.
5. If company keeps its own stock record books:
  - a. Prepare a carryforward schedule showing certificate number, date and to whom issued, number of shares issued and date of examination.
  - b. Reconcile schedule to general ledger.
  - c. Determine that all issued certificates have been accounted for as outstanding or cancelled.
  - d. Account for all unissued certificates.
  - e. Examine supporting correspondence for stock transfers.
6. If the company does not keep its own stock record books:
  - a. Obtain confirmation of shares outstanding from the registrar and transfer agent.
  - b. Reconcile confirmation with general ledger accounts.
7. For stock options and stock option plans, trace authorization to the minutes of the board of directors meetings, review the plan and the option contracts. Obtain or prepare and test analyses of stock options which include the following information:
  - For option plans, the date of the plan, number and class of shares reserved for option, method for determining the option price, period during which options may be granted, and identity of persons to whom options may be granted.

- For options granted, identity of persons to whom granted, date of grant, number of shares under option, option price, option period, number of shares as to which options are exercisable, and the market price and value of shares under option as of the date of grant or measurement (first date on which are known both (1) number of shares individual is entitled to receive, and (2) the option or purchase price, if any).
  - For options outstanding, number of shares subject to option at the beginning of the period, activity during the period (additional shares subjected to option, number of shares exercised under options, number of shares associated with options which expired during the period), and number of shares subject to option at the end of the year (period).
8. Identify all stock rights and warrants outstanding as of the balance sheet date including the number of shares involved, period during which exercisable and exercise price; determine that the rights and warrants were authorized.
  9. Identify any stock subscriptions receivable, and:
    - a. Determine if they were authorized.
    - b. Obtain confirmation from subscribers.
    - c. Ascertain that subscriptions receivable are classified as a reduction of stockholders' equity on the balance sheet.
  10. Obtain or prepare an analysis of the treasury stock account and:
    - a. Inspect the paid checks and other documentation in support of the treasury stock acquisitions.
    - b. Examine the treasury stock certificates; ascertain that the certificates are in the company's name or endorsed to the company.
    - c. Reconcile treasury stock to the general ledger.
  11. Ascertain amount of dividends in arrears, if any, on cumulative preferred shares.

### **.380 Retained Earnings**

1. Analyze activity during the period; trace the opening balance to the balance sheet as at the end of the year (period) previously examined; trace net income to financial statement assembly sheets, and trace unrealized loss on noncurrent investments to investment working papers.
2. Determine that dividends paid or declared have been authorized by the board of directors and:
  - a. Examine paid checks and supporting documents for dividends paid (selected checks to shareholders or to a dividend disbursing agent).
  - b. Recompute amounts of dividends paid and/or payable.

3. Investigate any prior period adjustments and determine if they were made in accordance with FASB Statement No. 16, *Prior Period Adjustments*.
4. Examine supporting documents and authorization for all other transactions in the account, considering conformity with GAAP.
5. Determine amount of restrictions, if any, on retained earnings at end of period which result from loans, other agreements, or state law.

## Revenues and Other Income

### .390 Illustrative Audit Objectives

To determine that:

- Revenue transactions represent consideration applicable to goods shipped and/or completed services rendered to customers (or clients) in the normal course of business during the year (period).
- Revenue transactions have resulted in collections or bona fide receivables.
- All revenues earned during the year (period) are recorded and included in the financial statements.
- Revenues are properly classified and described in the financial statements and accompanied by adequate disclosure.
- Other income has been properly recognized, classified and described in the statement of income.
- The income statement is prepared in conformity with generally accepted accounting principles consistently applied.

### .400 Illustrative Substantive Test Procedures

1. Obtain or prepare a comparative analysis of sales for the current and preceding year (period) (and budgeted amounts) including gross sales, discounts granted, returns, credits allowed, and net sales. (Consider additional subclassifications such as sales by product line, division, seasons during the year or period, etc.). Obtain explanations for significant or unusual fluctuations from the preceding year (period) and from budgeted amounts.

NOTE: Revenue and profit recognition on long term service contracts, installment sales, and long term construction contracts are specialized matters which are common to certain industries; see the applicable industry audit guides.

2. Ascertain whether the entity ships goods to be held on consignment by others, and if so:

- a. Identify the control accounts, procedures, and entities to whom consignment shipments are made.
  - b. Examine consignment agreements.
  - c. Review subsidiary accounts for entities to whom consignment shipments are made; examine supporting detail and ascertain that shipments on consignment are properly recorded.
  - d. Review shipping advices and trace consignment shipments to the applicable subsidiary records and control accounts; ascertain that consignment shipments are correctly classified and recorded.
  - e. Investigate old or significant consignments to determine whether there are any unrecorded sales.
3. Identify amounts of sales to affiliates; obtain an understanding of their business purpose, and note for disclosure and/or tracing to consolidation eliminating entries. Identify amounts of sales to other related parties (see SAS No. 6, AU section 335).
  4. For sales cut off as of the closing date for the year (period) and/or the date of the physical inventory:
    - a. Select sales invoices for testing from the sales register for several days before and after the year end (or at the physical inventory date) and examine shipping records and determine that they were recorded in the proper period.
    - b. Select credit memos issued after year end and examine underlying documentation (for example, record of receipt of returned goods) to determine period to which credit memo is applicable and whether it was recorded in the proper period.
    - c. Inquire of the client if there are any unprocessed sales or customer credit memos. Inspect supporting documents to determine whether they should have been recorded prior to year end.
  5. Ascertain that the following income accounts have been traced to the analysis working papers for examination of the related balance sheet accounts:
    - a. Interest income (notes receivable, debt securities, capitalized leases, etc.)
    - b. Dividend income and realized gains (marketable equity securities)
    - c. Increase in investments accounted for on the equity method (investments)
    - d. Gain on sale of property and equipment (property and equipment)

6. Obtain (or prepare) an analysis of rent and royalty income and examine supporting agreements (should be related to examination of leases and other agreements).

## **Operating and Other Expenses**

### **.410 Illustrative Audit Objectives**

To determine that:

- Reported expenses include costs which are properly allocable to the year (period) and are properly matched with revenues.
- Recognition has been given to all costs and expenses (including losses) which should be recognized.
- All tax timing differences have been accounted for.
- Extraordinary items have been properly classified and disclosed.
- The income statement is prepared in conformity with generally accepted accounting principles consistently applied.
- Costs and expenses are appropriately classified and described in the statement of income.

### **.420 Illustrative Substantive Test Procedures**

1. Obtain or prepare comparative analyses showing amounts for the current and preceding years or periods (and budgeted amounts) and the amounts of changes for the following:
  - Income statement with each classification of expenses also analyzed as a percentage of net sales.
  - Schedules showing the individual account balances which comprise each classification in the income statement (for example: comparative schedules of components of manufacturing costs plus opening inventory less closing inventory, selling expenses, general and administrative expenses, etc.).
    - a. Consider whether the classification of expenses is in conformity with generally accepted accounting principles consistently applied.
    - b. Obtain explanations for significant or unusual fluctuations in expense account balances from the preceding year (or period) and from budgeted amounts. (Consider results of work done on accrued expense balances for the current and preceding year.)
    - c. Obtain explanations for significant or unusual differences between the current year and preceding year relationships of statement classifications of expenses as percentages of revenue.
    - d. Compare the inventory turnover and gross profit ratios for the current and preceding year.

2. Determine that the following expense accounts have been traced to the analysis working papers for examination of the related asset and liability balances :
  - a. Bad debt expense (allowance for doubtful accounts—trade receivables)
  - b. Insurance expense (prepaid insurance, and accrued premiums for workmen's compensation)
  - c. Property taxes (prepaid and/or accrued property taxes)
  - d. Depreciation expense (property and equipment, and accumulated depreciation)
  - e. Amortization costs (intangible assets)
  - f. Interest expense (notes payable, long-term debt, capitalized leases)
  - g. Provision for income taxes (liability for income taxes currently payable, deferred income taxes)
  - h. Realized losses on current investments (marketable equity securities)
  - i. Loss on sale or disposition of property and equipment (property and equipment)
3. Obtain or prepare analyses of the following accounts and examine supporting detail (on a complete or test basis as deemed appropriate) :
  - a. Professional fees (lawyers' invoices should have been examined and noted during work on commitments and contingencies concerning pending litigation).
  - b. Rent and royalty expense (should be related to examination of leases and other agreements—other lease obligations or license agreements may be disclosed).
  - c. Officers' salaries and directors' fees (to determine that amounts agree with those authorized per the minutes of board of directors' meetings).
  - d. Maintenance and repairs (if not already tested in connection with property and equipment; determine that expenses do not include amounts which should be capitalized).
  - e. Travel and entertainment (review client's procedures for compliance with income tax requirements).
  - f. Unusual classifications such as loss provisions for discontinued operations and plant closings.
4. Consider obtaining or preparing analyses and examining supporting detail on a test basis for the following expenses :



- a. Research and development
  - b. Advertising
  - c. Contributions
5. Based on the evaluation of internal accounting control for payroll, consider reconciling wages and salaries and payroll taxes to amounts reported per the payroll tax returns.

## **Litigation, Claims and Assessments**

### **.430 Illustrative Audit Objectives**

- Identify the existence of any contingencies arising from litigation, claims and assessments; when the underlying cause occurred; the likelihood of an unfavorable outcome, and the amount or range of possible loss.
- Determine that the financial statements include proper accruals and/or disclosure of the contingencies.

### **.440 Illustrative Substantive Test Procedures**

1. Assemble findings concerning litigation, claims and assessments from such other procedures as:
  - a. Reading minutes of meetings of stockholders, directors, and appropriate committees held during and subsequent to the period being examined.
  - b. Reading contracts, loan agreements, leases, and correspondence from taxing or other governmental agencies, and similar documents.
  - c. Obtaining information concerning guarantees from bank confirmation forms.
  - d. Inspecting other documents for possible guarantees by the client.
2. Inquire of and discuss with management the policies and procedures adopted for identifying, evaluating, and accounting for litigation, claims, and assessments.
3. Obtain from management a description and evaluation of litigation, claims, and assessments that existed at the date of the balance sheet being reported on, and during the period from the balance sheet date to the date the information is furnished, including:
  - a. Identification of those matters referred to legal counsel.
  - b. Assurances from management, ordinarily in writing, that they have disclosed all such matters required to be disclosed by Statement of Financial Accounting Standards No. 5.

4. Examine documents in the client's possession concerning litigation, claims, and assessments, including correspondence and invoices from lawyers.
5. Obtain assurance from management, ordinarily in writing, that they have disclosed all unasserted claims that the lawyer has advised them are probable of assertion and must be disclosed in accordance with Statement of Financial Accounting Standards No. 5. Also the auditor, with the client's permission, should inform the lawyer that the client has given the auditor this assurance. This client representation may be communicated by the client in the inquiry letter or by the auditor in a separate letter.
6. Request the client's management to send a letter of inquiry to those lawyers consulted by the client concerning litigation, claims, and assessments (see SAS No. 12, AU section 337, for guidance).

## **Subsequent Events**

### **.450 Illustrative Audit Objectives**

- To identify any events or transactions occurring after the balance sheet date, but before issuance of the financial statements and auditor's report (subsequent events) which require adjustment or disclosure in the financial statements.
- To determine that the financial statements have been adjusted for changes in estimates resulting from evidence provided by subsequent events.
- To determine that the financial statements include adequate disclosure of evidence provided by subsequent events which should not result in adjustment of the financial statements but should be disclosed.

### **.460 Illustrative Substantial Test Procedures**

1. Read the latest available interim financial statements:
  - a. Compare them with the financial statements being reported upon; and make any other comparisons considered appropriate in the circumstances.
  - b. Inquire of officers and other executives having responsibility for financial and accounting matters as to whether the interim statements have been prepared on the same basis as that used for the statements under examination.
2. Inquire of and discuss with officers and other executives having responsibility for financial and accounting matters as to:
  - a. Whether any substantial contingent liabilities or commitments existed at the date of the balance sheet being reported on or at the date of inquiry.

- b. Whether there was any significant change in the capital stock, long-term debt, or working capital to the date of inquiry.
  - c. Whether there were any significant changes in estimates with respect to amounts included or disclosed in the financial statements being reported on.
  - d. Whether any unusual adjustments had been made during the period from the balance-sheet date to the date of inquiry.
3. Read the available minutes of meetings of stockholders, directors, and appropriate committees; as to meetings for which minutes are not available, inquire about matters dealt with at such meetings.
  4. Assemble pertinent findings resulting from response of client's legal counsel and other auditing procedures concerning litigation, claims, and assessments.
  5. Obtain a letter of representation, dated as of the date of the auditor's report, from appropriate officials, generally the chief executive officer and chief financial officer (see item number 6 at AAM section 5400.040) in accordance with SAS No. 19 (AU section 333).
  6. Make such additional inquiries or perform such procedures deemed necessary and appropriate to dispose of questions that arise in carrying out the foregoing procedures, inquiries, and discussions.
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## AAM Section 6000

**WORKING PAPERS**

Sample working papers are presented for illustrative purposes only. They are intended as mere conveniences for users of this Manual who may want points of departure when designing their own formats to meet their individual needs. These illustrations are neither all-inclusive nor prescribed minimums. Auditors and accountants are to rely on professional standards and their individual professional judgment in determining the workpapers needed in the circumstances.

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»»»→ *The next page is 6101* ←«««





**AAM Section 6100*****Working Papers—General***

.01 Working papers serve both as tools to aid the auditor in performing his work, and as written evidence of the work done to support the auditor's report. SAS No. 1, section 338, provides authoritative guidance on the functions and nature, general content, and ownership and custody of working papers.

**General Discussion**

.02 These sections present points of view on the organization and preparation of working papers and include selected illustrations of working papers, primarily analyses and schedules.

.03 Proper planning is important in the design of specific working papers if they are to serve the objective of aiding the auditor in the conduct of his work. For example, a well-planned working paper may be designed to provide information that will be needed later in the preparation of tax returns and other required reports, such as those to regulatory bodies, and may therefore eliminate the need for examining the same documents twice to obtain necessary information. The format and content of the working papers may vary with the individual preferences of auditors and firms. These preferences may be informal common practices or expressed as part of a firm's formal written policies and procedures. A firm should consider the nature of its practice and the services commonly provided to its clients, as well as professional standards in developing its procedures and policies on working papers. Those procedures and policies should permit the flexibility necessary to meet the needs of individual engagements.

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➤→ *The next page is 6201.* ←➤



## AAM Section 6200

### *Basic Elements of Format*

.01 Working paper formats generally include at least the following for identification purposes:

- A title or heading comprised of (a) the name of the client, (b) a caption that briefly describes the paper's contents, (c) the nature of the engagement, and (d) the applicable period or closing date covered by the engagement.
- The initials or names of the auditors who performed and reviewed the work presented in the paper and the date the paper was completed.

.02 In instances when one working paper requires more than one page, some auditors present the heading on only the lead page, fasten or staple all the applicable pages together as a unit and number each page, for example, 1 of 5, 2 of 5, and so forth. Many auditors index each working paper in some organized pre-established manner. This provides for ease in cross referencing to other relevant papers, for more organized indexing and filing, and for a form of control over the working papers. (See section 6400.)

.03 Some auditors purchase standard analysis paper that includes preprinted blocks for the initials or signature of the preparer and reviewer, and the dates on which the paper was prepared and reviewed. Others design their own signature and reference blocks and have them imprinted on all of their analysis paper and lined pads. These signature blocks may include captions such as the following:

- prepared by client and tested by
- prepared by
- date prepared
- date tested
- reviewed by
- date reviewed
- source
- work paper reference
- footed by
- extensions checked by

.04 Some auditors prefer to identify client preparation of schedules and analysis by notations or codes, such as "PBC," for prepared by client, rather than use a detailed signature and reference block.

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➡ *The next page is 6301.* ←



**AAM Section 6300*****Content of Working Papers***

.01 The content of working papers varies with the circumstances and needs of the auditors on individual engagements. Some firms, however, include various general and specific instructions on working paper content in their policies concerning working papers.

**General Considerations**

.02 The following are some general considerations on working paper content that may be helpful.

- Working papers should be sufficiently intelligible, clear and neat so that another auditor who has had no previous association with the engagement can review the papers and determine the nature and extent of the work done and how the conclusions were reached that support the resulting auditor's report.
- The content of an individual working paper or group of related papers should include identification of the (1) source of the information presented (e. g., fixed assets ledger, cash disbursements journal), (2) the nature and extent of the work done and conclusions reached (by symbols and legend, narrative, or a combination of both), and (3) appropriate cross references to other working papers.
- Before completion of the engagement, all questions or exceptions in the working papers should be resolved. If for some reason the auditor must leave the assignment without resolving all items, he should provide an open items listing on a separate temporary paper for the in-charge auditor's attention. An unresolved exception or incomplete explanation in the working papers may be construed by some as indication of an inadequate audit.
- Information and comments in the working papers generally represent statements of fact and professional conclusions. Accordingly, language should be clear and free from such vague judgmental adjectives as "good" or "bad." Conclusions should be supported by documented facts, especially if they concern the adequacy of the client's records.
- Working papers should be viewed as an integrated presentation of information. The auditor should cross-reference working papers to call attention to interaccount relationships and to

reference a paper to other working papers summarizing or detailing related information.

- The preparer should view the working papers as if he were the in-charge auditor. All inferences and conclusions should be supported in the working papers and no misleading or irrelevant statements should be made.
- It is preferable to have negative figures in working papers indicated by parentheses instead of red figures to preserve their identity if the papers are photocopied or microfilmed.

### **Timesaving Considerations**

.03 There are a number of ways to save time and avoid unnecessary detail in working paper preparation. The following examples may be helpful.

- Whenever possible, have the client's employees prepare schedules and analyses. (This, of course, presupposes that the client has the necessary personnel to prepare the materials.)
- Use of a detailed audit program may eliminate the need for lengthy comments in the working papers on the scope of audit procedures. (However, some believe that such comments are still necessary when a detailed program is used; this is a matter of individual firm judgment.)
- Analyze asset (or liability) accounts and their related expense or income accounts on the same working paper. Examples include property, plant and equipment, accumulated depreciation and related depreciation expense; notes receivable, accrued interest receivable and interest income; notes payable, accrued or pre-paid interest, and interest expense; and accrued taxes and related provisions for tax expense.
- Avoid unnecessary computations. For example, if only the totals are meaningful and can be tested by a single independent computation, check the total and avoid unnecessary checking of details.
- Consider using carryforward analyses for accounts that tend to remain constant each year or vary only in accordance with a constant predetermined formula. Examples may include long-term assets and related depreciation or amortization such as plant, equipment and intangibles, long-term debt with predetermined payment schedules, and capital stock.
- Consider using adding machine tapes instead of writing separate lists. Enter names or explanations on the tapes, when appropriate.
- Do not manually copy a document when photographic reproduction is feasible.

- If in doubt, use a larger sheet of paper—an unused portion is less of a problem than running out of space.
- Use symbols (tick marks) whenever possible, especially when the same symbol applies to several working papers.

### **Symbols (Tick Marks)**

.04 When using symbols, it should be helpful to consider the following basic concepts:

- Symbols are merely a shorthand means of explaining a work step performed on a particular item of data. Symbols serve as means of conserving time and space and, if properly used, may ease review of the working papers.
- For a working paper to be clear to a reviewer or other reader, each symbol must be clearly explained. The explanation may be located on the same page as the items subjected to the work step, or on a separate legend that is clearly cross-referenced to and from the page that presents the applicable items.
- Symbols should be kept simple, distinctive and clear so they can be quickly written by the preparer and easily identified by a reviewer.

.05 Applying these basic concepts is not that simple. Various auditors have conflicting notions about symbols. For example, on the matter of color, some believe all tick marks should be in color to make it easy to spot them in the working papers. Others believe it is a waste of time to keep “switching pencils” and observe that the color distinction is lost in photocopying. On another matter, some believe a set of standardized symbols can expedite preparation and review. Others believe that a set of standardized symbols is impractical because it lacks flexibility. Because it is generally agreed that symbols are an effective timesaver, it is desirable for firms to establish and communicate a policy on their use to maximize their potential effectiveness.

.06 Commonly used symbols, as noted, should be simple and distinctive, not elaborate hieroglyphics. The most common are variations on a simple checkmark—for example, a checkmark with a slash, a checkmark with a circle at the end, a double checkmark, and any one of these within a circle. This abbreviated listing alone provides eight distinctive tick marks. Symbols may also include circled letter or numbers.

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➤→ *The next page is 6401.* ←➤





## AAM Section 6400

### **Organization and Filing (Indexing)**

.01 Some auditors organize their working papers during the course of an engagement into general categories such as the following:

- Planning and administration.
- Internal control review and compliance testing.
- Substantive test working papers arranged in order of the balance sheet and income statement classifications.
- Trial balances, consolidating working papers, journal entries (adjustments, reclassifications, eliminations for consolidation), and potential entries.
- Draft reports, financial statements and footnotes.
- Programs, checklists and questionnaires (some keep these as separate units, others interfile them among working papers by statement classifications).
- General matters such as current minutes, contracts, and articles of incorporation that may apply to future engagements as well as current work.

Under this approach, actual indexing and filing would be deferred until the conclusion of the engagement.

#### **Predetermined Indexing**

.02 Other practitioners and firms may use a predetermined indexing approach so that working papers can be indexed while the field work is still in progress. This offers the following advantages:

- Better control over working papers during the performance of field work.
- Constant arrangement of working papers in logical order to aid in review.
- Less time required in assembling and binding them into indexed files.
- Quicker access to specific working papers after they are filed.

.03 Predetermined indexing involves establishing a standard code for each section of the working papers, using letters and numbers, or numbers only. For example—

	<u>Two Possible Alternatives</u>	
Working trial balance—assets.....	B/S-A	T/B-1
Working trial balance—liabilities.....	B/S-L	T/B-2
Working trial balance—income & expense.....	P/L	T/B-3
Cash summary schedule.....	A	10
Receivables summary schedule.....	B	20
Inventory summary schedule.....	C	30

.04 Predetermined indexing requires recognition of the need for flexibility to meet unanticipated working paper needs or specialized industry requirements and it requires care to avoid undue complexity. Excessively complex references may obstruct rather than ease working paper preparation, cross-referencing and filing. Accordingly, it is helpful to develop an organizational plan adaptable to each section of the working papers. For example, some accountants classify working papers as lead schedules, primary detail, and secondary detail which might result in the following classification scheme for the above examples for cash:

	<u>Using Letters and Numbers</u>	<u>Using Only Numbers</u>
Lead schedule .....	(A)	(10)
Primary detail schedules .....	(A-1) (A-2) etc.	(10-1) (10-2) etc.
Secondary detail schedules.....	(A-1-1) (A-1-2) (A-1-3) (A-2-1) (A-2-2) (A-2-3)	(10-1-1) (10-1-2) (10-2-1) (10-2-2)

.05 Predetermined (standardized) indexing systems may be printed on separate pages for reference during the performance of field work and insertion in the front of working paper binders or files when the work is completed. Some firms have their uniform indexing systems printed directly on their file or binder covers.

### **Current and Permanent Files**

.06 Working paper files are generally classified as current files and permanent (continuing) files. Current files contain information that is pertinent to a single engagement. Permanent files include information relevant to several recurring engagements. Some firms have their binder or file covers preprinted as current or permanent accompanied by pertinent portions of their uniform working paper indexes.

.07 A common challenge to many auditors is to keep the permanent file complete and current, and free from outdated or irrelevant materials that belong in an inactive file of superseded materials.

.08 Some auditors who have confronted one too many unwieldy permanent files believe all working papers should be classified as current with certain materials designated as matters of continuing interest to be carried forward each year until they become outdated. Under this approach, a firm may preprint its complete index on one type of file or binder cover and provide space to indicate whether specific contents are continuing or carry-forward in nature.

## Index Topics

.09 The following is a list of topics to consider in developing a standard index for working papers. This list is detailed, but is by no means all-inclusive. For example, specialized industries such as life insurance and banking need other specialized topics. Several of the topics may be eliminated, condensed or expanded, depending on the auditor's needs and preferences. Topics that some auditors prefer to include in both the permanent and current files or only in the permanent files are followed by the letter (P).

### Planning and administration

- . Time & budget data
- . General correspondence & memos
- . Planning memos—current
- . Planning notes & confirm copies for use in next engagement
- . Engagement letters
- . Schedules & analyses to be prepared by client
- . Minutes
- . Checklist of an administrative nature if required by firm policy

### Audit or work program (Note 1)

### Matters of continuing concern

- . Client's industry—background (P)
- . Description & brief history of client (P)
- . Data & ratio analysis of client's operations (P)
- . Client's facilities (P)
- . Articles of incorporation (P)
- . Bylaws (P)
- . Current contracts & agreements (P)
  - . . Debt agreements (P)
  - . . Leases (P)
  - . . Labor contracts (P)
  - . . Agreements with officers & key people (P)
  - . . Pension plans (P)
  - . . Profit-sharing plans (P)
  - . . Stock warrants (P)
  - . . Stock options (P)
  - . . Other agreements (P)
- . Client's accounting policies & procedures (P)
- . Carryforward analyses (Note 2)

### Internal accounting control

- . Internal control questionnaire, narratives, flow charts, etc. (Note 3)
- . Preliminary evaluation memos
- . Compliance (procedural) tests

- Reports, financial statements and footnotes, trial balances and assembly sheets
- . Reports & financial statements (including letter, if any, on material weaknesses in internal accounting control)
- . Consolidating working papers
- . Consolidation eliminating entries
- . Trial balance
- . Adjusting journal entries
- . Reclassification journal entries
- . Recap of possible adjusting entries
- . Assembly sheets supporting footnote disclosures (if the information is not included elsewhere in the working papers)
- . Disclosure checklists (if required by firm policy)
- . Supporting schedules (if required for reports to regulatory bodies or other long-form reports)
- . Tax return info & work sheets (Note 4)

#### Assets

- . Cash
- . Marketable securities (and related income)
- . Notes receivable (and related interest)
- . Accounts receivable
  - . . Summary and analyses
  - . . Confirmation procedures (Notes 2 and 5)
- . Allowance for doubtful accounts & notes (Note 2)
- . Inventories
  - . . Summary and analyses
  - . . Price tests, cost & market
  - . . Obsolescence review
  - . . Observation, test counts & cut-off data
  - . . LIFO determinations
- . Prepaid expenses
- . Other current assets
- . Investments
- . Property plant & equipment, and accumulated depreciation, depletion & amortization (Note 2)
- . Intangible assets, deferred charges & amortization (Note 2)
- . Other assets
- . Intercompany accounts

#### Liabilities

- . Notes payable (and related interest)
- . Accounts payable
- . Accrued liabilities other than income taxes
- . Accrued income taxes (current & deferred), related provisions & credits (Note 2)
  - . . Federal
  - . . State & local

- . Other current liabilities
- . Long term debt (including current maturities and capitalized leases) (Note 2)
- . Other long term liabilities
- . Deferred income (Note 2)

#### Commitments and contingencies

- . Attorneys' letters
- . Abstracts of commitments & contingencies noted during review of minutes, contracts & agreements, confirmation responses, etc.
- . Subsequent events review
- . Management representation letter

#### Equity (capital accounts) (Note 2)

- . Capital stock
- . Additional paid-in capital
- . Treasury stock
- . Retained earnings
- . Partnership capital

#### Revenue and expenses

- . Operating revenues
- . Cost of sales
- . Selling, general & administrative
- . Other operating expenses
- . Other income
- . Other expense
- . Extraordinary & unusual items
- . Secondary schedules
  - . . Maintenance & repairs
  - . . Taxes other than income taxes
  - . . Rents
  - . . Royalties
  - . . Advertising costs
  - . . Legal fees
  - . . Interest expense recap

---

#### NOTES TO USER:

1. Alternate practices of filing audit programs include:
  - (a) Putting the program in a binder that is separate and distinct from the current and permanent files.
  - (b) Putting the signed off program in the current file.
  - (c) Keeping a master copy of the program in the permanent file with the signed off copies dispersed among the related working paper segments in the current file.
2. Certain classifications may lend themselves to carry-forward working papers. Examples include allowances for doubtful accounts, brief summaries of confirmation response statistics, accumulated

## NOTES TO USER—continued

- depreciation and amortization, deferred income taxes and open tax positions, long-term debt, and capital accounts.
3. Internal accounting control questionnaires may be filed as separate binders or as part of current or permanent files.
  4. Some firms and practitioners keep tax return preparation working papers in files that are completely separate from other types of engagement working papers.
  5. For situations involving voluminous confirmation responses or bulk inventory listings, the bulk materials may be filed in separate binders that are cross referenced to the pertinent working papers (for example: accounts receivable, accounts payable, and inventory).
- 

➤→ *The next page is 6501.* ←➤

## AAM Section 6500

### Sample Working Papers

.010 The samples of individual working paper formats included in this section are for illustrative purposes only.

#### General Comment

.020 These illustrations are included to help users of the manual save time by using them as points of departure in designing their own formats to meet their individual needs. For example, the analysis formats included among the samples tend to present a single step of activity between balances at the opening and closing dates of a fiscal year. If an auditor decides to do substantive testing prior to a fiscal year end, he may wish to use analysis formats that show activity between balances at the opening date of a fiscal year and a preliminary date during the year, and another step of activity from the preliminary date to the fiscal year end. Also the analysis formats in this section tend to present balance and activity captions as column headings with components shown on the line items as follows:

Description	Opening balance	Expense provision	Disbursements	Closing balance
.....	xxx	xxx	(xxx)	xxx
.....	xxx	xxx	(xxx)	xxx
.....		xxx	(xxx)	xxx
Totals.....	<u>xxx</u>	<u>xxx</u>	<u>(xxx)</u>	<u>xxx</u>

An alternate approach would be to present balance and activity captions as line items and use the column headings for components as shown in the following example:

	Totals	Components		
Opening balance .....	<u>xxx</u>	...	...	...
Expense provision ....	xxx	xxx	xxx	xxx
Disbursements .....	(xxx)	(xxx)	(xxx)	(xxx)
Closing balance .....	<u>xxx</u>	<u>xxx</u>	<u>xxx</u>	<u>xxx</u>

.030 The decision as to appropriate format must be made by the individual auditor after considering all the circumstances of the engagement.

➤ The next page is 6503. ←





.040 ABC Co.  
Assembly Sheet - Balance Sheet  
12/31/15

Prepared By	
Reviewed By	

Working paper # & (B)	Classifications (A) (P)	Final balance (C) client 12/31/15	Per client 12/31/15	Adjusting Entries (D) Ch. 12/31/15	Balance as adj. 12/31/15	Reclassification Entries (E) Dr. Cr.	Final (for report) (F)	Remarks
1	Current assets:							
2	Cash							
3	Marketable securities							
4	Accounts receivable							
5	Less, allowance for doubtful accounts							
6	Net Inventories - raw materials							
7	- supplies							
8	- work-in-process							
9	- finished goods							
10	Total							
11	Prepaid expenses							
12	Other current assets							
13	Total current assets							
14	Other security investments							
15	Less, valuation allowance							
16	Property plant & equipment, at cost							
17	Land							
18	Buildings							
19	Machinery & equipment							
20	Furniture & fixtures							
21	Leasehold improvements							
22	Less, accumulated depreciation & amortization							
23	Buildings							
24	Machinery & equipment							
25	Leasehold improvements							
26	Finance & leases							
27	Leasehold improvements							
28	Net							
29	Other assets - Cash, marketable value							
30	- Intangible assets							
31	- Other							
32	TOTAL ASSETS							

NOTES:

- (A) Financial statement assembly sheets generally include the same captions (classifications) as the financial statements. For comparison purposes they also show the final amounts reported for the preceding year. For convenience, some auditors may include additional detail in support of the statement classifications on their assembly sheets.
- (B) The amounts for each caption would be supported by comparative lead sheets in each grouping of substantive test working papers. These lead sheets provide a trail to evidence of the work done and show comparatively how specific amounts in the client's accounts are grouped for classification in the financial statements for both the current year and as reported for the preceding year. (However, see the sample "Working Trial Balance" for an alternative approach)
- (C) The column "work paper ref." in this illustration may include specific indexing codes used in a predetermined indexing approach.
- (D) The final balances for the preceding year (12/31/14) in this illustration would be obtained from last year's audit report to the assembly sheets and from last year's working papers for the supporting comparative lead sheets. The per client balance for the current engagement would be developed from the supporting comparative lead sheets which have been agreed to by the client's general ledger.
- (E) Adjusting entries would be posted to the comparative lead sheets developed when the grouped adjusting entries would be taken from the comparative lead sheets to these assembly sheets. The adjusted balance on the lead sheets as of 12/31/15 would agree with the client's final account balances after posting of the adjusting entries.

(continued)

Assembly Sheet - Balance Sheet (continued)

ABC Co.

12/31/75

Prepared by	Date
Approved by	

Work paper No. (A)	Classifications (A) (F)	Final Balance (C) 12/31/74	Per 12/31/75	Adjusted Balance 12/31/75	Reclassification Entries (E)	Final report (F) 12/31/75	Remarks
1	Liabilities						
2	Current Liabilities:						
3	Notes payable						
4	Accounts payable						
5	Accrued expenses						
6	Income taxes						
7	Deferred income taxes - current portion						
8	Other Current Liabilities						
9	Current portion of Long-Term Debt						
10	Total Current Liabilities						
11	Long-Term Debt						
12	Deferred Income Taxes						
13	Total Liabilities						
14	Stockholders' Equity:						
15	Common Stock						
16	Paid-in Capital						
17	Retained Earnings						
18	Less: cost of common stock in treasury						
19	Stockholders' equity						
20	Total Liabilities and Stockholders' Equity						
21							
22							
23							
24							
25							
26							
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NOTES: (continued)

(E) Columns are also provided for reclassification entries that may be needed for financial statement purposes but do not need to be posted to the client's accounts.

(F) The amounts presented in the assembly sheets and supporting comparative lead sheets should be consistent and clearly cross-referenced.

050 Assembly Sheet - Results of Operations, Retained Earnings  
12/31/X5

Prepared by	Date
Approved by	

W.P. No.	Classifications (A)	Final Balance client 12/31/X4	Per client 12/31/X5	Adjusting Entries Dn. Cr.	Balance as adj. 12/31/X5	Reclassification Entries Dn. Cr.	Final Report	Remarks (B)
AA-1	Net sales							
BB-1	Cost of sales*							
BB-2	Research & development*							
CC-1	Selling, general & administrative expenses*							
	Subtotal before other income & expense							
B-2	Other income & expense							
EE	Dividend income							
EE	Interest expense							
GG-1	Other expense							
	Net							
	Total expenses before inc. taxes							
	Income before income tax provisions							
Q	Provision for income taxes							
	Current - federal							
	state							
	Deferred							
	Subtotal							
	Subtotal							
Y	NET INCOME							
Y	Retained earnings - beginning of year							
Y	Less - Dividends							
Y	Retained earnings, end of year							
BB-1	*Memo - Depreciation included above in							
BB-2	Cost of sales							
BB-3	R&D							
J-1	SG&A							
	Total							

NOTES:

- (A) Each classification should be supported by a comparative lead sheet. This illustration includes the following assumptions:
  - Research and development ops are of enough significance to require a separate caption.
  - R&D generally is not required to report segment information or earnings per share.
  - Depreciation expense is to be disclosed in the statement of changes in financial position; the auditor also noted Depreciation expense on this working paper as a memo for his convenience.
- (B) See SAS No. 43 for guidance on analytical review procedures:

DEF Company  
Changes in Financial Position Worksheet (A)  
12/31/85

060

Line	From assembly sheets for reworked balance sheet and other W.P.s	Net Change (C)		Net Inc. Dpct. Amt.	Other funds provided	Funds applied	Changes in W.C.
		12/31/84	12/31/85				
1	Cash	10000	5000				15000
2	Marketable securities	50000	10000				10000
3	Accounts receivable, net	400000	500000				100000
4	Inventory	300000	350000				50000
5	Prepaid expenses & other current assets	10000	15000				5000
6							
7	Property plant & equipment, at cost	500000	650000			200000	
8	Accumulated depreciation	100000	130000	(60000)			
9							
10	Other assets	50000	55000				
11	Total assets	7220000	5050000	5000		5000	
12							
13	Notes payable	100000	130000				
14	Accounts payable	100000	110000				
15	Accrued expenses	20000	30000				
16	Income taxes	40000	50000				
17	Deferred income taxes - current portion	20000	30000				
18	Other current liabilities	20000	5000				
19	Current portion - long-term debt	20000	30000				
20							
21	Long-term debt	260000	300000				
22	Deferred income taxes	60000	80000				
23							
24	Capital stocks	100000	120000				
25	Additional paid-in capital	100000	120000				
26	Retained earnings	4000000	4000000				
27	Net income	2000000	1000000				
28	Dividends	1000000	500000				
29							
30	Total liabilities & equity	7220000	5050000				
31	Profits						
32							
33							
34							
35							
36							
37							
38							
39							
40							

NOTES:  
(A) This working paper supports the statement of changes in financial position. Proponents of this schedule believe that taking short-cuts may often lead to excessive preparation time (not being able to reconcile because of omissions, etc.) and review time (unable to spend reference back to sources).

.070

ABC Co.  
Adjusting Journal Entries  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	
W.P. Ref.				Client's acct. no.	Dr.	Cr.		
1							1	
2			①				2	
3	U-1	Provision for doubtful accts.		xxxx	xxxx	(P)	3	
4		Allowance for doubtful accounts		xxxx		xxxx (P)	4	
5							5	
6		To provide an allowance for the balance of xxxx due from Zxywvts Ind. which disclosed its intent to file under Chapter 11 on 12/27/X5						6
7							7	
8							8	
9							9	
10			②				10	
11		Cost of sales		xxxx	xxxx	(P)	11	
12	E-3	Inventory - supplies		xxxx		xxxx (P)	12	
13							13	
14		To adjust supplies inventory at Plant B to xxxxx per the 12/31/X5 physical.						14
15							15	
16							16	
17							17	
18							18	
19							19	
20		(P) = Traced to client's posting of general ledger.						20
21							21	
22							22	
23							23	
24							24	
25		NOTE:					25	
26							26	
27		Adjustments affect the client's accounts and are the client's entries. Their explanations should offer a reader enough information to know why the entry is needed. To merely say "adjust balance to actual" or "per working paper page xx" is not enough.						27
28							28	
29							29	
30							30	
31							31	
32							32	
33							33	
34							34	
35							35	
36							36	
37							37	
38							38	
39							39	
40							40	

.080

ABC Company  
 Reclassification Entries  
 12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
					Workpaper Reference	Dr.	Cr.
1		(A)					
2	Long-Term Debt				S	xxxxx	
3	Current Portion of Long-Term Debt				\$		xxxxx
4	To reclassify the portion of long-term debt due within one year to current						
5	portion for statement purposes						
6							
7							
8		(B)					
9	Accounts Receivable				C	xxxx	
10	Accounts Payable				O		xxxx
11	To reclassify credit balances in accounts receivable to accounts payable for state-						
12	ment purposes						
13							
14							
15		NOTE:					
16	These entries are made for classification purposes within an individual financial statement and do not affect earnings.						
17	Normally, they do not affect the client's accounts and are made only for reporting purposes. However, their explanations should offer a reader enough information to understand why the entry is needed.						
18	For information purposes, it may be helpful to provide the client with a copy of the reclassification entries.						
19							
20							
21							
22							
23							
24							
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38							
39							
40							

ARC Co.  
Potential Adjustments  
12/31/85

090

Prepared By: \_\_\_\_\_  
Approved By: \_\_\_\_\_

U.P. Refs.		Dr. (Cr.)	P&L E&G Increase decrease	Disposi- tion	NOTES:
	Provision for doubtful accts.	(A) 10000	(CR) 100000	AJE 1 (10000)	<p>(A) In this example debits and credits are grouped in one column and should foot to zero. This was done merely to save space. An auditor may prefer to use separate columns for debits, credits and effect on income. There are many approaches for accumulating potential entries. For example, see the illustrative working paper for accumulating potential adjustments and reclassifications. It provides for accumulation of the effect of potential entries on the balance sheet as well as the income statement.</p> <p>(B) This column provides for identification of the cumulative effect (which may be material) of a series of relatively immaterial items which are biased in one direction.</p> <p>(C) For this illustration, the client's effective income tax rate is assumed to be 40%. The resulting percent is arbitrarily selected solely for illustrating arithmetic in this illustration.</p>
(C-3)	Allowance for doubtful accts.	(10000)			
(D-1)	Re pat. of xxx due from XYZ Corp. Inc. announced intent of bankruptcy 12/31/85.				
	Cost of sales	10000	(10000)	AJE 2 (10000)	
	Inventory - supplies	(10000)			
(E-1)	To adjust books to 12/31/85 physical of supplies inventory at plant B.				
(D-2)	SG&A	500	(500)	valued as immaterial	
	Acct. payable	(500)			
	Unrecorded liabilities				
	Phone 300				
	Electric 200				
	Total P&L effect of potential adj. less net effect of adjusting journal entries (AJE)		(20500)		
	P&L effect of other items included		(20000)	(20000)	
	Less - Estimated effect of income taxes on net income net of tax (100) at percent of final net income 00.5% (D)		200(C)	5000(C)	
	Net income per financial statements unadj.		300	17000	
	Net income per financial statements unadj. final as adjusted			7000	
	Adjusted items net of tax (100) at percent of final net income 00.5% (D)			6000	
	Approved Signature of audit partner Date (Complete)				
	DK (date)				

XVZ Corp.  
Potential Adjustments and Reclassifications  
3/31/82

100

W.P. Ref.	Dr.	Cr.	Eff. on net inc. Inc (dec)	Assets Current	Balance sheet effect, Liabilities Current	Cap stock Accum	Remarks & disposition
1	B/S, P&L Pot financial statements unadjusted		xxxxx	xxxxxx	xxxxx	xxxxxx	
2	① Leased equipment, capitalized	xxxxx(a)		xxxxxx(a)			AJE (1) sep (a)
3	Depreciation expense	xxxxx(b)	(xxxx)			(xxxx)	AJE (2) sep (b)
4	Interest expense	xxxxx(c)	(xxxx)			(xxxx)(c)	AJE (3) sep (c)
5	T-1 Capitalized lease obligation	xxxxx			xxxxxx(c)		Split into 3 AJEs
6	Accumulated depreciation	xxxxx(b)				xxxxx(c)	(1) To capitalize lease
7	Equipment rental expense	xxxxx(c)	xxxx				(2) To prov. depen
8	Equipment rental expense dated 10/15/81 to period 1/1/82	xxxxx					(3) To correct client's JE re rental exp.
9	② Correct client's entry regarding payments of xxx as rental expense, memo disp-	xxxxx(a)					
10	Total rentals per lease	xxxxx					
11	Per lease	xxxxx(a)					
12	Per lease	xxxxx					
13	Interest expense	xxxxx					
14	③ Capital lease obligation	xxxxx					
15	Current portion-cap-lease oblig.	xxxxx			xxxxx		
16	of capitalized lease obligation						
17	④ Travel expense	xxx	(xxx)				Item waived as immediate
18	Advanced to employee						
19	of advances as of 3/31/82. As of 3/31/81, same						
20	amount of adjustment for 8899 waived as immaterial						
21	Cumulative effect of potential entries		(xxx)				
22	Less, cumulative effect of items waived						
23	Effect of A/E & R/E Debit Inc. 8899		(xxx)				
24	Estimated income tax effect		(xxx)				
25	Net effect on financial statements		(xxx)				
26	Per financial statements, as adjusted						
27	⑤ Waived items net of inc. tax-8899 of kind net income		xxxxx			xxxxxx	
28	(a) (b) (c) Cross references only						
29	NOTE:						
30	This expanded working paper format allows for accumulating the effect of potential entries on working capital as well as P&L.						
31							
32							
33							
34							
35							
36							
37							
38							
39							
40							

Prepared By	Initials	Date
Reviewed By		



110 ABC Co.  
Working Trial Balance  
12/31/1X5

Prepared by:	Checked by:
Approved by:	Date:

Account Number	Account Title	Final 12/31/1X4 Grouped Account for rep. balances	Pea books 12/31/1X5	Adjusting Journal Entries	Final 12/31/1X5 Grouping for rep. balances	12/31/1X5 Reclassifications	Final 12/31/1X5 Grouping for rep. balances	Final 12/31/1X5 Reclassifications	Final 12/31/1X5 Working paper
1									
2									
3									
4									
5									
6									
7									
8									
9									
10									
11									
12									
13									
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NOTES:  
(continued)

This illustration is an alternative to the assembly sheets and lead sheets previously shown. It is a format that may be useful if the client's individual accounts are in a sequence that allows easy grouping into the statement classifications. The form should also offer enough space for symbols and notations of work done, cross references, and a clear identification of the statement groupings. If the client's trial balance is segmented for easy grouping into statement classifications, pasting a copy of the trial balance into folders similar to these illustrations may save preparation time.

- Proponents of this alternative format believe that preparation of lead sheets requires excessive time and duplicates information on the working trial balance. Proponents of the lead sheet approach argue that benefits such as the following more than justify the preparation time:
- Lead sheets assemble working papers into groups that aid the review process and help staff see detail work in the context of the statements.
  - Consistent features of lead sheets aid the analytical review process.
  - Lead sheets offer a structure for delegating portions of the work to staff.

- Lead sheets help avoid a cluttered top summary and thereby minimize the potential for clerical error.
- The choice of format is the auditor's and should be based on his judgment about the most efficient way to structure the working papers for a particular engagement.

.120 Tax Return Worksheet - Reconciliation to Reported P&L (B)  
12/31/85

Prepared By	Checked	Date
Approved By		

Line Ref.	Classification	Pay Tax Return	Amount for Ref	Schedule M-1	M-1 Adjs Reported	NI in ntr	Net	Classifications per	reported	Income Statement(A)	Prov. for	
				Increase	Decrease	format	Cost of	RED	SGSA	Interest	Other	
							Sales	Exp.	Exp.	Exp.	Inc. Tax	
1	Gross sales											
2	Less, returns & allowances											
3	Net sales											
4	Cost of goods sold											
5	Gross profit											
6	Dividends											
7	Interest - obligations of U.S.											
8	Interest - other											
9	Gross rents											
10	Gross royalties											
11	(a) Capital gain											
12	(b) Net gain or loss Form 4797											
13	Other income											
14	TOTAL INCOME											
15	Compensation of officers											
16	Salaries & wages											
17	Repairs											
18	Bad debts											
19	Rents											
20	Taxes											
21	Interest											
22	Contributions											
23	Amortization											
24	Depreciation											
25	Depletion											
26	Advertising											
27	Pension & profit sharing											
28	Employee benefit plans											
29	Other deductions											
30	TOTAL DEDUCTIONS											
31	TAXABLE INCOME											

NOTES:

(A) This sample working paper reconciles the amounts per line items on the return with the reported income statement, and where necessary, directly to the source working papers. All schedule M-1 items should also be explained on this page or an attached set of supporting pages, and referenced to the supporting working papers. In some situations, it may be necessary to prepare this type of schedule in further detail than that of the reported statement of income (or loss).

(B) Some auditors believe that this type of reconciliation should be prepared for all items, not just the major and easily audited items, and that the balance sheet and capital statements:

.130

ABC Company  
Confirmation Control Sheet

12/31/X5

	Initials	Date
Prepared By		
Approved By		

	Description	Dates of			Response received	W.P. Ref of response
		(1) First request	(2) Second request	(3) Additional requests		
1						1
2	Client's rep					2
3						3
4	Attorneys letters					4
5	John Doe, Esq.					5
6	Brown & Jones					6
7						7
8						8
9	Bank confirmations					9
10	See attached list					10
11						11
12	A/C Receivable					12
13	See attached					13
14	copies					14
15						15
16	Other descriptions					16
17	and addresses					17
18	such as custo-					18
19	dians of market					19
20	able securities					20
21	and holders or					21
22	trustees of long-					22
23	term debt would					23
24	be entered simi-					24
25	lar to the above.					25
26						26
27	<b>NOTE:</b>					27
28						28
29	Some auditors prepare this type of control sheet to					29
30	include all confirmations and representations requested.					30
31	Others prepare it for the client's representation and					31
32	attorneys letters and use tissue copies as the control					32
33	for other requests until routine prompt responses have					33
34	cleared. Then the addressees who have not responded					34
35	promptly would be entered on this control sheet for special					35
36	attention.					36
37						37
38						38
39						39
40						40

.140

ABC Company  
 Materials to be Prepared by Client  
 12/31/X5

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)
	Description		Date promised	Date received	Effect on time? (Yes/No)
1					
2	Working trial balance				
3					
4	Bank reconciliations - 12/31 (copies)				
5					
6	Standard bank confirms				
7					
8	Accts. receivable - schedule of balances written off				
9					
10					
11	Accts. receivable - aged trial balance				
12					
13	Inventory - copy of physical, priced, extended and summarized				
14					
15					
16	Inventory - standard cost work-up				
17					
18	Prepaid insurance - analysis				
19					
20	Property taxes analysed				
21					
22	Property, plant & equipment Additions schedule				
23					
24	Retirements schedule				
25	Analysis of asset accounts				
26	Analysis of accumulated depreciation				
27					
28					
29	Accounts payable listing				
30					
31	Maintenance and repair expense				
32					
33	<u>NOTE:</u>				
34					
35	The above materials are illustrative only, and in no way meant to be a comprehensive example of what materials may be prepared by clients.				
36					
37					
38					
39					
40					

150

ABC Co.  
Lead Schedule (Sheet) - General Example  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Client's A/C Code	Account Title	12/31/X4 Final Bal	← 12/31/X5 Bal per Client	12/31/X5 Adj. Dr. (Cr.)	→ as ad- justed		W.P. Ref.
1							1
2							2
3							3
4							4
5							5
6							6
7							7
8							8
9							9
10							10
11							11
12							12
13							13
14							14
15							15
16							16
17							17
18							18
19							19
20							20
21							21
22							22
23							23
24							24
25							25
26							26
27							27
28							28
29							29
30							30
31							31
32							32
33							33
34							34
35							35
36							36
37							37
38							38
39							39
40							40

NOTES:

- This type of schedule may be prepared for any caption in the financial statements to show a comparative grouping of individual accounts, aid in analytical review at a detailed level, and provide a trail between the financial statement classifications, the client's accounts, and the detailed papers concerning the work done.
- Lead schedules may also include the preparer's conclusion on the results of the work done and notations on such matters as relationship with other accounts, and proposed adjustments, reclassifications and disclosure requirements. Some firms require that the lead sheet include the auditor's individual conclusions on the audit objectives, work done and resulting findings.
- This schedule can readily be modified to allow for two columns for adjustments, additional space for the account title, and additional columns for remarks.

Prepared By	Checked	Date
Approved By		

ABC Company  
Cash - Lead Sheet  
12/31/X5

.160

Work paper Reference	Description	Account Number	Final Balance 12/31/X4	Pet. Books 12/31/X5	Adjusting Entries	Journald Adjusted Balance 12/31/X5	Reclassification Entries	Final Balance 12/31/X5
(A-1)	Petty Cash (A)							
(A-2)	Fifth National Bank (A)							
(A-3)	Sixth National Bank (B)							
(A-4)	Ninth State Bank - payroll A/C (B)							
(A-5)	Upperon Bank & Trust Co. (A)							
(A-6)	Opencoun Bank & Trust Co. (B)							
(A-7)	Standard bank congloms (A-7-1) (A) (B)							
(A-8)	Symbol legend - bank reconciliations (A) (C)							
(A-9)	Bank transfer schedule (A)							
	NOTES:							
	(A) Illustrative working papers are present for pages (A-1) (A-2) (A-7-1) (A-9) and (A-9) behind lead sheet.							
	(B) Illustrations are not present for pages (A-3) (A-4) (A-5) (A-6) (A-7-2) (A-7-3) (A-7-4) and (A-7-5).							
	(C) This symbol legend is located behind the reconciliation because the legend is in column 9-16 of a 16-column spread sheet. This allows a reviewer to flip out the legend and see it as he looks at each reconciliation filed in front of it. If the papers are bound at the top of the page, and individual worksheets are spread to the right such as on 16-column paper, the legend may be set up so it folds out to the left. Then a reviewer can still see the legend as he looks at individual spread sheets.							

.170

ABC Company  
 Petty Cash Count  
 12/31/X5

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)
			Wrapped	Loose	Total
1	Currency:				
2	\$100.00				
3	50.00				
4	20.00				
5	10.00				
6	5.00				
7	1.00				
8	Coin:				
9	1.00				
10	.50				
11	.25				
12	.10				
13	.05				
14	.01				
15					
16	Vouchers, Undeposited Checks, etc.				
17	(describe):				
18					
19					
20					
21	Less-Receipts Subsequent to Cut-				
22	off (describe):				
23					
24					
25					
26					
27	Amount of Fund-As Counted				
28	(Overage)-Shortage				
29					
30					
31	Amount of Fund-Per Books				
32					
33	Receipt				
34					
35	The above detailed items were counted in my presence and				
36	returned to me intact by [insert individual's name],				
37	representative of [insert auditor's firm name].				
38					
39	Date and Time				
40					
	Cut-off Information	Last Recpt. No.	Signature of Custodian	Last Check No.	

(A-1)

ABC Company  
 Bank Reconciliation - Fifth National Bank  
 12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1							
2	Balance per Bank						xxxxx C
3							
4	Add Deposits in Transit						
5							
6							
7							
8							
9							
10							xxxxx
11							
12	Less - Checks Outstanding						
13							
14							
15							
16							
17							
18							
19							
20							
21							
22	Other Reconciling items						
23							
24	Balance per Books 12/31/X5						xxx
25							
26							G/L T/BA
27							
28	See symbol legend pg (A-8)						
29							
30							
31							
32							
33							
34							
35							
36							
37							
38							
39							
40							



.190

STANDARD BANK CONFIRMATION INQUIRY
Approved 1968 by
AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS
and
BANK ADMINISTRATION INSTITUTE (FORMERLY NABAC)

ORIGINAL
To be mailed to accountant

December 28, 19X5

Your completion of the following report will be sincerely appreciated. IF THE ANSWER TO ANY ITEM IS "NONE," PLEASE SO STATE. Kindly mail it in the enclosed stamped, addressed envelope direct to the accountant named below.

Report from

Yours truly,

ABC Company
(ACCOUNT NAME PER BANK RECORDS)

(Bank) Fifth National Bank

By Charles Delta
Authorized Signature

P.O. Box 31428
Downtown, NJ XXXX

Bank customer should check here if confirmation of bank balances only (item 1) is desired.

NOTE--If the space provided is inadequate, please enter totals hereon and attach a statement giving full details as called for by the columnar headings below.

Accountant [Name of auditor]
[Address of auditor]

1. At the close of business on December 31, 19X5 our records showed the following balance(s) to the credit of the above named customer. In the event that we could readily ascertain whether there were any balances to the credit of the customer not designated in this request, the appropriate information is given below.

Table with 5 columns: AMOUNT, ACCOUNT NAME, ACCOUNT NUMBER, Subject to Withdrawal by Check?, Interest Bearing? Give Rate. Row 1: \$ XXXX (A-2), ABC Company, 7806-8224, Yes, No.

2. The customer was directly liable to us in respect of loans, acceptances, etc., at the close of business on that date in the total amount of \$ ... as follows:

Table with 6 columns: AMOUNT, DATE OF LOAN OR DISCOUNT, DUE DATE, INTEREST Rate, Paid to, DESCRIPTION OF LIABILITY, COLLATERAL, SECURITY INTERESTS, LIENS, ENDORSERS, ETC. Row 1: \$ XX,XXX, 2/14/X4, 2/14/X7, 9%, 12/31/X5, None T(N-1).

3. The customer was contingently liable as endorser of notes discounted and/or as guarantor at the close of business on that date in the total amount of \$ None as below:

Table with 5 columns: AMOUNT, NAME OF MAKER, DATE OF NOTE, DUE DATE, REMARKS. Row 1: \$, , , , .

4. Other direct or contingent liabilities, open letters of credit, and relative collateral, were

None

5. Security agreements under the Uniform Commercial Code or any other agreements providing for restrictions, not noted above, were as follows (if officially recorded, indicate date and office in which filed):

None

Yours truly, (Bank) Fifth National Bank

Date January 5, 19 X6

By J.P. Valid Asst. V.P.
Authorized Signature

Additional copies of this form are available from the American Institute of CPAs, 1211 Avenue of the Americas, New York, N. Y. 10036

Note: The confirmation response should be cross-referenced to all relevant working papers (in this example, to the bank reconciliation [page A-2] and notes payable [N-1]). The circled items should also be cross-referenced to indicate it was noted regarding working papers on commitments and contingencies. The bank should answer all questions. If some are not answered the bank should be called or written so the missing information can be obtained (in writing).

A-7-1



.210

ABC Company  
Bank Transfer Schedule  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	
Reviewed bank statements and cash receipts & disbursement journals from 12/XX/X5 to 1/YY/X6 for bank transfers of \$XXX or larger. (A)								
1	Check No.	Bank Accounts From	To	Amount	Date disbursed per Books (B)	Bank (C)	Date deposited per Book (B) Bank (C)	
2								
3								
4	1010	5th Natl.	Downtown	xxxxx	12/31	1/05 (A-2)	12/31 1/02 (D)	
5								
6	1009	5th Natl.	9th State	xxxxx	12/31	1/04 (A-2)	12/31 1/02 (D)	
7								
8	5440	6th Natl.	Downtown	xxxx	1/03	1/04	1/03 1/06	
9								
10	1040	Uptown	Downtown	xxxx	12/30	1/05 <del>Ø</del>	12/30 1/03 (D)	
11								
12		Ø - Should be cross-referenced to outstanding checklist of applicable bank reconciliations						
13								
14								
15		(D) - Should be cross-referenced to deposit in transit per applicable bank reconciliation.						
16								
17								
18								
19								
20		NOTES:						
21								
22		(A) The number of days before and after the balance sheet date selected for testing will depend on the auditor's study and evaluation of internal accounting control; the use of a minimum dollar amount in selecting transfers also depends on the auditor's judgment concerning materiality.						
23								
24								
25								
26								
27								
28		(B) Receipts and disbursements per books should be recorded in the same month.						
29								
30								
31		(C) Any disbursements with bank statement dates that precede the dates per books should be investigated.						
32								
33								
34								
35								
36								
37								
38								
39								
40								

(A-9)

.220

ABC Company  
 Proof of Cash 9/30 - 12/31/X5  
 12/31/X5

Prepared By	Initials	Date
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
(Name of Bank (Bank A/C Number))			Recon. of	Activity		Recon. of	
			balance	10/1-	12/31	balance	
			9/30/X5	Receipts	Disb.	12/31/X5	
1							1
2	Balances and activity per						2
3	bank statements		xxxxx	xxxxx	(xxxxx)	xxxxx	3
4							4
5	Deposits in transit						5
6	9/30/X5		xxxx	(xxxx)			6
7	12/31/X5		.....	xxxxx		xxxxx	7
8							8
9	Outstanding checks						9
10	9/30/X5		(xxxx)		xxxx		10
11	12/31/X5				(xxxxx)	(xxxxx)	11
12							12
13	Other reconciling items						13
14							14
15	(Describe)		xxx		(xxx)		15
16				xxx		xxx	16
17							17
18							18
19	Per books		xxxxx	xxxxx	xxxxx	xxxxx	19
20							20
21							21
22							22
23	NOTES:						23
24	• All columns and lines should foot and cross-foot,						24
25	and there should be clear indications of the work						25
26	done.						26
27	• Some find it helpful to prepare this analysis by						27
28	(1) first entering the bank reconciliations of						28
29	the opening and closing balances, (2) then iden-						29
30	tifying the deposits and disbursements per the						30
31	bank statements and the client's cash receipts						31
32	journal and cash disbursements journals, and						32
33	(3) analyse and complete reconciliation of						33
34	deposits and disbursements.						34
35	• See sections 5400.080 and 5400.100--110,						35
36	Illustrative Audit Objectives and Audit						36
37	Procedures.						37
38							38
39							39
40							40

ABC Company

**.230** Marketable Equity Securities, Cost, Market & Gross Unrealized Gains (Losses)

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Description	No. of shares	12/31/X5 Cost	Market value (A) per share	Gross unrealized (A) amt	Gross unrealized (A) Gain	(Loss)	
1							
2	Current						
3	XYZ Corp 5% cum pfd	xxx	xxxxx	xx	xxxxx	xxxx	
4	UVW Co. 6% pfd	xxx	xxxxx	xx	xxxxx		(xxx)
5	Manx Corp com	xxx	xxxxx	xx	xxxxx	xxx	
6			xxxxx		xxxxx	xxxx	
7						(xxx)	(xxx)
8	Net unrealized gain					xxx	
9	Carrying amount 12/31/X5		xxxxx				
10							
11							
12	Non Current						
13	Amalgamated Co. com	xxxx	xxxxx	xx	xxxxx		(xxxx)
14	WXY Co. 8% cv pfd	xxx	xxxxx	xx	xxxxx	xxx	
15			xxxxx		xxxxx	xxx	(xxxx)
16							xxx
17	Net unrealized loss		(xxxx)				(xxxx)
18	Carrying amount 12/31/X5		xxxxx		xxxxx		
19							
20							
21							
22							
23							
24	Ø Valuation allowance required						
25							
26							
27	NOTE:						
28							
29	(A)	The above columns for market value, gross unrealized gains and gross unrealized losses may also be worked into the marketable securities analysis (section 6500.240) if wider analysis paper is available. This would avoid the need to recopy or photocopy the descriptions, numbers of shares and costs for the above.					
30							
31							
32							
33							
34							
35							
36							
37							
38							
39							
40							

240 ABC Company  
Marketable Equity Securities - Analysis  
12/31/X5

Prepared By: \_\_\_\_\_  
Approved By: \_\_\_\_\_

Description	12/31/X4 Balance		Additions		Sales and Dispositions		12/31/X5 Bal. (A)		Dividend Income (B)		Accrued 12/31/X5	
	Number of Shares	Cost	Date	No. of Shares	Date	Shares	Cost	Proceeds	Realized Gain/(Loss)	12/31/X4		19X5
1 Current												
2 XYZ Corp. 5% Cum Pfd	xxx	xxxxx						xxxxx	xxx	xxxxx	xxx	xxx
3 UVW Co. 8% Pfd	xxx	xxxxx			11/30	xxx	xxxxx	xxxxx	xxx	xxxxx	xxx	xxx
4 Solex Ind com	xxx	xxxx			9/15	xxx	xxxxx	xxxxx	(xxx)	xxx	xxx	xxx
5 Marx Corp com			3/15	xxx			xxxxx			xxx	xxx	xxx
6							xxxxx			xxxxx	xxxxx	xxxxx
7												
8												
9												
10												
11												
12												
13												
14												
15												
16 Non Current												
17 ABC Company Co com	xxxxx	xxxxx					xxxxx				xxxxx	xxxxx
18 WXY Co. 8% Cv Pfd	xxxx	xxxxx					xxxxx				xxxxx	xxxxx
19							xxxxx				xxxxx	xxxxx
20												
21 Dividend Income - accrued req - per client											xxx	xxx
22 Adjustments - accrued div re WXY Co, 8% Cv Pfd											xxxxx	xxxxx
23											xxxxx	xxxxx
24											xxxxx	xxxxx
25											xxxxx	xxxxx
26											xxxxx	xxxxx
27											xxxxx	xxxxx
28											xxxxx	xxxxx
29											xxxxx	xxxxx
30											xxxxx	xxxxx
31											xxxxx	xxxxx
32											xxxxx	xxxxx
33											xxxxx	xxxxx
34											xxxxx	xxxxx
35											xxxxx	xxxxx
36											xxxxx	xxxxx
37											xxxxx	xxxxx
38											xxxxx	xxxxx
39											xxxxx	xxxxx
40											xxxxx	xxxxx

NOTES:  
 (A) The auditor may wish to use wider paper and insert the following additional columns between "12/31/X5 balance at cost" and the columns on Dividend Income:  
 • Market value per share  
 • Market value amount  
 • Gross unrealized gains  
 • Gross unrealized losses  
 (B) The dividend income analysis was included above so the auditor could refer to the timing of additions, sales and dispositions on the same page when checking dividends earned.

ABC Company

**.250 Marketable Equity Securities - Valuation Allowances**  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	
				Val. allow	Dr or	Cr to	Val allow	
				12/31/X4	Net	Stkhdrs	12/31/X5	
					income (A)	equity (A)		
1	Current portfolio							1
2								
3								
4	Market valuation			70000 Ø			75000 (B)	
5	Cost			75000 Ø			72000 (B)	
6	Net unrealized gain (loss)			( 5000) Ø			3000 (B)	
7								
8	Val. allowance required			5000 Ø	( 5000 )		0	
9								
10	Non-current portfolio							10
11								
12								
13	Market valuation			82000 Ø			81000 (B)	
14	Cost			80000 Ø			82000 (B)	
15	Net unrealized gain (loss)			2000 Ø			( 1000) (B)	
16								
17	Val allowance required			-0- Ø		1000	1000	
18								
19	Ø - Per 12/31/X4 working papers							19
20								
21	<b>NOTES:</b>							21
22								22
23								23
24	(A) See Statement of Financial Accounting Standards No. 12,							24
25	paragraph 11.							25
26								26
27	(B) This illustration uses summary captions rather than a listing							27
28	of the individual securities in each portfolio on the assumption							28
29	that amounts are cross-referenced to the related illus-							29
30	trative working papers on cost, market, & gross unrealized							30
31	gains (losses); and analysis of balances and activity.							31
32								32
33								33
34								34
35								35
36								36
37								37
38								38
39								39
40								40





ABC Company  
Accounts Receivable - Lead Sheet  
12/31/XX

.270

Prepared by:	Initials:	Date:
Approved by:		

Work paper ref	Account titles (B)	Client's acct. no.	Final Bal. 12/31/XX	Per client 12/31/XX	A.J.'s Dr Cr	Balance as adjusted (A) 12/31/XX	Remarks
1	Trade accounts receivable, gross						
2	Less allowances for						
3	- Doubtful						
4	- Bad debts						
5	- Discounts						
6	- Other						
7	- Total						
8	- Net						
9	- Total						
10	- Total						
11	- Total						
12	- Total						
13	- Total						
14	- Total						
15	- Total						
16	- Total						
17	- Total						
18	- Total						
19	- Total						
20	- Total						
21	- Total						
22	- Total						
23	- Total						
24	- Total						
25	- Total						
26	- Total						
27	- Total						
28	- Total						
29	- Total						
30	- Total						
31	- Total						
32	- Total						
33	- Total						
34	- Total						
35	- Total						
36	- Total						
37	- Total						
38	- Total						
39	- Total						
40	- Total						

NOTES:  
(A) This format may be expanded to show columns for reclassification entries.  
(B) The account titles and other captions on this work sheet are also merely illustrative. Actual titles will depend on the circumstances of the engagement and business and preferences of the auditor.

Trade receivables, net  
Trade receivables, net  
Other receivables:  
    - Prepaid individual accounts, to more practical, list them on a separate sheet as a separate lead sheet with a separate grouping of working papers  
    - Relationships - Sales and trade receivables  
    - Goods sales, discounts, allowances  
    - Net sales  
    - Cash sales  
    - Net account sales  
    - Temporary notes

ABC Co.

280 Accts. Receivable - Confirm Statistics  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5) Number of Accounts		(6) Dollars		
					Count	Percent	Amount	Percent	
1	Confirm requests								1
2	Positives								2
3	Negatives								3
4	Total sent								4
5	Accts picked-client asked us not								5
6	to confirm (A) (B)								6
7	Total picked for testing				xxx(D)	yy(D)	xxxxxx(D)	zz(D)	7
8	Total accts rec at (insert								8
9	confirm date)				aaaaaa	100%	aaaaaa	100%	9
10	RESULTS - replies received								10
11	through (insert date)								11
12	Positives - no exception								12
13	Negatives - did not reply								13
14	or reported no exceptions								14
15									15
16	Differences reported & resolved								16
17	as no exceptions								17
18	Positive								18
19	Negative								19
20	Totals confirmed								20
21	Unanswered positives and accts								21
22	client asked us not to								22
23	confirm (B)								23
24	Total confirmed & tested								24
25	Differences found to be								25
26	potential adjustments								26
27	Positive replies								27
28	Negative replies								28
29	Total (C)								29
30	Totals selected for testing				xxx(D)	yy(D)	xxxxxx(D)	zz(D)	30
31									31
32	(A) See W.P. (ref _____) on accts client asked us not to confirm &								32
33	disposition.								33
34	(B) See W.P. (ref _____) on alt means procedures and results.								34
35	(C) See W.P. (ref _____) on conclusions reached and proposed disp.								35
36	(D) These two lines present identical data for balancing purposes.								36
37									37
38	NOTE:								38
39									39
40	Comparative summaries of confirmation results in carryforward								40
	working papers may be informative and useful.								

ABC Company  
 .290 Accts Receivable - Reconciliation from Confirmation  
 Date to Year End

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
			<u>12/31/X5</u>				
1	Balance	1/30/X5, confirm date				xxx,xxx	(A)
2							
3	Add:	Sales		xxxxxx			
4							
5		Other (describe if any):		xxxx(D)			
6				xxxx			
7						xxxxxx	
8						xxxxxx	
9							
10	Deduct:	Cash receipts		xxxxxx(B)			
11							
12		Credit memos		xxxxxx(C)			
13							
14		Other (describe if any):		xxxx(D)			
15				xxxx			
16						xxxxxx	
17	Balance per books	12/31/X5				xxxxxx	
18							
19	Adjustments (describe if any):						
20							
21		Final balance				xxx,xxx	
22							
23	<u>NOTES:</u>						
24							
25	(A)	Should be cross-referenced to working paper summarizing or					
26		scheduling total of subsidiary detail used for confirmation					
27		selections.					
28							
29	(B)	Should be traced to source, such as sales journal and cash					
30		receipts journal.					
31							
32	(C)	Depending on the circumstances, it may be necessary to segregate					
33		by such types of credits as adjustments of selling prices and					
34		returns of shipments.					
35							
36	(D)	There are various possibilities. For example, the client may					
37		make adjustments based on the auditor's findings during prelim-					
38		inary work, or adjustments to resolve certain differences					
39		disclosed by the confirmation procedures.					
40							

ABC Co.

.300 Accts. Rec. - Review of Post Bal. Sheet Cr. Memos  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
		Name of Customer			Credit Memo Date No. Amount		Description		
1									1
2									2
3									3
4									4
5									5
6									6
7									7
8									8
9									9
10									10
11									11
12									12
13									13
14									14
15									15
16									16
17									17
18									18
19									19
20									20
21									21
22									22
23									23
24									24
25									25
26									26
27									27
28									28
29									29
30									30
31									31
32									32
33									33
34									34
35									35
36									36
37									37
38									38
39									39
40									40

ILLUSTRATIVE COMMENT ON WORK DONE:

Reviewed sales journal for 1/1/X6 through (indicate date) and examined all credit memos of \$XXX and over. Also reviewed file of unposted memoranda on (indicate date) and examined all credit memos of \$XXX and over.

.310

ABC Company  
Confirmation Control Sheet (A)  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

Confirm. Control No.	Name of Company	1st Request		2nd Request		
		Date Sent	Date Received	Date Sent	Date Received	
1						1
2						2
3						3
4						4
5						5
6						6
7						7
8						8
9						9
10						10
11						11
12						12
13						13
14						14
15						15
16						16
17						17
18						18
19						19
20						20
21						21
22						22
23						23
24						24
25						25
26						26
27						27
28						28
29						29
30						30
31						31
32						32
33						33
34						34
35						35
36						36
37						37
38						38
39						39
40						40

NOTE:

(A) There are various approaches to controlling confirmation procedures. Some auditors may use copies of the confirmation letters to control positive confirmation requests and use a symbol and legend on a schedule, tape or aging analysis to indicate balances selected for confirmation and the type of response received.

ABC Company  
 Accs. Receivable - Aging Analysis (A)  
 12/31/55

320

Initiated \_\_\_\_\_ Date \_\_\_\_\_  
 Prepared By \_\_\_\_\_  
 Approved By \_\_\_\_\_

Name of customer (B)	Total bal per sub. Ledger	Total bal				Remarks	Allowance needed (C)	Amount
		Current 1-30 days	31-60 days	61-90 days	Over 90 days			
1								
2								
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15								
16								
17								
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

NOTES (continued)

- (A) This analysis is often prepared by clients for internal purposes. If practical, the auditor may save time by using a copy of the client's schedule for working paper purposes. The auditor may need to modify his (her) copy of the client's schedule by adding additional columns or pasting the copy on to a format similar to this illustration.
- (B) Depending on the circumstances (internal accounting control, relative number of customer accounts and significance of individual balances) the auditor may include any of the following in the working papers:
  - (i) copy of the complete aging analysis.
  - (ii) detail aging analysis of only those customer accounts with balances over a predetermined dollar amount and summary amounts for aging of accounts with balances equal to and lesser than the predetermined amount.
  - (iii) summary of the aging analysis totals and other schedules and narratives to describe detail testing.
- (C) These columns are used when individual customer balances may be large enough in relation to the total receivables balance for review on a specific account basis to determine the need for allowances.

.330

ABC Company  
Accounts Receivable - Other  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Due from	Explanation			Final bals. 12/31/X4	Balances Per client	12/31/X5 AJEs Dr (Cr)	as ad- justed
				(A)	(A)		
1	Describe individual components						
2	deemed significant enough for						
3	application of auditing						
4	procedures.						
5							
6							
7							
8							
9							
10							
11	Subtotal						
12							
13	Other (B)						
14	Total						
15							
16							
17	<u>NOTES:</u>						
18	(A) The comparative columns are provided for review and explanation						
19	of fluctuations.						
20							
21	(B) Components which total to an amount believed not significant						
22	enough to merit audit attention may be grouped as one amount.						
23							
24							
25							
26							
27							
28							
29							
30							
31							
32							
33							
34							
35							
36							
37							
38							
39							
40							

ABC Company

.340 Allowance for Doubtful Accounts - Related Expense  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Description	Final Balance 12/31/X4	Activity 19X5 Write offs	Prov. for Expense	Recoveries	Bal 12/31/X5		
1							1
2	If there are significant individual components, describe or cross reference to a supporting paper that presents particulars.						2
3							3
4							4
5							5
6							6
7							7
8							8
9							9
10							10
11							11
12						12	
13						13	
14						14	
15						15	
16	Totals per client	xxxxx	x xxxx	(xx xxx)	xxxxx	xxxxxx	16
17							17
18	Adjustments: (describe)		xxxxx			xxxxx	18
19							19
20							20
21	Final	xxxxxx	xxxxx	(xxxxxx)	xxxxx	xxxxxx	21
22							22
23							23
24							24
25							25
26							26
27							27
28							28
29							29
30							30
31							31
32							32
33							33
34							34
35							35
36							36
37							37
38							38
39							39
40							40



ABC Company  
 Allowance for Doubtful Accounts, Provisions,  
 Write Offs and Recoveries

.350

	19X0	19X1	19X2	19X3	19X4	19X5	19X6
1	xxxx						
2	xxxx						
3	xxxx						
4	xxxx						
5	xxxx						
6	xxxx						
7	xxxx						
8	xxxx						
9	xxxx						
10	xxxx						
11	xxxx						
12	xxxx						
13	xxxx						
14	xxxx						
15	360000						
16	6000						
17	7000						
18	50000						
19							
20							
21	12						
22							
23							
24							
25	30 days						
26							
27	xx8						
28							
29	xx8						
30							
31							
32							
33							
34							
35							
36							
37							
38							
39							
40							

NOTES:  
 (A) Depending on the circumstances, an auditor may find it useful to maintain continuing analysis of the allowance for doubtful accounts and related activity. For clients with a small number of significant trade accounts receivable, an auditor may decide it is more practical to review each balance individually and may consider this type of schedule as unnecessary.  
 (B) In this illustration, it is assumed that recoveries of accounts written off are restored to the allowance.  
 (C) A 360 day year was used in this illustration to simplify computations.

.360

ABC Company  
 Inventories - Lead Sheet  
 12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	
W.P. Ref	Account title (B)	Account No.	Final 12/31/X4	Per Client 12/31/X5	Adjustments(A) Dr (Cr)	as adjusted 12/31/X5		
1	Raw materials						1	
2							2	
3							3	
4	Work in process						4	
5							5	
6	Finished goods						6	
7							7	
8	Supplies						8	
9							9	
10							10	
11							11	
12	Cost of sales (C)						12	
13	Ratios (describe) (D)						13	
14							14	
15							15	
16	<b>NOTES:</b>							16
17	(A) This paper may be expanded for such purposes as providing additional columns for reclassifications, and using separate debit and credit columns for adjustments.							17
18								18
19								19
20	(B) These account titles might be far more complex than the above. Work-in-process accounts, for example, might be expanded to identify separate processes, departments or plants.							20
21								21
22								22
23								23
24	(C) It may be useful to also present data from related expense accounts and selected ratio analyses on the inventory lead sheet.							24
25								25
26								26
27	(D) Some firms require that the lead sheet also include the auditor's individual conclusions on the audit objectives, work done and resulting findings.							27
28								28
29								29
30								30
31								31
32								32
33								33
34								34
35								35
36								36
37								37
38								38
39								39
40								40

ABC Company  
 .370 Inventory - Analysis from Physical to Year End (A)  
 12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	
				Raw Materials	Work in Process	Finished Goods	Supplies	
1								
2	Balance per books 11/30/X5			xxxxxx	xxxxx	xxxxxx	xxxxx	
3	Adjustment of books to physical (B)			xxxx	( xxxxx )	(xxxx)	xxxx	
4	Per physical 11/30/X5			xxxxxx	xxxxx	xxxxxx	xxxxx	
5								
6	December 19X5 activity							
7								
8	Purchases-raw materials-supplies			xxxxxx			xxx	
9	Requisitions-			(xxxxxx)	xxxxx		( xxxxx )	
10	Direct labor				xxxxxx			
11	Overhead				xxxxxx			
12					xxxxxx			
13	Cost of goods manufactured				(xxxxxx)	xxxxxx		
14						xxxxxx		
15	Cost of goods sold					(xxxxxx)		
16								
17	Other (describe)							
18								
19	Balance 12/31/X5			xxxxxx	xxxxx	xxxxxx	xxxxx	
20								
21								
22								
23								
24								
25	NOTES:							
26	(A)	This type of analysis will vary greatly with the circumstances.						
27		For example, some clients may use several general ledger accounts						
28		for production and inventory while others may have a small number						
29		of general ledger controlling accounts that are tied to a detailed						
30		cost accounting system. Other obvious variables include the fol-						
31		lowing:						
32		• Assumptions on the flow of cost (FIFO, LIFO, etc.).						
33		• Method of cost accounting (process, job order, direct costing						
34		for internal reports and adjustment to absorption costing for						
35		external reporting, standard costs, retail method, etc.).						
36	(B)	Adjustment may be more complex than a simple difference between						
37		the book balances and the priced physical inventory. This may re-						
38		quire a separate analysis of adjustments to the inventory per books						
39		and/or the physical.						
40								

ABC Company

.380

Inventory - Test Counts 11/30/X5 (A) (B)  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	
Ticket No. or other ref.	Location & Description [Part #] [B]			Count Client	per Auditor	Difference test over (under)		
1	<u>Department A</u>					client	1	
2							2	
3	xxxx	xxxx	xxxxxx	xx	xx	—	3	
4							4	
5	xxxx	xxxx	xxxxxx	xx	xx	x	5	
6							6	
7	xxxx	xxxx	xxxxxx	xx	xx	( x )	7	
8							8	
9	<u>Department B</u>						9	
10							10	
11	xxxx	xxx x	xxxxxx	xxx	xxx	—	11	
12							12	
13	xxxx	xxx x	xxx xxx	xxx	xxx	—	13	
14							14	
15							15	
16							16	
17	<u>NOTES:</u>							17
18	(A) The design of test count work sheets will depend on the circumstances and may vary extensively from the above which is assumed to involve simple unit counts. Other physical inventories, for example, may involve conversion of units to weight, surveys of volume with conversion to tonnage, or special techniques such as engineering surveys of volume, aerial photography, and chemical analyses.							18
19								19
20								20
21								21
22								22
23								23
24								24
25	(B) For each item, the location, reference, description and other data must provide sufficient detail for subsequent tracing of the auditor's test counts or observations into the client's compilation and summarization of its physical inventory. Accordingly, advance planning is extremely important in preparing for observation and testing of a client's physical inventory. Provision should be made for inclusion in the working papers of such information as number of tickets used, unused and voided, or the number of count sheets used.							25
26								26
27								27
28								28
29								29
30								30
31								31
32								32
33								33
34								34
35								35
36								36
37								37
38								38
39								39
40								40





## **Inventory Price Tests of Work-in-Process and Finished Goods—General Note on Working Papers**

.400 The working paper formats for price tests of work-in-process and finished goods inventories will vary with the circumstances of individual engagements. Among the variables are the following:

- The client's particular industry and business.
- Cost accounting method (job order or process cost, use of standard costs, application of overhead costs, retail method).
- Assumptions about flow of costs (FIFO, LIFO, moving average).
- Other cost accounting matters such as allocation of costs to various products included in inventories.

Because of the many complex variables involved, sample working papers on price tests of work-in-process and finished goods inventory are not presented. However, the following possible column headings may be useful in considering working paper formats for price tests of specific items of work-in-process and finished goods inventory:

Part number or product code  
 Job order number  
 Description  
 Department or plant location  
 Quantity in inventory  
 Date produced (is it slow-moving or obsolete?)  
 Material cost  
 Labor cost  
 Overhead cost  
 Total cost  
 Unit cost  
 Inventory dollar amount  
 Status (stage of completion, process code no., etc.)  
 Recent actual job order cost  
 Recent process or standard unit cost  
 Recent actual selling price and gross profit percentage (is it adequate?)  
 Recent sales volume (is item slow-moving or obsolete?)

Depending on the circumstances, it may be more efficient to use copies of the client's analyses and prepare supplementary schedules rather than develop completely separate analysis formats.





.420 ABC Company  
 Prepaid Insurance (Alternative Format)  
 12/31/X5

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
				Total A/C # XXX	XYZ Fire Ins Co.	XYZ Casualty Co.	Blanket Insurance Co.	
1								1
2	Policy numbers							2
3								3
4	Coverages:							4
5	Types							5
6								6
7								7
8								8
9	Amount							9
10								10
11								11
12								12
13	Book value of assets							13
14	insured							14
15								15
16	Terms of coverage							16
17	From							17
18	To							18
19								19
20	Premium amount							20
21	Monthly write-off							21
22								22
23	Prepaid bal 12/31/X4							23
24								24
25	Additions							25
26								26
27	Expense							27
28								28
29	Prepaid bal 12/31/X5							29
30								30
31								31
32								32
33								33
34								34
35								35
36								36
37								37
38								38
39								39
40								40

ABC Company  
Property Taxes - Prepaid & Accrued (A)  
12/31/85

Prepared By	Date
Reviewed By	Date

.430

←	Property	Assessed Value	Total Tax	Payment date	Period From	Covered To	12/31/84		1985		Sal 12/31/85	
							Prepaid	Accrued	Payments	Expense Incurred		
1	2	3	4	5	6	7	8	9	10	11	12	13
1												
2												
3												
4												
5												
6												
7												
8												
9												
10												
11												
12												
13												
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32												
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36												
37												
38												
39												
40												

NOTES:

(A) This analysis may support prepaid expenses included among assets, accrued taxes included among liabilities and tax expenses. The auditor's preference determines whether this analysis is filed among papers on assets, liabilities or expenses. However, the amounts should be cross-referenced with their location in lead sheets that support all relevant statement groupings.

(B) The column for expenses incurred may include write-offs of prepaid amounts and provisions for amounts incurred but not yet paid. This will depend on the timing of the payment due dates and periods covered for each taxing organization.

.440

ABC Company  
 Prepaid expenses - other  
 12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)		(2)		(3)		(4)		(5)		(6)		(7)		(8)		
Acct No.		Description	Period covered		Bal 12/31/X4	Additions	Charges to expense	Bal 12/31/X5								
			From	To												
1																1
2																2
3																3
4																4
5																5
6																6
7																7
8																8
9																9
10																10
11																11
12																12
13																13
14																14
15																15
16																16
17																17
18																18
19																19
20																20
21																21
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24																24
25																25
26																26
27																27
28																28
29																29
30																30
31																31
32																32
33																33
34																34
35																35
36																36
37																37
38																38
39																39
40																40

.450

ABC Company  
 Deposits & Miscellaneous Current Assets  
 12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Client's Acct No.	Description			Final Bal. 12/31/X4	Bal per client 12/31/X5	Adjustments Dr (Cr)	as adjusted 12/31/X5
1							
2							
3							
4							
5							
6							
7							
8							
9							
10							
11							
12							
13							
14							
15							
16							
17							
18							
19							
20							
21							
22							
23							
24							
25							
26							
27							
28							
29							
30							
31							
32							
33							
34							
35							
36							
37							
38							
39							
40							

NOTES:

The comparative format may aid in review of fluctuations at the detail level.

Symbols and legends may be used to indicate confirmation and/or other procedures applied, and as cross-references to explanatory notes if required, concerning individual balances or disposition of prior year balances.



470 ABC Company  
Property Plant & Equipment - Additions (A)  
12/31/85

Prepared by	Checked	Date
Approved by		

10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31	32	33	34	35	36	37	38	39	40	
Date Recd	Vendor	Description	Depre- ciable Life	Cost	Not eligible	Total eligible	Analysis for Investment Credit New Eligible Property 7 or more	5 to under 7	3 to under 5	Used Eligible Property 7 or more	5 to under 7	3 to under 5																			
		Positive individual additions including whether item is new or used (H)																													
		Subtotal, additions of over XXX each																													
		Other, each of XXX or less																													
		Total additions (B)																													
		Analysis for investment credit (C):																													
		... Deduct excess of used property over limitation (b)																													
		... Fraction for qualified portion																													
		... Qualified amounts (C)																													
		NOTES:																													
		(A) This illustration is assumed to support a particular category such as machinery and equipment which may include property that qualifies for an investment tax credit. Some auditors may prefer to group all additions on one schedule and use analysis columns to segregate amounts into such classifications as land, buildings, machinery and equipment. When a separate analysis may be prepared concerning additions which qualify for the investment tax credit.																													
		(B) Depending on the circumstances, an auditor may have all additions listed or select a minimum dollar amount and have only those additions over that amount listed.																													
		(C) Auditors should carefully consider applicable income tax requirements.																													

ABC Company  
 .480 Property Plant - Equipment - Retirements & Dispositions  
 12/31/45

Page No.	
Volume No.	
Date	

Date sold or disposed	Classification & Description	Date acquired	Depreciation Method	Life	Cost	Accum. depreciation value	Net carrying value	Proceeds of disp.	Net gain or loss	See note
1										
2										
3										
4										
5										
6										
7										
8										
9										
10										
11										
12										
13										
14										
15										
16										
17										
18										
19										
20										
21										
22										
23										
24										
25										
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27										
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30										
31										
32										
33										
34										
35										
36										
37										
38										
39										
40										

**NOTE:**  
 The auditor may find it useful to use additional analysis columns to aid in such matters as tax return preparation. For example, columns may be used to distinguish ordinary and capital gains and losses, and to identify recapture, if any, of depreciation and/or investment tax credits.

.490

ABC Company  
Intangible Assets  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)		(7)	(8)	
Description	Balance 12/31/X4	Additions at cost	Charged to P&L	Deductions		Other Additions (Deductions)	Balance 12/31/X5	
				Charged to other ATCs				
1							1	
2	Describe significant individual components.						2	
3							3	
4							4	
5							5	
6							6	
7							7	
8							8	
9							9	
10							10	
11							11	
12							12	
13							13	
14							14	
15							15	
16	NOTE:	This type of analysis might be arranged as follows for carryforward purposes:						16
17							17	
18							18	
19							19	
20		Total	Organiza-	Goodwill	Goodwill		20	
21		intangib-	tion	acc - XYZ	acc -		21	
22		ble	Costs	Co.	DEF Co.		22	
23	Date incurred		12/31/X2	9/30/X3	4/1/X4		23	
24	Amortizable life		60 months	10 years	40 years		24	
25	Orig Cost incurred		xxxx	xxxxx	xxxx		25	
26	Monthly charge		xx	xxx	xx		26	
27	Annual charge		xxx	xxxx	xxx		27	
28							28	
29	Balance 12/31/X2	xxxx	xxxx				29	
30	Additions	xx xxx		xxxxx			30	
31	Amortization	xxxx	xxx	xxxxx			31	
32	Bal 12/31/X3	xxxxxx	xxxxx	xxxxxx			32	
33	Additions	xxxxx			xxxxx		33	
34	Amortization	xxxxx	xxx	xxxxx	xxx		34	
35	Bal 12/31/X4	xxxxxx	xxxxx	xxxxxx	xxx		35	
36	Additions						36	
37	Amortization	xxxxxx	xxx	xxxxx	xxx		37	
38	Bal 12/31/X5	xxxxxx	xxxxx	xxxxxx	xxxxx		38	
39							39	
40							40	



.500

ABC Company  
Accounts Payable Lead Sheet

	Initials	Date
Prepared By		
Approved By		

(1) Client's acct.no. or code	(2) Acct title	(3)	(4) Final bal 12/31/X4	(5) ← 12/31/X5 →			(7) as ad- justed	(8) W.P. Ref.
				Per client	AJEs (Dr) Cr			
1								1
2	Trade accts payable							2
3								3
4	(If comprised of a group of general ledger account							4
5	balances, list the individual accounts to show							5
6	how they group to the total for trade accounts							6
7	payable.)							7
8								8
9								9
10	Other current payables							10
11								11
12	(It may be practical to include the groupings							12
13	general ledger accounts for other current payables							13
14	on the same lead sheet, especially if considera-							14
15	tion is given to showing one balance sheet classi-							15
16	fication for trade and other accounts payable.)							16
17								17
18								18
19								19
20								20
21								21
22								22
23								23
24								24
25								25
26								26
27								27
28								28
29								29
30								30
31								31
32								32
33								33
34								34
35								35
36								36
37								37
38								38
39								39
40								40

.510 ABC Company  
Trade Accounts Payable - Schedule (A)  
12/31/X5

Prepared By	Initials	Date
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	
Source:	Note (B)			Balance 12/31/X5		Remarks		
	Vendor							
1							1	
2		XYZ Corp		xxxx	(D)		2	
3		TUV Industries		xxx			3	
4		P&Q Company		xxxx			4	
5		L and Sons		xxx			5	
6		John Doe Mfg		xxxx			6	
7							7	
8		Other, each under					8	
9		xxx dollars (NOTE (C))		xxxx			9	
10							10	
11		Total		xxxx			11	
12							12	
13							13	
14							14	
15							15	
16							16	
17							17	
18							18	
19							19	
20							20	
21	<b>NOTES:</b>							21
22								22
23	(A) Many auditors believe this schedule should be prepared by the							23
24	client and would have a staff auditor prepare this listing only							24
25	as a last resort. However, some auditors, depending on their							25
26	study and evaluation of internal accounting control, may believe							26
27	this type of schedule need not be included in their working papers.							27
28	(B) This schedule should include indication of where the detail was							28
29	obtained, for example, "per voucher register." In some instan-							29
30	ces, it may be a carbon or photocopy of the client's own year end							30
31	tabulation of trade payables.							31
32	(C) This type of schedule may include all trade payables as of the							32
33	balance sheet date or only those over a given amount selected by							33
34	the auditor.							34
35	(D) A symbol and explanation may be used to identify amounts sub-							35
36	jected to examination of supporting evidence and/or confirmation							36
37	procedures (see section _____ in the chapter on audit objec-							37
38	tives and programs regarding confirmation of accounts payable).							38
39								39
40								40

ABC Company  
 Unrecorded Liabilities Test  
 12/31/75

Prepared By	Checked	Date
Approved By		

520

Check No You No on Other Ref.	Vendor	Date Received	Description	Account Code Changed	Amount affects		Disposition
					P&L	Bal. Sheet	
1							
2							
3							
4							
5							
6							
7							
8							
9							
10							
11							
12							
13							
14							
15							
16							
17							
18							
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27							
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31							
32							
33							
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35							
36							
37							
38							
39							
40							

NOTES:

This working paper should indicate the particular period selected and records examined in the search for unrecorded liabilities. For example, Cash disbursements book and voucher register for 1/21/76-1/31/76. The period selected will vary with the circumstances. For example, pre-closures of client accounts, bill backlog or billing pattern of client's vendors (do they bill weekly or slowly after delivery of goods or services) and whether other audit procedures such as confirmation of payables are to be used.

If amounts selected are subject to a minimum amount(s), this should be indicated on this working paper. For example, "selected all items of \$500 or over" or "selected all items of \$10 for 1/1/76 and all items of \$500 and over for 1/11-1/20 and all items of \$1000 and over from 1/20 to date of audit report."

ABC Company  
Accounts Payable - Confirmation Differences  
12/31/83

Prepared By	Date
Approved By	

.530

W.P. Ref	Vendor	Balance per Books	Conf/Lim	Conf/Lim over (under) books	← Unrec'd Payment ded Lib in trans-act	← Analysis of Conf/Lim difference	Other	Remarks
1								
2								
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15								
16								
17								
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

.540 ABC Company  
 Miscellaneous Current Liabilities  
 12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)		(5)	(6)	(7)	(8)
Acct. No.	Description			Balance 12/31/X4	Balance 12/31/X5	Remarks		
1								1
2								2
3								3
4								4
5								5
6								6
7								7
8								8
9								9
10								10
11								11
12								12
13								13
14								14
15								15
16								16
17								17
18								18
19								19
20								20
21								21
22								22
23								23
24								24
25								25
26								26
27								27
28								28
29								29
30								30
31								31
32								32
33								33
34								34
35								35
36								36
37								37
38								38
39								39
40								40

NOTE:  
 Depending on materiality and the study and evaluation of internal accounting control, the auditor may limit work to review of comparative amounts. Generally, the auditor's concern relates to searching for unrecorded liabilities.

.550

DEF Company  
Dividends Payable  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
					Preferred (A)	Common (A)	
1		Final bal	12/31/X4		_____	_____	1
2							2
3		Add: Declarations	(Describe including				3
4			reference to minutes & applic-				4
5			able number of shares per work-				5
6			ing papers on capital stock) (B)				6
7					_____	_____	7
8			Total declared		_____	_____	8
9							9
10		Less: Payments	(Describe including				10
11			testing of payments) (B)				11
12					_____	_____	12
13			Total paid		_____	_____	13
14							14
15		Balance	12/31/X5		_____	_____	15
16							16
17							17
18							18
19							19
20		NOTES:					20
21		(A)	This illustration assumes that the client has only				21
22			one class each of preferred and common stock. The				22
23			analysis columns may be expanded if more classes of				23
24			capital stock are present. However, if the timing				24
25			of the dividend declarations and payment dates results				25
26			in no year end liability for unpaid dividends, the				26
27			testing shown on this working paper may appear in an				27
28			analysis of retained earnings, and this paper would				28
29			be unnecessary.				29
30		(B)	If the auditor prefers, the detail of individual divi-				30
31			dends declared may be presented in an analysis of re-				31
32			tained earnings with a cross reference of unpaid				32
33			dividends to a recap or lead sheet concerning other				33
34			payables.				34
35							35
36							36
37							37
38							38
39							39
40							40

.560 ABC Company  
 Liability for Payroll Taxes Withheld  
 12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Client's Acct	Description	Final Bal 12/31/X4	Bal per client 12/31/X5	AJEs Incr. (DeCr.)	Bal as adjusted 12/31/X5		
1							1
2							2
3		Federal income tax					3
4							4
5		FICA					5
6							6
7		State income tax					7
8							8
9		Other (describe)					9
10							10
11							11
12							12
13							13
14							14
15							15
16							16
17							17
18							18
19							19
20							20
21							21
22		NOTE:					22
23							23
24							24
25							25
26							26
27							27
28							28
29							29
30							30
31							31
32							32
33							33
34							34
35							35
36							36
37							37
38							38
39							39
40							40

Depending on the auditor's study and evaluation of internal accounting control, these balances may be tested by reference to subsequent payments and related payroll tax returns, and by analytical review procedures.

.570

ABC Company  
 Accrued Payroll Taxes  
 12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Client's Acct Code	Description	Final Bal 12/31/X4	Bal client 12/31/X5	AJEs Increase (Decrease)	Bal as adjusted 12/31/X5		
1							1
2							2
3							3
4							4
5							5
6							6
7							7
8							8
9							9
10							10
11							11
12							12
13							13
14							14
15							15
16							16
17							17
18							18
19							19
20							20
21							21
22							22
23							23
24							24
25							25
26							26
27							27
28							28
29							29
30							30
31							31
32							32
33							33
34							34
35							35
36							36
37							37
38							38
39							39
40							40

NOTE:

Depending on the auditor's study and evaluation of internal accounting control, these balances may be tested by reference to subsequent payments and related payroll tax returns, and by analytical review procedures.



.580  
 ABC Company  
 Accrued Payroll  
 12/31/X5

Prepared By	Initials	Date
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
						Components of Accrual (A)	
1	TEST						
2	Total payroll week ended Fri 12/28, paid 1/3				100%	xxxxx	
3							
4							
5	Total payroll week ended Fri 1/4 paid 1/9				xxxxx		
6		12/19-12/31		2 days	33%	xxx	
7		1/1-1/4		4 days	67%		
8							
9		(12/30=Sunday - Sundays paid separately if worked per Union Contract & company pol)					
10							
11			Amount per test			xxxxx	
12							
13			Amount per client			xxxxx	(B)
14							
15							
16				Difference			(B)
17							
18							
19							
20							
21	NOTES:						
22	(A)	Depending on circumstances, the auditor may find it practical to expand this column to an analysis by components, for example, production wages, office salaries and officers salaries.					
23							
24	(B)	The auditor may also wish to note on this working paper the accrual as of the prior year end and comment on fluctuation if significant.					
25							
26							
27							
28							
29							
30							
31							
32							
33							
34							
35							
36							
37							
38							
39							
40							

.590

ABC Company  
Accruals - Other  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	
Client's	Title or description		W.P. Ref	12/31/X4 Final	12/31/X5 Per Client	AJEs, Incr (Decr)	Bal as adjusted	
1								
2								
3	Property taxes		(A)					
4								
5	Other, describe		(B)					
6								
7								
8								
9								
10								
11								
12								
13								
14								
15								
16								
17								
18								
19								
20								
21	<b>NOTES:</b>							
22	(A) Accrued property taxes should be cross-referenced to the working paper on property taxes prepaid accrued and expensed. See section							
23								
24								
25	(B) The auditor may evaluate the significance or relative immateriality of other accruals and then decide whether to limit work to inquiry of the client and analytical review, or to perform additional tests.							
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								



XYZ Company

.610

Debt - Summary of Assets Pledged  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Description of Asset	Creditor & description			Liability Bal 12/31/X5	Book val of asset 12/31/X5		
1							1
2	Accounts receivable	NOP Factors			xxxxx	xx xxx	2
3		3/15/X5	Financing agreement				3
4							4
5							5
6	Inventory-finished goods	NOP Factors			xxxxx	xx xxx	6
7		4/15/X5	Financing agreement				7
8							8
9							9
10							10
11	Property, plant-equip	LMN Mfg Corp			xxxxx	xxxxx	11
12		2/28/X4	conditional sales				12
13	10 milling machines		agreement-last payment				13
14			due 1/31/X9				14
15							15
16							16
17	Building #3	PQ Life Insurance Co			xxxxxx	xxxxxx	17
18		4/1/X2	Mortgage Note				18
19			matures 3/31/Y9				19
20							20
21							21
22	Fire Insurance - XYZ Insurance Co	TUV Brokerage and Finance Corp					22
23	Policy 11/15/X5-	Note payable			xxxx	xxxx	23
24	11/15/X6						24
25							25
26							26
27							27
28							28
29							29
30							30
31							31
32							32
33							33
34							34
35							35
36							36
37							37
38							38
39							39
40							40

Client	Date
Prepared by	
Reviewed by	

620 Federal (State) Income Taxes-Accrued & Provided (A)  
12/31/75

ABC Company

	Current year 1975	1974	1973	open years (B) 1972 1971	1970
1	Accrued payable 12/31/74				
2	(Refundable) 12/31/74 (C)				
3	Payments and/or recoveries in 1975				
4					
5					
6	Itemize and describe individual cash transactions (D)				
7					
8					
9					
10	Provision - current year (E)				
11					
12	Accrued payable 12/31/75 (F)				
13					
14					
15	Deferred taxes (G)				
16					
17					
18					
19					
20					
21					
22					
23					
24					
25					
26					
27					
28					
29					
30					
31					
32					
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36					
37					
38					
39					
40					

NOTES:

- (A) This type of analysis may be prepared separately for Federal income taxes and state and local income taxes or depending on the circumstances, Federal and state income taxes may be presented on a single spread analysis.
- (B) This illustration assumes that several prior years are still open and provides individual measures for making each transaction with related provisions for each open year.
- (C) A separate line item for refundable taxes is provided to segregate these amounts from taxes payable.
- (D) Details of individual payments including date, description and amount should be shown separately because of the compliance implications in the timing and amounts of payments.
- (E) Generally, development of the current year's provision involves enough detail to require a separate working paper cross-referenced to this type of account analysis.

NOTES (continued)

- (F) In some circumstances, the auditor may prepare (or obtain from the client) this type of analysis through a preliminary rate and after testing and review with the client. The schedule may be subsequently brought forward to the year and date.
- (G) Deferred taxes are included in separate illustrative working papers at paragraphs \_\_\_\_\_

Prepared by	Checked by	Date
Approved by		

630 Provision for Federal (State) Income Taxes  
12/31/XS

	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31	32	33	34	35	36	37	38	39	40									
	Federal income tax										State income tax																													
	For cur- rent ref.										For cur- rent ref.																													
	Timing difference Amt										Timing difference Amt																													
	Tax effect										Tax effect																													
1	Income before federal and state income taxes, per books																																							
2																																								
3																																								
4	Add and/or (Deduct): interperiod timing difference																																							
5																																								
6	Deducting individuality and cross-reference																																							
7	to working papers that provide sources of																																							
8	data and further determination of deferred																																							
9	tax provisions and related balance sheet																																							
10	classifications.																																							
11																																								
12																																								
13	Add and/or (Deduct) permanent differences																																							
14																																								
15	Deductible specifically and cross-reference																																							
16	to working papers. For some																																							
17	situations such as tax exempt municipal																																							
18	bond interest, state and local income tax																																							
19	requirements may differ from those for																																							
20	federal income taxes.																																							
21																																								
22																																								
23	Estimated taxable income - state-local																																							
24	Less: provisions for state-local income taxes																																							
25																																								
26	Estimated taxable income - federal																																							
27																																								
28	Tax computations																																							
29																																								
30																																								
31	Estimated tax provision																																							
32																																								
33																																								
34																																								
35																																								
36																																								
37																																								
38																																								
39																																								
40																																								



.650  
 ABC Company  
 Contingent Liabilities and Commitments Other Than Leases  
 12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
W.P. Ref. (B)	Classification and Description (A)				Amount	Disposition (C)	
1							1
2							2
3							3
4							4
5							5
6							6
7							7
8							8
9							9
10							10
11							11
12							12
13							13
14							14
15							15
16							16
17							17
18							18
19							19
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24							24
25							25
26							26
27							27
28							28
29							29
30							30
31							31
32							32
33							33
34							34
35							35
36							36
37							37
38							38
39							39
40							40

NOTES:

- (A) See SAS No. 12, paragraphs 5-7 on audit procedures regarding litigation, claims and assessments. Also see SAS No. 19 on Client Representations.
- (B) Working paper references may include those on review of minutes, standard bank confirmations, review of agreements and contracts, review of legal fees, inquiries of management and lawyers' letters.
- (C) Disposition column may include reference to footnote disclosure, inclusion in the client representation, and, if necessary, the item's effect on the auditor's report.



ABC Company  
 .660 Capital Stock & Additional Pd in Capital-Analysis  
 12/31/X5

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)		(5)		(6)		(7)		(8)		
				Capital Auth No.	stock, of shares	par XXXXX	val X per share				Additional paid in			
				No. of shares issued	Amount	No. of shs held in treasury	Cost of treas. stock							
1														1
2														2
3														3
4														4
5														5
6														6
7														7
8														8
9														9
10														10
11														11
12														12
13														13
14														14
15														15
16														16
17														17
18														18
19														19
20														20
21														21
22														22
23														23
24														24
25														25
26														26
27														27
28														28
29														29
30														30
31														31
32														32
33														33
34														34
35														35
36														36
37														37
38														38
39														39
40														40

Balance 12/31/X4

Describe individual trans-  
 actions and cross refer-  
 ence to authorization per  
 minutes or per such agree-  
 ments as options and/or  
 warrants.

Balance 12/31/X5

NOTES:

It may be helpful to prepare this type of analysis as a  
 carry forward working paper.

If several classes of capital stock are present, the analysis  
 can be prepared on wider columnar paper to use the additional  
 columns for the various classes of stock.

ABC Company  
 Capital Stock - Certificate Book Examination  
 (Carry Forward)

670

Exam Done by	Date	Unissued C.S. Nos. From-To	Name of whom Issued	Certificate Issued		Date Acquired or Transferred		Number of Shares		Date of Shares	Total Shares
				Ctg. No.	No. of Shares	Date	Ctg. no. of shares	12/31/XX	12/31/XX		
			Albert Abe	1	500	3/15/40	5	500	500	12/31/40	500
			Bartolo Comow Babba	2	500	3/15/40	6	500	500	12/31/40	500
			Re 2/31/40				8	1000	1000	12/31/40	1000
			Carlton P. Charzie	3	250	4/11/41	9	250	250	12/31/41	250
			Re 12/31/41					1250	1250	12/31/41	1250
			Carlton P. Charzie	4	250	12/30/42		250	250	12/31/42	250
			Re 2/31/42					1500	1500	12/31/42	1500
			Re 2/31/43					1500	1500	12/31/43	1500
			Re 2/31/44					1500	1500	12/31/44	1500
			Fredoline P. Abbe	5	100	5/30/45		100	100	12/31/45	100
			Albert Abe	6	400	5/30/45		400	400	12/31/45	400
			Godfrey Della	7	100	9/12/45		100	100	12/31/45	100
			Mary Babba	8	100	10/31/45		100	100	12/31/45	100
			Bartolo Comow Babba	9	400	10/31/45		400	400	12/31/45	400
			Re 12/31/45					1600	1600	12/31/45	1600
			Re 12/31/46					1600	1600	12/31/46	1600

.680 ABC Company  
Retained Earnings - Analysis  
(Carryforward)

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
			19X0	19X1	19X2	19X3	19X4	19X5
1								
2	Balance, beginning							
3	of year							
4								
5	Net income for year							
6								
7	Dividends declared							
8	and paid:							
9	(Describe) (A)							
10								
11								
12								
13								
14								
15								
16								
17								
18								
19								
20								
21								
22								
23								
24								
25	Balance, end of year							
26								
27								
28								
29								
30								
31								
32								
33								
34	<u>NOTE:</u>							
35								
36	(A) If more than one class of stock is present, segregate dividends							
37	into groups according to each class of stock.							
38								
39								
40								

**Revenue and Expense Working Papers—General Note**

.690 Working papers on revenue and expense accounts would include comparative lead sheets for each income statement classification. Expenses such as depreciation, insurance, interest, and the provision for doubtful accounts would be cross-referenced to related analyses included among working papers concerning the balance sheet classifications.

The auditor, after considering his evaluation of internal accounting control, may decide that analytical review procedures (see SAS No. 23) and substantive tests of balance sheet accounts (including related income and expense effects) provide enough evidence to avoid the need for detailed analysis of most individual revenue and expense accounts. Some revenue and expense accounts, however, are ordinarily analyzed and tested because of the following:

- Identification of possible disclosure matters (especially lawyers' billings).
- Information needed for preparation of tax returns and other reports.
- Generalized titles that make accounts subject to misclassifications and errors.

Accounts requiring separate analysis generally are:

- Legal expenses and other professional fees
- Maintenance and repairs
- Travel and entertainment
- Officers' salaries and expenses
- Taxes, licenses and fees
- Rents and royalties
- Contributions
- Advertising

For timesaving purposes, the auditor may request the client to prepare analyses of these accounts and to assemble the related vouchers and other supporting documents.

.700

ABC Company  
 Legal Expense  
 12/31/X5

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	
	Name of lawyer or law firm		Description of matter				Date of billing	Amount	
1									1
2									2
3									3
4									4
5									5
6									6
7									7
8									8
9									9
10									10
11									11
12									12
13									13
14									14
15									15
16									16
17									17
18									18
19									19
20									20
21									21
22									22
23									23
24									24
25									25
26			Total 19X5						26
27			Total 19X4						27
28									28
29									29
30									30
31	<b>NOTES:</b>								31
32	● Descriptions should be related (referenced) to such other working papers as contingencies and commitments and management representations.								32
33	● The final amount from the preceding year may be useful for comparison purposes. A significant fluctuation should be explained.								33
34	● A similar working paper format may be used for other professional fees.								34
35									35
36									36
37									37
38									38
39									39
40									40

.710 ABC Company  
 Maintenance & Repairs Expense  
 12/31/X5

Prepared By	Initials	Date
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Date	Check or Vou. No.	Vendor	Description				Amount
1							1
2							2
3							3
4							4
5							5
6							6
7							7
8							8
9							9
10							10
11							11
12							12
13							13
14							14
15							15
16							16
17							17
18							18
19							19
20							20
21							21
22							22
23							23
24							24
25							25
26							26
27							27
28							28
29							29
30							30
31							31
32							32
33							33
34							34
35							35
36							36
37							37
38							38
39							39
40							40

Subtotal, details requested (A)

All other, each of which is under \$XXX (A)

Total

Memo - final total 12/31/X4 (B)

NOTES:

(A) The auditor may decide to limit testing to items over a certain dollar amount, based on the client's capitalization policy, rather than all components of the account. If so, the limits should be indicated.

(B) The final amount for the preceding year may be useful for comparison purposes. A significant fluctuation should be explained.

.720 ABC Company  
 Officers Salaries and Expense  
 12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)		
Name of officer and position		Social security no.	Time devoted to business	Percent of corp. stock owned Common	Percent of corp. stock owned Preferred	Amount of compensa.	Expense account allowance		
1								1	
2								2	
3								3	
4								4	
5								5	
6								6	
7								7	
8								8	
9								9	
10								10	
11								11	
12								12	
13								13	
14								14	
15								15	
16								16	
17								17	
18								18	
19								19	
20								20	
21								21	
22								22	
23								23	
24								24	
25								25	
26		Total				=====	=====	26	
27								27	
28		Final amount 19X4*				=====	=====	28	
29								29	
30								30	
31	* The final amount from the preceding year may be useful for comparison purposes. A significant fluctuation should be explained.								31
32									32
33									33
34									34
35									35
36									36
37									37
38									38
39									39
40									40

.730

ABC Company  
 Taxes, Licenses and Fees  
 12/31/X5

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
					19X4	19X5		
1								
2	State and local income taxes							
3								
4	(Relate to balance sheet analysis							
5	working papers on income taxes							
6	accrued and provided, or provide							
7	details)							
8								
9	Property taxes							
10								
11	(Relate to balance sheet analysis							
12	working papers on property taxes							
13	prepaid and accrued, or provide							
14	details)							
15								
16	Payroll taxes							
17	FICA							
18	SUI							
19	FUI							
20								
21	(Relate to balance sheet analysis							
22	working papers on payroll taxes							
23	accrued, or provide details)							
24								
25	Other taxes, licenses and fees							
26								
27	(Describe in detail)							
28								
29								
30								
31	Totals							
32								
33								
34								
35								
36								
37								
38								
39								
40								



.740 ABC Company  
Rents and Royalties (A)  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
				19X4 Final as reported (B)	← 19X5 Per client	AJEs Incr/Decr	as ad- justed	W.P. Ref
1								
2	Rents							
3								
4	(Describe and cross-							
5	reference to working							
6	papers on the under-							
7	lying leases.)							
8								
9								
10								
11								
12								
13	Royalties							
14								
15	(Describe and cross-							
16	reference to working							
17	papers on the under-							
18	lying royalties.)							
19								
20								
21								
22								
23								
24								
25	NOTES:							
26								
27	(A) Separate schedules may be prepared for rents, and for							
28	royalties if more practical.							
29								
30	(B) If the fluctuation between the current and preceding							
31	year is significant, it should be explained.							
32								
33								
34								
35								
36								
37								
38								
39								
40								

.750

ABC Company  
Interest Expense Recap  
12/31/X5

Prepared By	Initials	Date
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	
W.P. Ref. (A)	Description (A)			Final 19X4	Per client 19X5	AJEs incr(decr)	as ad- justed 19X5	
1								
2		Notes payable						
3								
4		Long term debt						
5								
6								
7		Capitalized leases						
8								
9								
10		Other (describe) (B)						
11								
12								
13								
14								
15								
16		Total						
17								
18								
19								
20					(B)			
21	NOTES:							
22								
23	(A)	Generally, the significant components of interest expense						
24		should be totals cross-referenced from applicable balance						
25		sheet analyses of the underlying debt and its related interest						
26		accruals and expense.						
27								
28	(B)	If the difference between amounts for the current and preced-						
29		ing year are significant, they should be explained.						
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

.760

ABC Company  
Other Income  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	
	Date	Received	From	Description			Amount		
1									1
2									2
3									3
4									4
5									5
6									6
7									7
8									8
9									9
10									10
11									11
12									12
13									13
14									14
15									15
16									16
17									17
18									18
19									19
20									20
21									21
22									22
23									23
24									24
25									25
26									26
27									27
28									28
29									29
30									30
31									31
32									32
33									33
34									34
35									35
36									36
37									37
38									38
39									39
40									40

.770

ABC Company  
Other Expense  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Date	Payee	Description					Amount
1								1
2								2
3								3
4								4
5								5
6								6
7								7
8								8
9								9
10								10
11								11
12								12
13								13
14								14
15								15
16								16
17								17
18								18
19								19
20								20
21								21
22								22
23								23
24								24
25								25
26								26
27								27
28								28
29								29
30								30
31								31
32								32
33								33
34								34
35								35
36								36
37								37
38								38
39								39
40								40

## AAM Section 7000

# CORRESPONDENCE, CONFIRMATIONS & REPRESENTATIONS

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These samples are presented for illustrative purposes only. They are intended as mere conveniences for users of this Manual who may want points of departure when designing their own formats to meet their individual needs. These illustrations are neither all inclusive nor are they prescribed minimums. Auditors and accountants are to rely on professional standards and their individual professional judgment in determining what may be needed in the circumstances.

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➤ *The next page is 7101.* ←

## AAM Section 7100

### ***Control of Confirmations and Correspondence***

.01 Generally, clients prepare correspondence and confirmation requests on their own letterheads and submit the signed originals and copies needed to the auditor. The auditor may obtain one or more copies to serve as file copies for the current working papers, second requests and manuscript copies for the next engagement.

.02 The auditor should review the confirmation requests to the extent he considers necessary. For example, the auditor may perform the following for accounts receivable confirmation requests before they are mailed:

- Compare the customer names and addresses to the client's records.
- Compare balances per confirmation requests to the subsidiary ledger.

.03 The requests would then be stuffed in envelopes and submitted to the post office under the auditor's control.

.04 The auditor controls the mailings and receipt of responses so that the confirmation process is independent of the client.

.05 Mailing envelopes have the auditor's office or post office box number as the return address so that undeliverable letters are returned to the auditor and not to the client. For mailings, the auditor may provide the envelopes or affix a label on the client's envelope that covers the client's return address and replaces it with the auditor's address.

.06 Reply envelopes addressed to the auditor are enclosed with the request letter. Reply envelopes generally have prepaid postage to encourage responses. Some auditors also use codes on the reply envelopes so that responses may be sorted by engagement before the mail is opened. This feature may be particularly useful when there are several engagements that involve voluminous mailings.

.07 If the client objects to use of the auditor's name and address, some auditors suggest that a post office box in the client's name be used, with the returns to be opened under the auditor's control for the confirmation process, and that the post office be instructed that after the box is closed subsequent mail be forwarded to the auditor.

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➤→ *The next page is 7201.* ←➤





**AAM Section 7200*****Requests for Confirmations  
and Related Materials*****Wording of Confirmation Request Forms**

.01 Forms and correspondence used for confirmation requests should state clearly that the client is requesting a reply be sent to the CPA. Forms and correspondence used for information requests for engagements other than audits should not refer to “an examination.” They should also use the term “accountant(s)” rather than “auditors.” Suggested wording follows:

Please send the following information to our professional accountants (insert name and address of accountants) who are performing services for the company.

.02 The samples of correspondence in this section include language that refers to auditors and an examination of the client’s financial statements on the assumption that an audit is being performed. This language needs to be modified if services other than an audit are being performed.

**.03 Request for Bank Cutoff Statements**

(Prepared on client's letterhead)

(Date) [Note (A) below]

(Name of Bank)

(Address)

Dear .....

Please send the following information directly to our auditors (insert name and address of auditors) who are performing their regular examination of our financial statements [Note (B) below] as of the close of business (insert date):

1. The information requested on the enclosed standard bank confirmation inquiry form(s)
2. Statement(s) of our account(s) and the related paid checks for the period from (insert date) to (insert date) inclusive. (Give name and bank account number for each bank account)
3. [Note(C)]

Very truly yours,

(Name of client)

(Signature and title of authorized officer)

## NOTES TO USER:

- (A) The request should be sent at least ten days prior to the audit date so the bank will be able to provide the information requested and to render the cutoff statements as requested. If the request does not reach the bank before the cutoff date, the cutoff statement will include transactions recorded after that date.
- (B) It is helpful to include a list of the account names and bank account numbers for each of the clients' accounts to receive timely and complete response.
- (C) The letter may also include requests for:
  - A statement of all securities or other items held for the client's account as of the closing date for collection or safekeeping, or as agent or trustee (including titles and bank account numbers).
  - List of authorized check signers for the above accounts. (This may have been previously requested at a preliminary date in connection with the study and evaluation of internal accounting control.)

**.04**

**STANDARD BANK CONFIRMATION INQUIRY**  
 Approved 1968 by  
 AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS  
 and  
 BANK ADMINISTRATION INSTITUTE (FORMERLY NABAC)

<b>ORIGINAL</b> To be mailed to accountant
---

\_\_\_\_\_ 19\_\_\_\_

Dear Sirs:

Your completion of the following report will be sincerely appreciated. IF THE ANSWER TO ANY ITEM IS "NONE," PLEASE SO STATE. Kindly mail it in the enclosed stamped, addressed envelope *direct* to the accountant named below.

Report from \_\_\_\_\_

Yours truly,

\_\_\_\_\_  
 (ACCOUNT NAME PER BANK RECORDS)

(Bank) \_\_\_\_\_

By \_\_\_\_\_

Authorized Signature

Bank customer should check here if confirmation of bank balances only (item 1) is desired.

NOTE—If the space provided is inadequate, please enter totals hereon and attach a statement giving full details as called for by the columnar headings below.

Accountant \_\_\_\_\_

Dear Sirs:

1. At the close of business on \_\_\_\_\_ 19\_\_\_\_ our records showed the following balance(s) to the credit of the above named customer. In the event that we could readily ascertain whether there were any balances to the credit of the customer not designated in this request, the appropriate information is given below.

AMOUNT	ACCOUNT NAME	ACCOUNT NUMBER	Subject to Withdrawal by Check?	Interest Bearing? Give Rate
\$	(Some banks request that they be provided with account name and number)			

2. The customer was directly liable to us in respect of loans, acceptances, etc., at the close of business on that date in the total amount of \$ \_\_\_\_\_, as follows:

AMOUNT	DATE OF LOAN OR DISCOUNT	DUE DATE	INTEREST		DESCRIPTION OF LIABILITY, COLLATERAL, SECURITY INTERESTS, LIENS, ENDORSERS, ETC.
			Rate	Paid to	
\$					

3. The customer was contingently liable as endorser of notes discounted and/or as guarantor at the close of business on that date in the total amount of \$ \_\_\_\_\_, as below:

AMOUNT	NAME OF MAKER	DATE OF NOTE	DUE DATE	REMARKS
\$				

4. Other direct or contingent liabilities, open letters of credit, and relative collateral, were \_\_\_\_\_

5. Security agreements under the Uniform Commercial Code or any other agreements providing for restrictions, not noted above, were as follows (if officially recorded, indicate date and office in which filed): \_\_\_\_\_

Yours truly, (Bank) \_\_\_\_\_

Date \_\_\_\_\_ 19\_\_\_\_

By \_\_\_\_\_

Authorized Signature

Additional copies of this form are available from the American Institute of CPAs, 1211 Avenue of the Americas, New York, N. Y. 10036

Correspondence, Confirmations & Representations

**STANDARD BANK CONFIRMATION INQUIRY**  
 Approved 1966 by  
 AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS  
 and  
 BANK ADMINISTRATION INSTITUTE (FORMERLY NABAC)

**D U P L I C A T E**  
 To be retained by Bank

\_\_\_\_\_ 19\_\_\_\_

Dear Sirs:

Your completion of the following report will be sincerely appreciated. IF THE ANSWER TO ANY ITEM IS "NONE," PLEASE SO STATE. Kindly mail it in the enclosed stamped, addressed envelope *direct* to the accountant named below.

Report from \_\_\_\_\_

Yours truly,

\_\_\_\_\_  
 (ACCOUNT NAME PER BANK RECORDS)

(Bank) \_\_\_\_\_

By \_\_\_\_\_  
 Authorized Signature

Bank customer should check here if confirmation of bank balances only (item 1) is desired.

NOTE—If the space provided is inadequate, please enter totals hereon and attach a statement giving full details as called for by the columnar headings below.

Accountant \_\_\_\_\_

Dear Sirs:

1. At the close of business on \_\_\_\_\_ 19\_\_\_\_ our records showed the following balance(s) to the credit of the above named customer. In the event that we could readily ascertain whether there were any balances to the credit of the customer not designated in this request, the appropriate information is given below.

AMOUNT	ACCOUNT NAME	ACCOUNT NUMBER	Subject to Withdrawal by Check?	Interest Bearing? Give Rate
\$	(Some banks request that they be provided with account name and number)			

2. The customer was directly liable to us in respect of loans, acceptances, etc., at the close of business on that date in the total amount of \$ \_\_\_\_\_, as follows:

AMOUNT	DATE OF LOAN OR DISCOUNT	DUE DATE	INTEREST		DESCRIPTION OF LIABILITY, COLLATERAL, SECURITY INTERESTS, LIENS, ENDORSERS, ETC.
			Rate	Paid to	
\$					

3. The customer was contingently liable as endorser of notes discounted and/or as guarantor at the close of business on that date in the total amount of \$ \_\_\_\_\_, as below:

AMOUNT	NAME OF MAKER	DATE OF NOTE	DUE DATE	REMARKS
\$				

4. Other direct or contingent liabilities, open letters of credit, and relative collateral, were \_\_\_\_\_

5. Security agreements under the Uniform Commercial Code or any other agreements providing for restrictions, not noted above, were as follows (if officially recorded, indicate date and office in which filed): \_\_\_\_\_

Yours truly, (Bank) \_\_\_\_\_

Date \_\_\_\_\_ 19\_\_\_\_

By \_\_\_\_\_  
 Authorized Signature

Additional copies of this form are available from the American Institute of CPAs, 1211 Avenue of the Americas, New York, N. Y. 10036

**.05 Request for Confirmation of Petty Cash Fund and Advances to Employees**

(Prepared on client's letterhead)

(Date)

(Name)  
(Address)

Dear .....

Our auditors, (insert name and address of auditors) are performing their regular examination of our financial statements. Accordingly, please confirm directly to our auditors the balance of the petty cash fund (or amount of advances) in your possession as of December 31, 19XX which was shown by our records as \$.....

Please indicate in the space provided below whether the amount above agrees with your records. If not, please send the auditors any information you have that will help them reconcile the difference.

After signing and dating your reply, please return it directly to the auditors. A stamped, addressed envelope is enclosed for your convenience.

Very truly yours,

(Client's authorized signature)

\_\_\_\_\_

The foregoing information is in agreement with my records as of December 31, 19XX with the following exceptions (if any) :

.....  
.....  
.....

Date: ..... Signed: .....

**.06 Securities and Cash in Custodian or Trust Accounts**

(Prepared on client's letterhead)

(Date) [Note (A) below]

(Name of custodian  
or trustee)  
(Address)

Dear .....

Our auditors, (insert name and address of auditors) are performing their regular examination of our financial statements. Accordingly, please send directly to our auditors a list of our securities owned at (insert date) and the amount of principal and income cash held by you at that date for each of the following accounts [Notes (C) & (D)]:

	Name of account	Account no. [Note (B)]
1.	.....	.....
2.	.....	.....
3.	.....	.....

Please also indicate to the auditors whether to your knowledge any of the securities are pledged or otherwise encumbered.

Please mail your reply directly to the auditors. A stamped, addressed envelope is enclosed for your convenience.

Very truly yours,

(Client's authorized signature)

---

NOTES TO USER:

- (A) The request should be sent so it reaches the trustees or custodians sufficiently in advance of the listing date for them to respond in a practical manner.
- (B) Use the custodian or trustee's account number.
- (C) This letter may be expanded, if necessary, to request cutoff statements of activity (principal and interest) in the accounts.
- (D) Sometimes this request is combined with a request for cutoff bank statements and a standard bank confirmation. However, it may be more practical to send separate letters because a bank's commercial banking and trust departments are usually separate operations.

**.07 Securities Held by Brokers**

(Prepared on client's letterhead)

(Date) [Note (A) below]

(Broker's Name)

(Address)

Dear .....

In connection with their regular examination of our financial statements, please send directly to our auditors (insert name and address of auditors), a statement of our account(s) [Note (B)] with you as of (insert date), indicating the following information:

1. Securities held by you for our account.
2. Securities out for transfer to our name.
3. Any amounts payable to or due from us.

Please mail your reply directly to the auditors. A stamped, addressed envelope is enclosed for your convenience.

Very truly yours,

(Client's authorized signature)

## NOTES TO USER:

- (A) The request should be sent so it reaches the broker sufficiently in advance of the listing date for the broker to respond in a practical manner.
- (B) It may be helpful to include the account number(s) used by the broker for the client's account(s).

**.08 Sample Receipts for Return of Cash or Securities Counted by Auditor's Representative, and Cutoff Bank Statements Received Directly by the Auditors**

**Cash Count**

The above detailed items were counted in my presence and returned to me intact by (insert individual's name), representative of (insert auditor's firm name).

(Date and Time) Custodian .....  
(custodian's signature)

**Securities Count**

Received intact from (insert individual's name), representative of (insert auditor's firm name), the securities listed above contained in Box ..... of the (insert name of bank or custodian) which were counted by him in my presence (or presented to him for count).

Date and Time ..... Signed .....  
Title .....

**Cutoff Bank Statement(s)**

Received intact from (insert individual's name), representative of (insert auditor's firm name), the cutoff bank statements and related paid checks for the period from ..... to ..... (periods indicated) for the accounts listed below:

Date and Time ..... Signed .....  
Title .....

---

**NOTES TO USER:**

- Receipt(s) should be written and signed in *ink*.
- For counts of petty cash funds, the receipt may be written directly on the bottom of the petty cash-count working paper. For security counts and returns of cutoff bank statements, the receipt may be prepared as a separate working paper.



**.09 Accounts Receivable—Positive**

(Prepared on client's letterhead)

(Date)

(Customer's Name)

(Address)

Dear ..... :

In connection with their regular examination of our financial statements, please confirm directly to our auditors (insert name and address of auditors) the amount of your indebtedness to us which according to our records as of (insert date) amounted to \$.....

If the amount shown is in agreement with your records at that date, please sign in the place provided below and return this letter directly to our auditors in the enclosed envelope.

If the amount is not in agreement with your records, please note the amount shown in your records and any information which may help reconcile the difference on the back of this letter and send it directly to our auditors in the enclosed envelope.

Remittances should not be sent to the auditors.

Very truly yours,

(Client's authorized signature)

\_\_\_\_\_

The above stated amount is correct as of (insert date) with the following exceptions (if any): .....

.....

.....  
(Signed by)

.....  
(Title)

**NOTES TO USER:**

- The auditor should consider sending confirmation requests at the time of the client's regular monthly billings. Coordination of confirmation procedures with the client's routine preparation and mailing of statements may offer efficiency to both the auditor and client.
- Some auditors use their own standard forms for accounts receivable confirmation requests rather than correspondence prepared by the client. In such instances, it may be advisable for the form to include a prominent notice that "this is not a request for payment."

**.10 Accounts Receivable—Negative**

(May be a sticker or stamp used on client's statements to customers)

PLEASE CHECK THIS STATEMENT

If this statement is *not correct* please write promptly (using the enclosed envelope), giving details of any differences, directly to our auditors,

(Name of auditors)

(Address of auditors)

who are now making an examination of our financial statements.

If you do not write to our auditors, they will consider this statement to be correct.

Remittances should NOT be sent to the auditors.

---

**NOTES TO USER:**

- A negative confirmation may also be requested in letter form using similar wording.
- The auditor should consider sending confirmation requests at the time of the client's regular monthly billings. Coordination of confirmation procedures with the client's routine preparation and mailing of statements may offer efficiency to both the auditor and client.

**.11 Notes Receivable**

(Prepared on client's letterhead)

(Date)

(Name)  
(Address)

Dear .....

Our auditors (insert name and address of auditors) are performing their regular examination of our financial statements. Accordingly, please confirm directly to our auditors the amount of your note(s) and collateral held by us as of (insert date), and the interest rate and date to which interest has been paid, which our records show as follows:

<u>Date of Note</u>	<u>Due Date</u>	<u>Original Amount</u>	<u>Unpaid Principal</u>	<u>Interest Rate</u>	<u>Interest Paid to</u>
---------------------	-----------------	------------------------	-------------------------	----------------------	-------------------------

Collateral:

If the above information is in agreement with your records at that date, please so indicate by signing in the place provided below and return the copy of this letter directly to our auditors in the enclosed envelope.

If the above is not in agreement with your records, please note in the space provided the particulars shown in your records and any information which may help reconcile the difference from our records. Remittances should not be sent to the auditors.

Very truly yours,

(Client's authorized signature)

\_\_\_\_\_

The above information is correct as of (insert date) with the following exceptions (if any):  
.....  
.....  
.....

(Signed by)

(Title)

## **.12 Inventories Held by Warehouses or Others When Listing Is Not Provided by Client**

(Prepared on client's letterhead)

(Date)

(Name of warehouse)

(Address)

Dear .....

Our auditors (insert name and address of auditors) are performing their regular examination of our financial statements. Accordingly, please send directly to our auditors the following information about merchandise held in your custody for our account at (insert date) :

1. Quantities on hand; for each lot please indicate the following:
  - (a) Lot number (list each lot separately)
  - (b) Date received
  - (c) Kind of merchandise
  - (d) Unit of measure or package
    - (1) Number of units
    - (2) Kind of units (box, can, crate, quart, pound, dozen, etc.)
2. A statement about how you determined the above requested quantities; specify whether they were determined by physical count, weight or measure, or if they represent your book record.
3. A list of negotiable or nonnegotiable warehouse receipts issued, if any, and whether or not such receipts have, to your knowledge, been assigned or pledged.
4. Statement of any known liens against this merchandise.
5. Amount of unpaid charges, if any, as of (insert date).

Please mail your reply directly to the auditors. A stamped, addressed envelope is enclosed for your convenience.

Very truly yours,

(Client's authorized signature)

### **.13 Inventories Held by Warehouses or Others When Listing Is Provided by Client**

(Prepared on client's letterhead)

(Date)

(Name of Warehouse)  
(Address)

Dear .....

Our auditors (insert name and address of auditors) are performing their regular examination of our financial statements. Accordingly, please confirm directly to our auditors the following information about the merchandise held by you for our account as of (insert date) :

1. The correctness of the quantities shown on the enclosed listing of such merchandise prepared from our records (a second copy is enclosed for your files). If the enclosed listing differs from the quantities you held for us as of (insert date), please include details of the specific differences in your response to our auditors.
2. Your statement on how you determined the correctness of the quantities you are confirming; please specify whether determined by physical count, weight or measure, or whether the quantities are from your records.
3. A list of negotiable or nonnegotiable warehouse receipts issued, if any, and whether or not such receipts have, to your knowledge, been assigned or pledged.
4. Statement of any known liens against these goods.
5. Amount of any unpaid charges as of (insert date).

Please mail your reply directly to (insert name and address of auditors). A stamped, addressed envelope is enclosed for your convenience.

Very truly yours,

(Client's authorized signature)

➤➤➤ *The next page is 7215.* ←➤➤➤



.14

STANDARD CONFIRMATION INQUIRY  
FOR LIFE INSURANCE POLICIES

Developed by  
AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS  
LIFE OFFICE MANAGEMENT ASSOCIATION  
MILLION DOLLAR ROUND TABLE

**ORIGINAL**  
To be mailed to accountant

19

Dear Sirs:

Please furnish the information requested below in items 1 through 9 (and also in items 10 through 12 if any of those items are checked) for the policies identified on lines A, B and C. This information is requested as of the date indicated. **IF THE ANSWER TO ANY ITEM IS "NONE," PLEASE SO STATE.** The enclosed envelope is provided for the return of one copy of this form to the accountant named below.

(Ins. Co.) \_\_\_\_\_

\_\_\_\_\_  
(Name of owner as shown on policy contracts)

Information requested as of \_\_\_\_\_

(Accountant) \_\_\_\_\_

Request authorized by \_\_\_\_\_

	Col. A	Col. B
<b>A.</b> Policy number		
<b>B.</b> Insured		
<b>C.</b> Beneficiaries as shown on policies (if verification requested in item 11) Col. A— Col. B—		
<b>1.</b> Face amount of basic policy	\$	\$
<b>2.</b> Values shown as of (insert date if other than date requested)		
<b>3.</b> Premiums, including prepaid premiums, are paid to (insert date)		
<b>4.</b> Policy surrender value (excluding dividends, additions and indebtedness adjustments)	\$	\$
<b>5.</b> Surrender value of all dividend credits, including accumulations and additions	\$	\$
<b>6.</b> Termination dividend currently available on surrender	\$	\$
<b>7.</b> Other surrender values available to policyowner	a. Prepaid premium value	\$
	b. Premium deposit funds	\$
	c. Other	\$
<b>8.</b> Outstanding policy loans, excluding accrued interest	\$	\$
<b>9.</b> If any loans exist, complete either "a" or "b" a. Interest accrued on policy loans	\$	\$
	b. 1.) Loan interest is paid to (enter date)	
	2.) Interest rate is (enter rate)	

The accountant will indicate by a check (✓) which if any of items 10-12 are to be answered

<input type="checkbox"/>	<b>10.</b> Is there an assignee of record? (enter Yes or No)		
<input type="checkbox"/>	<b>11.</b> Is beneficiary of record as shown in item C above? (enter Yes or No*)	*	*
<input type="checkbox"/>	<b>12.</b> Is the name of policyowner (subject to any assignment) as shown at the top of the form? (enter Yes or No) If No, enter name of policyowner of record. _____		

\*If answer to 11 is No, please give name of beneficiary or date of last beneficiary change. \_\_\_\_\_

Date \_\_\_\_\_ By \_\_\_\_\_ Title \_\_\_\_\_

For the insurance company addressed

Additional copies of this form are available from the American Institute of CPAs, 1211 Avenue of the Americas, New York, N. Y. 10036

STANDARD CONFIRMATION INQUIRY  
FOR LIFE INSURANCE POLICIES

Developed by  
AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS  
LIFE OFFICE MANAGEMENT ASSOCIATION  
MILLION DOLLAR ROUND TABLE

**D U P L I C A T E**  
To be retained by insurance company

\_\_\_\_\_ 19\_\_\_\_

Dear Sirs:

Please furnish the information requested below in items 1 through 9 (and also in items 10 through 12 if any of those items are checked) for the policies identified on lines A, B and C. This information is requested as of the date indicated. **IF THE ANSWER TO ANY ITEM IS "NONE," PLEASE SO STATE.** The enclosed envelope is provided for the return of one copy of this form to the accountant named below.

(Ins. Co.) \_\_\_\_\_

\_\_\_\_\_ (Name of owner as shown on policy contracts)

Information requested as of \_\_\_\_\_

(Accountant) \_\_\_\_\_

Request authorized by \_\_\_\_\_

	Col. A	Col. B
<b>A.</b> Policy number		
<b>B.</b> Insured		
<b>C.</b> Beneficiaries as shown on policies (if verification requested in item 11) Col. A— Col. B—		
<b>1.</b> Face amount of basic policy	\$	\$
<b>2.</b> Values shown as of (insert date if other than date requested)		
<b>3.</b> Premiums, including prepaid premiums, are paid to (insert date)		
<b>4.</b> Policy surrender value (excluding dividends, additions and indebtedness adjustments)	\$	\$
<b>5.</b> Surrender value of all dividend credits, including accumulations and additions	\$	\$
<b>6.</b> Termination dividend currently available on surrender	\$	\$
<b>7.</b> Other surrender values available to policyowner	a. Prepaid premium value	\$
	b. Premium deposit funds	\$
	c. Other	\$
<b>8.</b> Outstanding policy loans, excluding accrued interest	\$	\$
<b>9.</b> If any loans exist, complete either "a" or "b"		
<b>a.</b> Interest accrued on policy loans	\$	\$
<b>b.</b> 1.) Loan interest is paid to (enter date)		
2.) Interest rate is (enter rate)		

The accountant will indicate by a check (✓) which if any of items 10-12 are to be answered

<input type="checkbox"/>	<b>10.</b> Is there an assignee of record? (enter Yes or No)		
<input type="checkbox"/>	<b>11.</b> Is beneficiary of record as shown in item C above? (enter Yes or No*)	*	*
<input type="checkbox"/>	<b>12.</b> Is the name of policyowner (subject to any assignment) as shown at the top of the form? (enter Yes or No) If No, enter name of policyowner of record. _____		

\*If answer to 11 is No, please give name of beneficiary or date of last beneficiary change. \_\_\_\_\_

Date \_\_\_\_\_ By \_\_\_\_\_ Title \_\_\_\_\_

For the insurance company addressed

Additional copies of this form are available from the American Institute of CPAs, 1211 Avenue of the Americas, New York, N. Y. 10036



**.15 Pension Plan Actuarial Cost Information**

(Prepared on client's letterhead)

(Date)

(Name of Actuary)

(Address)

Dear .....

Our auditors (insert name and address of auditors) are performing their regular examination of our financial statements as of (insert date) and for the (insert period) then ended. Accordingly, information is needed so we may determine the amounts of pension cost and other information to be disclosed in our financial statements in conformity with Opinion No. 8 issued by the Accounting Principles Board of the American Institute of Certified Public Accountants (APB No. 8).

In this connection, please provide our auditors with the following information about our Employees' Pension Plan (list the plans where several plans exist and are accounted for separately) as of the date when you last made an actuarial valuation of our Plan(s) :

1. Date of your most recent valuation.
2. Actuarial cost method(s) used.
3. Pension cost for the most recent year, specifically:
  - a. Normal cost.
  - b. Past service cost.
  - c. Vested benefit cost (if applicable).
4. Unfunded prior service cost, if any, at most recent valuation date.
5. Prior service cost arising from amendments to the plan, if any, indicating:
  - a. Date amendment established.
  - b. Initial amount at amendment date.
  - c. Unfunded amount at most recent valuation date.
  - d. Period of amortization.
6. Interest rate used in determining costs.
7. Actuarially computed value of unfunded vested benefits.
8. Total assets of the pension fund. (Indicate basis of valuation.)

9. Net annual actuarial gain or loss for most recent year, if separately calculated. Indicate method of recognizing such gains and losses in present or future actuarial determinations.
10. Indicate basis and extent of recognition, if any, of unrealized appreciation and depreciation of pension fund investments in actuarial determinations.
11. Minimum age or length of service, if any, used to exclude employees from basis for actuarial determinations, and your estimate of the effect of those exclusions on the pension cost calculations.
12. Describe any changes since your previous review or report in the matters covered by Items 2, 4 and 5 (re period of amortization), 6, 8 (re basis of valuation), 9 (re method of recognition), 10, and 11.
13. Describe any changes in actuarial assumptions and/or cost method used, and their approximate total dollar effect on annual pension cost.
14. Indicate whether your responses to the above items, in your opinion as actuaries for the Plan(s) have been made in accordance with the related provisions of APB Opinion No. 8. If not, describe the specific difference(s).
15. Indicate whether, in your opinion, the plan conforms to the requirements of ERISA.

A copy of your report covering the above items will suffice. If some of the above items are not covered in the report, please provide supplementary data.

Please mail your reply directly to the auditors. A stamped addressed envelope is enclosed for your convenience.

Very truly yours,

(Client's authorized signature)

**.16 Pension Plan Assets Held by Trustee**

(Prepared on client's letterhead)

(Date)

(Name of trustee or custodian)

(Address)

Dear .....

Our auditors (insert name and address of auditor) are now examining our financial statements. Accordingly, please provide our auditors directly with a listing of the assets including market values as of (insert date) for our employees' pension trust (insert title and trustee's account number).

Please also provide the auditors with the following information about our employees' pension trust for the period from (insert date) to (insert date) [see note below]:

1. Contributions by the Company during the above period.
2. Contributions by employees during the above period.
3. Payments to beneficiaries during the above period.
4. Any unpaid fees due for services rendered to (insert audit date).

Please send your reply directly to our auditors. A stamped addressed envelope is enclosed for your convenience.

Very truly yours,

(Client's authorized signature)

---

## NOTE TO USER:

A listing of the assets might not be requested if one had already been received by the client. In that case, the auditor might want the trustee to confirm the total market value per the listing.

**.17 Notes Payable**

(Prepared on client's letterhead)

(Date)

(Name)

(Address)

Dear .....

Our auditors (insert name and address) are performing their regular examination of our financial statements.

Accordingly, please confirm directly to them the following information relating to our note(s) payable to you, as of (insert date) :

Date of Note : (insert date)

Original Amount : (insert amount)

Unpaid Principal

Balance : (insert amount)

Maturity Date : (insert date)

Interest Rate : (insert rate)

Date to which interest has been paid : (insert date)

Amount and description of collateral : (insert description)

Any other direct or contingent liabilities to you : (insert "None" or description)

If the above information is in agreement with your records at that date, please so indicate by signing in the place provided below and return the copy of this letter directly to our auditors in the enclosed envelope.

If the above is not in agreement with your records, please note in the space provided the particulars shown in your records and any information which may help reconcile the difference from our records.

Very truly yours,

(Client's authorized signature)

The above information is correct as of (insert date) with the following exceptions (if any) : .....

Date ..... Signature ..... Title .....

**NOTE TO USER:**

Banks would ordinarily confirm this information in connection with the Standard Bank Confirmation form. Depending upon the note agreement, however, additional items may need to be requested.

**.18 Mortgage Debt**

(Prepared on client's letterhead)

(Date)

(Name of creditor or trustee)

(Address)

Dear . . . . . :

Our auditors (insert name and address of auditors) are now performing their regular annual examination of our financial statements. In this connection, please confirm directly to our auditors the following information about our mortgage indebtedness to you as of (insert date):

1. Unpaid principal balance.
2. Interest rate.
3. Terms for payment of principal.
4. Date to which interest has been paid.
5. Nature of mortgage and description or address of property mortgaged.
6. Amounts on deposit with you in escrow for:
  - a. Insurance
  - b. Real estate taxes
7. Amounts paid during the period (insert dates from and to) for:
  - a. Insurance
  - b. Taxes
8. Amounts on deposit with you for the "reserve for repairs."
9. The nature of defaults, if any.

A return envelope is enclosed for your reply.

Very truly yours,

(Client's authorized signature)

---

**NOTE TO USER:**

Many of the items requested will vary with the circumstances of the particular mortgage or other debt involved. The above sample assumes the indenture involves an escrow arrangement for insurance and real estate taxes and a deposit account for repairs.

**.19 Accounts Payable**

(Prepared on client's letterhead)

(Date)

(Name)  
(Address)

Dear .....:

In connection with their regular examination of our financial statements, please confirm directly to our auditors (insert name and address of auditors), whether or not there is a balance due you as of (insert date). If there is a balance due, please indicate the amount in the space provided below and attach a statement of the items making up the balance.

Please mail your reply directly to (name of auditors). A stamped addressed envelope is enclosed for your convenience.

Very truly yours,

(Client's authorized signature)



Our records indicate that a balance of \$. . . . . was due from (insert name of client) at (insert date) as itemized in the attached statement.

Date .....

Signed .....

Title .....

**.20 Obligation to Lessor**

(Prepared on client's letterhead)

(Date)

(Name of lessor)

(Address)

Dear .....

Our auditors (insert name and address of auditors) are performing their regular examination of our financial statements as of (insert balance sheet date) and for the (insert time period) then ended. In connection with this examination, please provide directly to our auditors the following information as of (insert balance sheet date) regarding the lease dated (insert date lease was executed) of (insert brief identification of property under lease) which we are leasing from you:

1. Inception and expiration dates for the lease period, from ..... to .....
2. Amount of monthly rent .....
3. Renewal options (if any) :
  - a. Dates of renewal period, from ..... to .....
  - b. Amount of monthly rent for renewal .....
4. Purchase options (if any) :
  - a. Amount of purchase price .....
  - b. Inception and expiration dates of option, from ..... to .....
  - c. Percent of monthly rent (if any) applicable towards purchase price .....
5. Dates and descriptions of amendments or supplementary understandings, if any, to the lease mentioned above.
6. The amount of outstanding delinquent payments, if any.
7. A statement that there are no defaults, or the nature of defaults, if any.

A return envelope is enclosed for your reply.

Very truly yours,

(Client's authorized signature)

**NOTE TO USER:**

The content of this type of letter will vary based on the auditor's professional judgment in the circumstances. To provide additional illustrative language, the above letter is not made parallel with the illustration at AAM section 7200.21.

**.21 Property Out on Lease**

(Prepared on client's letterhead)

(Date)

(Name of Lessee)

(Address)

Dear .....

Our auditors (insert name and address of auditors) are making their regular examination of our financial statements as of (insert balance sheet date) and for the (insert time period) then ended. In connection with this examination, please confirm directly to our auditors the following information regarding the lease dated (insert execution date of lease) of (insert brief identification of property under lease) which you are leasing from us:

1. Inception and expiration dates of lease period from ..... to .....
2. Amount of monthly rent .....
3. Total rental payments made .....
4. Date of last payment .....

A return envelope is enclosed for your reply.

Very truly yours,

(Client's authorized signature)

---

**NOTES TO USER:**

- If the leased property is of a mobile or portable nature such as a bulldozer or television camera, the confirmation may also include a request for specific serial numbers of significant equipment.
- In certain circumstances, the auditor may wish to consider confirming additional information such as renewal options, purchase options, and amendments or supplementary understandings.



**.22 Registrar—Capital Stock**

(Prepared on client's letterhead)

(Date)

(Name of Registrar)

(Address)

Dear .....

Our auditors (insert name and address of auditors) are performing their regular examination of our financial statements. Accordingly, please confirm directly to our auditors the following information as of the close of business (insert balance sheet date) about each class of our preferred and common stock:

1. Authorized number of shares
2. Issued number of shares
3. Outstanding number of shares

Please also indicate the amount of any unpaid registrar fees due you as of (insert balance sheet date).

A return envelope is enclosed for your convenience.

Very truly yours,

(Authorized signature for client)

---

**NOTES TO USER:**

- It may be helpful to include the registrar's account number for the client's account to receive a timely response.
- Some auditors prefer that the confirmation request include identification of each class of stock.
- The above illustration assumes the client has a separate transfer agent (see AAM section 7200.23).

**.23 Transfer Agent—Capital Stock**

(Prepared on client's letterhead)

(Date)

(Name of Transfer Agent)

(Address)

Dear .....

Our auditors (insert name and address of auditors) are performing their regular examination of our financial statements. Accordingly, please confirm directly to our auditors the following information as of (insert balance sheet date) about each class of our preferred and common stock:

1. Authorized number of shares
2. Number of shares issued and outstanding
3. Number of outstanding shares registered in the name of our Company.

Please also indicate the amount of any unpaid transfer agent fees due you as of (insert balance sheet date).

A return envelope is enclosed for your convenience.

Very truly yours,

(Authorized signature for client)

## NOTES TO USER:

- It may be helpful to include the transfer agent's account number for the client's account to receive a timely response.
- Some auditors prefer that the confirmation request include identification of each class of stock.
- Depending on the auditor's judgment in the circumstances the confirmation request may also include inquiries about such matters as (i) the number of shares issued to each of specifically mentioned officers and directors, (ii) specified information about shareholders owning more than a stated percent of the total outstanding shares, and (iii) amounts deposited during the year for the payment of dividends.

»»»→ *The next page is 7301.* ←«««

## AAM Section 7300

### *Inquiries to Legal Counsel*

#### **.01 Illustrative Inquiry Letter to Legal Counsel <sup>1</sup>**

(Prepared on client's letterhead)

Date [See Note A]

(Name of lawyer)

(Address of lawyer)

Dear .....

In connection with an examination of our financial statements at (balance sheet date) and for the (period) then ended, management of the Company has prepared, and furnished to our auditors (name and address of auditors), a description and evaluation of certain contingencies, including those set forth below involving matters with respect to which you have been engaged and to which you have devoted substantive attention on behalf of the Company in the form of legal consultation or representation. These contingencies are regarded by management of the Company as material for this purpose (management may indicate a materiality limit if an understanding has been reached with the auditor). Your response should include matters that existed at (balance sheet date) and during the period from that date to the date of your response.

#### **Pending or Threatened Litigation** (excluding unasserted claims)

[Ordinarily the information would include the following: (1) the nature of the litigation, (2) the progress of the case to date, (3) how management is responding or intends to respond to the litigation (for example, to contest the case vigorously or to seek an out-of-court settlement), and (4) an evaluation of the likelihood of an unfavorable outcome and an estimate, if one can be made, of the amount or range of potential loss.]

<sup>1</sup> Extracted from the Appendix to Statement on Auditing Standards No. 12 [AU section 337A, Volume 1, *AICPA Professional Standards*]. [See Note B.]

Please furnish to our auditors such explanation, if any, that you consider necessary to supplement the foregoing information, including an explanation of those matters as to which your views may differ from those stated and an identification of the omission of any pending or threatened litigation, claims, and assessments or a statement that the list of such matters is complete.

#### **Unasserted Claims and Assessments**

(considered by management to be probable of assertion, and that, if asserted, would have at least a reasonable possibility of an unfavorable outcome)

[Ordinarily management's information would include the following: (1) the nature of the matter, (2) how management intends to respond if the claim is asserted, and (3) an evaluation of the likelihood of an unfavorable outcome and an estimate, if one can be made, of the amount or range of potential loss.]

Please furnish to our auditors such explanation, if any, that you consider necessary to supplement the foregoing information, including an explanation of those matters as to which your views may differ from those stated.

We understand that whenever, in the course of performing legal services for us with respect to a matter recognized to involve an unasserted possible claim or assessment that may call for financial statement disclosure, if you have formed a professional conclusion that we should disclose or consider disclosure concerning such possible claim or assessment, as a matter of professional responsibility to us, you will so advise us and will consult with us concerning the question of such disclosure and the applicable requirements of Statement of Financial Accounting Standards No. 5. Please specifically confirm to our auditors that our understanding is correct.

Please specifically identify the nature of and reasons for any limitation on your response.

[The auditor may request the client to inquire about additional matters, for example, unpaid or unbilled charges or specified information on certain contractually assumed obligations of the company, such as guarantees of indebtedness of others.]

Very truly yours,

(Authorized signature for client)

## NOTES TO USER:

- (A) Sending of this letter should be timed so that the lawyer's response is dated as close to the auditor's opinion date as practicable. However, the auditor and client should consider early mailing of a draft inquiry as a convenience for the lawyer in preparing a timely response to the formal inquiry letter.
  - (B) Auditors should carefully consider the provisions of SAS No. 12 in drafting this letter.
- 

»»»→ *The next page is 7401.* ←«««



## AAM Section 7400

### **Representation Letters**

#### **.01 Illustrative Representation Letter—Examination of Financial Statements**

**Introductory Comment** (Extracted from the Appendix to SAS No. 19 [AU section 333A, Volume 1, *AICPA Professional Standards*])

The following letter is presented for illustrative purposes only. The written representations to be obtained should be based on the circumstances of the engagement and the nature and basis of presentation of the financial statements being examined. The introductory paragraph should specify the financial statements and periods covered by the auditor's report, for example, "balance sheets of XYZ Company as of December 31, 19X1 and 19X0, and the related statements of income and retained earnings and changes in financial position for the years then ended." Similarly, representations concerning inventories and sales and purchase commitments would not be obtained if such items are not material to the company's financial position and results of operations or if they are not recorded in the financial statements under a comprehensive basis of accounting other than generally accepted accounting principles, for example, financial statements prepared on the cash basis of accounting.

The illustrative letter assumes that there are no matters requiring specific disclosure to the auditor. If such matters exist, they should be indicated by listing them following the representation, by reference to accounting records or financial statements, or by other similar means. For example, if an event subsequent to the date of the balance sheet has been disclosed in the financial statements, item 14 could be modified as follows: "Except as discussed in Note X to the financial statements, no events have occurred. . . ." Similarly, in appropriate circumstances, item 4 could be modified as follows: "We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities, except that certain marketable securities have been excluded from current assets based on our intention not to dispose of them, which is supported by the minutes of the December 7, 19X1, meeting of the board of directors."

Certain terms are used in the illustrative letter that are defined elsewhere in authoritative literature, for example, irregularities (SAS No. 16 [AU section 327, Volume 1, *AICPA Professional Standards*]) and related party transactions (SAS No. 6 [AU section 335, Volume 1, *AICPA Professional Standards*]). To avoid misunderstanding concerning the meaning of such terms, the auditor may wish to furnish those definitions to the

client and request that the client include the definitions in the written representations.

The illustrative letter assumes that management and the auditor have reached an understanding on the limits of materiality for purposes of the written representations. However, it should be noted that a materiality limit would not apply for certain representations, as explained in SAS No. 19, paragraph 5 [AU section 333.05, Volume 1, *AICPA Professional Standards*].

**Illustrative Representation Letter** (Extracted from the Appendix to SAS No. 19 [AU section 333A, Volume 1, *AICPA Professional Standards*])

(Prepared on client's letterhead)

(Date of Auditor's Report)

(To Independent Auditor)

In connection with your examination of the (identification of financial statements) of (name of client) as of (date) and for the (period of examination) for the purpose of expressing an opinion as to whether the (consolidated) financial statements present fairly the financial position, results of operations, and changes in financial position of (name of client) in conformity with generally accepted accounting principles (other comprehensive basis of accounting), we confirm, to the best of our knowledge and belief, the following representations made to you during your examination.

1. We are responsible for the fair presentation in the (consolidated) financial statements of financial position, results of operations, and changes in financial position in conformity with generally accepted accounting principles (other comprehensive basis of accounting).
2. We have made available to you all—
  - a. Financial records and related data.
  - b. Minutes of the meetings of stockholders, directors, and committees of directors, or summaries of actions of recent meetings for which minutes have not yet been prepared.
3. There have been no—
  - a. Irregularities involving management or employees who have significant roles in the system of internal accounting control.
  - b. Irregularities involving other employees that could have a material effect on the financial statements.
  - c. Communications from regulatory agencies concerning noncompliance with, or deficiencies in, financial reporting practices that could have a material effect on the financial statements.



4. We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities.
5. The following have been properly recorded or disclosed in the financial statements:
  - a. Related party transactions and related amounts receivable or payable, including sales, purchases, loans, transfers, leasing arrangements, and guarantees.
  - b. Capital stock repurchase options or agreements or capital stock reserved for options, warrants, conversions, or other requirements.
  - c. Arrangements with financial institutions involving compensating balances or other arrangements involving restrictions on cash balances and line-of-credit or similar arrangements.
  - d. Agreements to repurchase assets previously sold.
6. There are no—
  - a. Violations or possible violations of laws or regulations whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency.
  - b. Other material liabilities or gain or loss contingencies that are required to be accrued or disclosed by Statement of Financial Accounting Standards No. 5 [AC section 4311, Volume 3, *AICPA Professional Standards*].
7. There are no unasserted claims or assessments that our lawyer has advised us are probable of assertion and must be disclosed in accordance with Statement of Financial Accounting Standards No. 5 [AC section 4311, Volume 3, *AICPA Professional Standards*].
8. There are no material transactions that have not been properly recorded in the accounting records underlying the financial statements.
9. Provision, when material, has been made to reduce excess or obsolete inventories to their estimated net realizable value.
10. The company has satisfactory title to all owned assets, and there are no liens or encumbrances on such assets nor has any asset been pledged.
11. Provision has been made for any material loss to be sustained in the fulfillment of, or from inability to fulfill, any sales commitments.
12. Provision has been made for any material loss to be sustained as a result of purchase commitments for inventory quantities in excess of normal requirements or at prices in excess of the prevailing market prices.
13. We have complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.

14. No events have occurred subsequent to the balance sheet date that would require adjustment to, or disclosure in, the financial statements.

.....  
(Name of Chief Executive  
Officer and Title)

.....  
(Name of Chief Financial  
Officer and Title)

---

NOTES TO USER:

This illustration is only one example of a representation letter. Alternate wording is permissible and it may be advisable to tailor the letter to the needs of an engagement. (See "Management representation letters—adapting them to the circumstances," by Brian Zell and Douglas R. Carmichael, Professional Notes, *Journal of Accountancy*, March 1979, pages 87-90.)

A booklet entitled *The Representation Letter* (New York, AICPA, 1978) explains to clients the purpose of representation letters.

## **.02 Illustrative Representation Letter—Review of Financial Statements**

### **Introductory Comment**

For reviews of financial statements, the following guidance is set forth in Statement on Standards for Accounting and Review Services (SSARS) No. 1, paragraph 31 [AR section 100.31, Volume 1, *AICPA Professional Standards*]:

The accountant may wish to obtain a representation letter from the owner, manager, or chief executive officer, and if appropriate, the chief financial officer.

The following comment is set forth in Appendix D to SSARS No. 1 [AR section 100.55, Volume 1, *AICPA Professional Standards*]:

A review of financial statements consists principally of inquiries of company personnel and analytical procedures applied to financial data. Because a review does not contemplate tests of accounting records and of responses to inquiries by obtaining corroborating evidential matter, among other things, the accountant may consider it advisable to obtain a written representation from his client to confirm the oral representations made to him. The following representation letter is included for illustrative purposes only. The accountant may decide, based on the circumstances of his review engagement, that other matters should be specifically included in the letter and that some of the representations included in the illustrative letter are not necessary.

### **Illustrative Representation Letter (from Appendix D to SSARS No. 1)**

(Prepared on client's letterhead)

(Date of Accountant's Report)

(To the Accountant)

In connection with your review of the (identification of financial statements) of (name of client) as of (date) and for the (period of review) for the purpose of expressing limited assurance that there are no material modifications that should be made to the statements in order for them to be in conformity with generally accepted accounting principles, we confirm, to the best of our knowledge and belief, the following representations made to you during your review.

1. The financial statements referred to above present the financial position, results of operations, and changes in financial position of (name of client) in conformity with generally accepted accounting principles. In that connection, we specifically confirm that—

- a. The company's accounting principles, and the practices and methods followed in applying them, are as disclosed in the financial statements.
  - b. There have been no changes during the (period reviewed) in the company's accounting principles and practices.
  - c. We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities.
  - d. There are no material transactions that have not been properly reflected in the financial statements.
  - e. There are no material losses (such as from obsolete inventory or purchase or sales commitments) that have not been properly accrued or disclosed in the financial statements.
  - f. There are no violations or possible violations of laws or regulations whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency, and there are no other material liabilities or gain or loss contingencies that are required to be accrued or disclosed.
  - g. The company has satisfactory title to all owned assets, and there are no liens or encumbrances on such assets nor has any asset been pledged.
  - h. There are no related party transactions or related amounts receivable or payable that have not been properly disclosed in the financial statements.
  - i. We have complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.
  - j. No events have occurred subsequent to the balance sheet date that would require adjustment to, or disclosure in, the financial statements.
2. We have advised you of all actions taken at meetings of stockholders, board of directors, and committees of the board of directors (or other similar bodies, as applicable) that may affect the financial statements.
  3. We have responded fully to all inquiries made to us by you during your review.

.....  
 (Name of Owner or Chief Executive  
 Officer and Title)

.....  
 (Name of Chief Financial Officer  
 and Title, where applicable)

## AAM Section 8000

# DISCLOSURE CHECKLISTS

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Many auditors and accountants find it helpful to use checklists as practice aids for disclosures required in financial statements and the preparation of their reports. These disclosure checklists typically consist of numerous brief inquiries which are accompanied by citations of particular paragraphs or sections in the applicable authoritative pronouncements. Because of the variables encountered in practice, these checklists cannot cover all circumstances. Any pronouncements issued after the updating of a checklist may require users to modify the checklist accordingly.

Some firms develop their own disclosure checklists for internal use. Some state CPA societies have developed financial reporting checklists as practice aids which may be available to other practitioners as well as their own members. Some commercial publishers also include disclosure checklists in certain of their publications. Included herein are the covering note, questions and cross reference tables on Auditor's Reports, Accountant's Reports on Compiled or Reviewed Financial Statements of Nonpublic Entities, and Financial Statements and Notes based on the checklist questionnaires used in the technical standards consulting review of the AICPA voluntary quality control review program for CPA firms. Those checklists may be purchased separately by members of the AICPA.

References to AICPA and FASB publications have been updated through SAS No. 27, SSARS No. 2, FASB Statement No. 34 and FASB Interpretation No. 30. These references are included in the Appendixes.

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➤ *The next page is 8101.* ←

**AAM Section 8100*****Notice to Users of the Technical Standards Consulting Review Checklist Questionnaires***

.01 The quality control standards committee intends that its checklists be used as a tool by trained personnel in reviewing working papers and reports of engagements in connection with technical standards reviews provided under the AICPA voluntary quality control review program for CPA firms. Such reviews are confidential consulting reviews that result in an oral report by the reviewers. Those checklists are also available, upon request, for purchase by AICPA members subject to their recognition of the following:

1. The checklists are “tools” and in no way represent official positions or pronouncements of the AICPA.
2. They are intended as a guide rather than a fixed program, and in application they will probably require some modification depending on the size and nature of the engagements being reviewed.
3. Pronouncements issued after preparation of the checklists will also require that they be modified accordingly.
4. The checklists should be used by persons having expert knowledge of generally accepted accounting principles, auditing standards, and standards for accounting and review services, and preferably by someone who has had experience in reviewing reports and working papers. An untrained person may find the checklists confusing and reach results and conclusions that may be meaningless or perhaps misleading.
5. The checklists were developed for use in reviewing engagements of general “for-profit” companies and probably will require extensive modification if applied to engagements of “not-for-profit” organizations and companies in specialized industries.

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➤ *The next page is 8201.* ←





## AAM Section 8200

### *Auditor's Report*

.01 Included in this section are materials based on an extract from the checklist questionnaire<sup>1</sup> for audited statement engagements used in the technical standards consulting review of the AICPA voluntary quality control review program for CPA firms. These materials have been updated by the staff of the AICPA technical information division and have not been reviewed by any senior technical committee of the AICPA.

.02 Following the checklist questionnaire is a cross reference table<sup>1</sup> indicating references to related pronouncements.

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<sup>1</sup> Based on *AICPA Technical Practice Aids*, QCR section 20,100.

Checklist Questionnaire

.03

NOTE:

SAS=Statement on Auditing Standards

The majority of cross-references to questions are contained in a cross-reference table at the end of the checklist. To determine the applicability of cross-referenced pronouncements, their effective date should be considered.

REMARKS

	YES	NO	N/A	REMARKS
1. If the auditor's report is unqualified, does its wording conform to the standard report?				
2. If required by the circumstances, does the auditor's report depart from the standard report?				
3. Do the circumstances presented in the working papers support the auditor's report?				
4. If necessary, does the auditor's report include recognition of the following:				
a. Part of the examination made by other independent auditors?				
b. Effect on financial statements of a departure from generally accepted accounting principles?				

1. If the auditor's report is unqualified, does its wording conform to the standard report?
2. If required by the circumstances, does the auditor's report depart from the standard report?
3. Do the circumstances presented in the working papers support the auditor's report?
4. If necessary, does the auditor's report include recognition of the following:
  - a. Part of the examination made by other independent auditors?
  - b. Effect on financial statements of a departure from generally accepted accounting principles?

Checklist Questionnaire (Continued)

	YES	NO	N/A	REMARKS
c. Reporting requirements for departure from a "Promulgated Accounting Principle?"				
d. Emphasis of a matter in a middle paragraph regarding the financial statements?				
e. Accounting principles not consistently applied?				
f. Uncertainties concerning future events, the outcome of which is not susceptible of reasonable estimation at the date of the auditor's report?				
g. Comparative financial statements with differing opinions?				
h. Updating of a previously issued opinion?				
i. Report of a predecessor auditor?				
j. Inclusion of unaudited financial statements?				

Checklist Questionnaire (Continued)

	YES	NO	N/A	REMARKS
k. Regulated companies?				
l. Negative assurances? (If a letter to an underwriter, see SAS No. 1, section 630 and SAS No. 26, paragraphs 18-20)				
m. Misstatement or omission of segment information if required?				
n. Omission, misstatement, or inability to apply prescribed procedures concerning supplementary information required by the FASB?				
5. Are the following appropriate:				
a. Date (or need for multiple dates) of report?				
b. Salutation used?				
6. If supplemental data accompanies the basic financial statements, does the auditors' report contain a clear-cut indication of the character of the examination and the degree of responsibility he is taking with respect to such data?				

Checklist Questionnaire (Continued)

REMARKS

YES NO N/A

YES	NO	N/A	REMARKS

7. If a short and long-form report is presented (issued) is the long-form presentation consistent with the short-form?

8. For special reports, have the provisions of SAS No. 14 been complied with for:

a. Statements prepared in accordance with a comprehensive basis of accounting other than generally accepted accounting principles?

b. Specified elements, accounts or items of a financial statement?

c. Compliance with aspects of agreements or regulatory requirements relating to audited financial statements?

d. Financial information presented in prescribed formats that require a prescribed form of auditor's report?

Checklist Questionnaire (Continued)

YES	NO	N/A	REMARKS

e. Segment information if applicable? (See Auditing Interpretation of SAS No. 21, "Applicability of SAS No. 21 to Nonpublic Companies," Journal of Accountancy, May 1978.) (AU section 9435.)

9. If a qualified opinion, adverse opinion or disclaimer was issued,

a. Were all the substantive reasons for the opinion or disclaimer adequately disclosed?

b. Was the reporting language clear and appropriate?

10. Is the firm aware that piecemeal opinions are prohibited?

11. If prior period statements used for comparative purposes were either unaudited or not examined by the reporting auditor are appropriate disclosures made in the auditor's report?

Checklist Questionnaire (Continued)

REMARKS

YES NO N/A

YES	NO	N/A	REMARKS

12. If financial statements of one or more prior periods are presented with those of the current year, does the language of the auditor's report appropriately cover the statements presented?

13. If the financial statements include representations to the effect that a related party transaction was consummated on terms no less favorable than those that would have been obtained if the transaction had been with an unrelated party, and the auditor--

- a. Was unable to reach a conclusion as to the propriety thereof, has the opinion been qualified or disclaimed?
- b. Believes that the representation is misleading, has the opinion been qualified or expressed as adverse depending upon materiality?

Checklist Questionnaire (Continued)

	YES	NO	N/A	REMARKS
14. If the work of a specialist was used, was the effect of the specialist's work on the auditor's report considered?				
15. If the financial statements include a note containing interim financial information, has the auditor's report been expanded, if required?				
16. If unaudited replacement cost information is presented:				
a. Is the language of the report appropriate?				
b. Does the language of the report reflect findings of the underlying procedures performed?				
17. Other remarks?				



.04

## Cross Reference Table to Pronouncements

NOTE: SAS=Statement on Auditing Standards  
 FASB=Statement of the Financial Accounting Standards Board  
 TB=Technical Bulletin issued by the staff of the FASB<sup>2</sup>

To determine the applicability of cross referenced pronouncements their effective dates should be considered

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**AUDITOR'S REPORT**

1. SAS No. 2, para. 7 (AU §509) and SAS No. 15, para. 3 (AU §505)
2. SAS No. 2, para. 9 (AU §509)
4.
  - a SAS No. 1, sec. 543 (AU §543) and SAS No. 2, para. 14 (AU §509)
  - b SAS No. 2, para. 9 and 15-19 (AU §509) and SAS No. 17, para. 15 (AU §328)
  - c SAS No. 2, paras. 9, 18, 19 (AU §509)
  - d SAS No. 2, paras. 9 and 27 (AU §509)
  - e SAS No. 1, secs. 420 & 546 (AU §420 and AU §546) and SAS No. 2, paras. 9, 20 and 38 (AU §509) See SAS No. 1, sec. 420.20-.21 for specific language of report (AU §420.20-.21)
  - f SAS No. 2, paras. 21-26 and 45 (AU §509) and SAS No. 17, para. 16 (AU §328)
  - g SAS No. 15, para. 5 (AU §505)
  - h SAS No 15, paras. 6-7 (AU §505)
  - i SAS No. 7 (AU §315) and SAS No. 15, paras. 8-12 (AU §505)

<sup>2</sup> The FASB staff issues FASB Technical Bulletins to provide guidance concerning the application of FASB Statements or Interpretations, APB Opinions, or Accounting Research Bulletins. FASB Technical Bulletins do not establish new financial accounting and reporting standards or amend existing standards.

## Cross Reference Table to Pronouncements (Continued)

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8200.03

- 4.
  - j SAS No. 26, paras. 14-17 (AU §504)
  - k SAS No. 1, sec. 544.02 (AU §554) and SAS No. 14 (AU §621)
  - l If a letter to an underwriter, see SAS No. 1, sec. 630 (AU §630) and SAS No. 26, paras. 18-20 (AU §504)
  - m SAS No. 21, paras. 8-16 (AU §435)  
FASB No. 21, paras. 12-16 (AC §2083)  
TB No. 79-8 (AC §B2083) re certain brokers and dealers in securities  
FASB No. 24, para. 5 (AC §2084)
  - n SAS No. 27, paras. 8-11 (AU §553)
- 5.
  - a SAS No. 1, sec. 530 (AU §530)
  - b SAS No. 2, para. 8 (AU §509)
- 6. SAS No. 1, sec. 610 (AU §610)
- 7. SAS No. 1, sec. 610.04 (AU §610)
- 8.
  - a SAS No. 14, paras. 2-8 (AU §621)
  - b SAS No. 14, paras. 9-17 (AU §621)
  - c SAS No. 14, paras. 18-19 (AU §621)
  - d SAS No. 14, paras. 20-21 (AU §621)
  - e SAS No. 14, paras. 10-13 (AU §621)  
SAS No. 21, paras. 17-18 (AU §435)  
FASB No. 21, paras. 12-16 (AC §2083)  
TB No. 79-8 (AC §B2083) re certain brokers and dealers in securities  
FASB No. 24, para. 5 (AC §2084)

## Cross Reference Table to Pronouncements (Continued)

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- 8.
    - e Auditing Interpretation of SAS No. 21 (AU §9435)
  - 9. SAS No. 2, paras. 15, 29-47 (AU §509)
  - 10. SAS No. 2, para. 48 (AU §509)  
For effective date - SAS No. 2, para. 50 (AU §509)
  - 11. SAS No. 2, paras. 10-12 (AU §509)  
SAS No. 15, paras. 8-12 (AU §505)  
SAS No. 26, paras. 14-17 (AU §504)
  - 12. SAS No. 15, paras. 2-7 (AU §505)
  - 13.
    - a SAS No. 6, para. 18 (AU §335)  
SAS No. 2, paras. 10-12 (AU §509)
    - b SAS No. 6, para. 18 (AU §335)  
SAS No. 2, paras. 15 and 16 (AU §509)  
SAS No. 19, para. 3 (AU §333)
  - 14. SAS No. 11, paras. 9-12 (AU §336)
  - 15. SAS No. 24, paras. 24-28 (AU §721)
  - 16.
    - a SAS No. 18, paras. 7-9 (AU §730)
    - b SAS No. 18, paras. 4-6 and 12 (AU §730)
- 

➤→ *The next page is 8301.* ←➤



**AAM Section 8300*****Accountant's Report on Compiled or Reviewed Financial Statements of Nonpublic Entities***

.01 Included in this section are materials based on an extract from the checklist questionnaire<sup>1</sup> for compiled or reviewed statements of nonpublic entities used in the technical standards consulting review of the AICPA voluntary quality control review program for CPA firms. These materials have been updated by the staff of the AICPA technical information division and have not been reviewed by any senior technical committee of the AICPA.

.02 Following the checklist questionnaire is a cross reference table to related pronouncements.

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**NOTE:**

Unaudited financial statements of some nonpublic entities are occasionally included in documents filed with the Securities and Exchange Commission. For example, a nonpublic entity may be required to file unaudited financial statements in connection with the issuance of stock to an employee stock purchase plan or in connection with the sale of certain limited partnership units.

Deciding whether an entity is public or nonpublic for purposes of determining the applicability of Statements on Standards for Accounting and Review Services involves consideration of all relevant facts and the application of professional judgment.

In the circumstances described above, the accountant might note that the definition of a nonpublic entity contained in SSARS No. 1 [AR section 100], developed from the definition of a publicly traded company in APB Opinion No. 28 [AC section 2071], differs from the definition of a nonpublic enterprise in FASB Statement No. 21 [AC section 2083], which excludes any entity "that is required to file financial statements with the Securities and Exchange Commission." This might lead the accountant to consider the significant responsibilities placed on independent accountants by the various securities acts. He might conclude that the users of unaudited financial state-

»»»→ *The next page is 8301-3.* ←«««

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<sup>1</sup> Based on *AICPA Technical Practice Aids*, QCR section 20,120.



ments included in documents filed with the SEC have objectives, needs, and expectations different from those of users of the unaudited financial statements of nonpublic entities that are not included in such filings. He might also conclude that communication with those users, because of the significance they attach to the regulatory and disciplinary responsibilities of the SEC, is not enhanced by including a compilation or review report in a document filed with the SEC, and might responsibly decide that the guidance in Statements on Auditing Standards is more appropriate in those circumstances.

[Source: Accounting and Review Services Interpretation of SSARS No. 1 regarding financial statements included in SEC filings (*AICPA Professional Standards*, AR section 9100.03—.05).]

Checklist Questionnaire

.03

NOTE: SSARS = Statement on Standards for Accounting and Review Services

- 1. Is the report appropriately worded?
  - a. For compiled financial statements does the report state (SSARS No. 1, paragraph 14) that:
    - A compilation has been performed?
    - A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners)?
    - The financial statements have not been audited or reviewed and, accordingly, the accountant does not express an opinion or any other form of assurance on them?
  - b. For reviewed financial statements does the report state (SSARS No. 1, paragraph 32) that:
    - A review was performed in accordance with standards established by the American Institute of Certified Public Accountants?
    - All information included in the financial statements is the representation of the management (owners) of the entity?
    - A review consists principally of inquiries of company personnel and analytical procedures applied to financial data?

REMARKS

N/A

NO

YES




Checklist Questionnaire (Continued)

YES	NO	N/A	REMARKS

- A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements taken as a whole and, accordingly, no such opinion is expressed?
  - The accountant is not aware of any material modification that should be made to the financial statements in order for them to be in conformity with generally accepted accounting principles or, where applicable, with another comprehensive basis of accounting, other than those modifications, if any, indicated in his report?
  - c. For both compiled and reviewed financial statements, does the report exclude a description of any other procedures that the accountant might have performed before or during the engagement (SSARS No. 1, paragraphs 14 and 32)?
2. For compiled financial statements that contain departures from generally accepted accounting principles or, where applicable, another comprehensive basis of accounting:
- a. If the departure is the omission in compiled financial statements of substantially all required disclosures does the accountant's report clearly indicate such omission? (SSARS No. 1, paragraphs 19 and 21)

Checklist Questionnaire (Continued)

REMARKS

YES NO N/A

	YES	NO	N/A

b. If compiled financial statements that omit substantially all of the disclosures required by generally accepted accountancy principles include disclosures about only a few matters in the form of notes to such financial statements, are such disclosures labeled "Selected Information - Substantially All Disclosures Required by Generally Accepted Accounting Principles" or, where applicable, another comprehensive basis of accounting) Are Not Included"? (SSARS No. 1, paragraph 19)

c. If compiled financial statements that omit substantially all required disclosures are prepared on a basis of accounting other than generally accepted accounting principles, and if such financial statements do not include disclosure of the basis of accounting used, does the accountant's report disclose the basis of accounting? (SSARS No. 1, paragraph 20)

d. If compiled financial statements contain other departure(s) from generally accepted accounting principles or, where applicable, another comprehensive basis of accounting, did the accountant modify his report to disclose the departure? (SSARS No. 1, paragraph 39)

i. If yes, did the accountant's modified report disclose the departure in a separate paragraph? (SSARS No. 1, paragraph 40)

Checklist Questionnaire (Continued)

YES	NO	N/A	REMARKS

ii If the effects of the departure on the financial statements have been determined by management or are known as a result of the accountant's procedures, are these effects also disclosed in the modified report? (SSARS No. 1, paragraph 40)

iii If the effects of the departure on the financial statements have not been determined, has the accountant stated this in his report? (SSARS No. 1 paragraph 40)

3. For reviewed financial statements that contain departures from generally accepted accounting principles or, where applicable, another comprehensive basis of accounting, (including the omission of required disclosures) did the accountant modify his report to disclose the departure? (SSARS No. 1, paragraph 39)

a. If yes, did the accountant's modified report disclose the departure in a separate paragraph? (SSARS No. 1, paragraph 40)

b. If the effects of the departure on the financial statements have been determined by management or are known as a result of the accountant's procedures, are these effects also disclosed in the modified report? (SSARS No. 1, paragraph 40)

c. If the effects of the departure on the financial statements have not been determined, has the accountant stated this in his report? (SSARS No. 1, paragraph 40)

Checklist Questionnaire (Continued)

REMARKS

YES NO N/A


4. If the accountant is not independent with respect to the entity for which he has compiled financial statements, did the accountant state in the last paragraph of his report, "I am (we are) not independent with respect to XYZ company" (SSARS No. 1 paragraph 22) (The accountant is precluded by paragraph 38 of SSARS No. 1 from issuing a review report on the financial statements of an entity with respect to which he is not independent.)

5. Is the report dated?

6. a. Does each page of the financial statements compiled by the accountant include a reference such as "See Accountants Compilation Report"? (SSARS No. 1, paragraph 15)

or

b. Does each page of the financial statements reviewed by the accountant include a reference such as "See Accountants Review Report"? (SSARS No. 1, paragraph 34)

7. When supplementary information is presented with the financial statements, did the accountant clearly indicate his degree of responsibility with respect to such information as follows: (SSARS No. 1, paragraph 43)

a. If the basic financial statements were reviewed, was the degree of responsibility disclosed in the report or in a separate report on the other data that states:

Checklist Questionnaire (Continued)

YES	NO	N/A	REMARKS

- The review has been made primarily for the purpose of expressing limited assurance that there are no material modifications that should be made to the financial statements in order for them to be in conformity with generally accepted accounting principles or, where applicable, another comprehensive basis of accounting, and either:

- The other data accompanying the financial statements are presented only for supplementary analysis purposes and have been subjected to the inquiry and analytical procedures applied in the review of the basic financial statements, and the accountant did not become aware of any material modifications that should be made to such data, or

- The other data accompanying the financial statements are presented only for supplementary analysis purposes and have not been subjected to the inquiry and analytical procedures applied in the review of the basic financial statements, but were compiled from information that is the representation of management, without audit or review, and the accountant does not express an opinion or any other form of assurance on such data.

Checklist Questionnaire (Continued)

	YES	NO	N/A	REMARKS
b. If the accountant has compiled both the basic financial statements and other data which is presented for supplementary analysis purposes, does the compilation report also include the other data?				
8. If an audit engagement has been changed to a review or compilation, does the report omit reference to: a) the original engagement, b) any auditing procedures that may have been performed, c) any scope limitation that resulted in the changed engagement (SSARS No. 1 paragraph 49)?				
9. If comparative financial statements are presented, does the accountant's report cover each period presented?				
10. Is the report appropriate for the current status of the entity?				
11. Does each page of the comparative financial statements compiled or reviewed include a reference such as "See Accountant's Report"?				
12. If compiled financial statements which omit substantially all of the disclosures required by generally accepted accounting principles are included among the comparative financial statements, do all the periods presented also omit such disclosures and does the accountant's compilation report include an additional paragraph which indicates:				

Checklist Questionnaire (Continued)

REMARKS

YES NO N/A

- The nature of the previous service rendered (compilation, review or audit)?
- Date of the previous report
- Appropriate language in accordance with SSARS No. 1, paragraphs 19-20 and SSARS No. 2, paragraph 30?

13. If the level of service performed by the continuing accountant on the current-period financial statements is the same or higher than that performed on the financial statements of the prior period presented, has the continuing accountant's report on the prior period been updated?

14. If the level of service performed by the continuing accountant on the current-period financial statements is lower than that performed on the financial statements of the prior period presented,

a. Does the report on the current period include a separate paragraph which describes the responsibility assumed for the prior period?

or

b. Is the report on the current period accompanied by or combined with a reissued report on the financial statements of the prior period presented?

**Checklist Questionnaire (Continued)**

REMARKS

YES NO N/A


15. If the report requires a changed reference to a departure from generally accepted accounting principles regarding the prior period presented, does the explanatory paragraph in the report include:

- The date of the previous report?
- Description of the circumstances or events underlying the change?
- Indication, if applicable, that the prior-period financial statements have been changed?

16. If the predecessor accountant does not reissue his compilation or review report on the prior-period financial statements, has the successor:

- a. Made appropriate reference in his report to the predecessor's report in accordance with SSARS No. 2?
- or
- b. Performed a compilation, review, or audit of the statements of the prior period and reported on them accordingly?

17. If the financial statements of the prior period presented have been changed, has the predecessor or successor reported on them as presented?



Checklist Questionnaire (Continued)

YES	NO	N/A	REMARKS

18. If the current-period financial statements were compiled or reviewed and the financial statements of the prior period presented were audited and the audit report has not been reissued, does the current-period report include a separate paragraph which contains the following:

- Statement that the prior-period financial statements were examined previously?
- Date of the previous report?
- Type of opinion expressed previously?
- If the opinion was other than unqualified, the substantive reasons therefor?
- That no auditing procedures were performed after the date of the previous report?

Note: For guidance on situations when the current period is audited and the prior period is compiled or reviewed see the Statement on Auditing Standards on association with financial statements.

19. If a disclaimer of opinion was previously issued on the prior-period financial statements in accordance with the standards then in effect, does the report(s) conform with the transition provisions of SSARS No. 2?

## .04 Cross Reference Table to Pronouncements

NOTE: SSARS=Statement on Standards for  
Accounting and Review Services

To determine the applicability of cross-referenced pronouncements their effective dates should be considered.

Section  
8300.03

**ACCOUNTANT'S REPORTS ON COMPILED  
OR REVIEWED FINANCIAL STATE-  
MENTS OF NONPUBLIC  
ENTITIES**

1.
  - a SSARS No. 1, para. 14 (AR \$100)
  - b SSARS No. 1, para. 32 (AR \$100)
  - c SSARS No. 1, paras. 14 & 32  
(AR \$100)
2.
  - a SSARS No. 1, paras. 19 & 21  
(AR \$100)
  - b SSARS No. 1, para. 19 (AR \$100)
  - c SSARS No. 1, para. 20 (AR \$100)
  - d SSARS No. 1, para. 39 (AR \$100)
    - i. SSARS No. 1. para. 40 (AR \$100)
    - ii. SSARS No. 1, para. 40 (AR \$100)
    - iii. SSARS No. 1, para. 40 (AR \$100)
3.
  - a SSARS No. 1, para. 39 (AR \$100)
  - b SSARS No. 1, para. 40 (AR \$100)
  - c SSARS No. 1, para. 40 (AR \$100)
4.
  - a SSARS No. 1, para. 22 (AR \$100)
  - b SSARS No. 1, para. 38 (AR \$100)

**Cross Reference Table to Pronouncements (Continued)**

**Section  
8300.03**

6.
    - a SSARS No. 1, para. 15 (AR \$100)
    - b SSARS No. 1, para. 34 (AR \$100)
  7. SSARS No. 1, para. 43 (AR \$100)
  8. SSARS No. 1, para. 49 (AR \$100)
  9. SSARS No. 2, para. 2 (AR \$200)
  10. SSARS No. 2, paras. 31 & 32 (AR \$200)
  11. SSARS No. 2, para. 6 (AR \$200)
  12. SSARS No. 1, paras. 19-21 (AR \$100)  
SSARS No. 2, paras. 5, 29 & 30 (AR \$200)
  13. SSARS No. 2, paras. 8-10 (AR \$200)
  14. SSARS No. 2, paras. 8, 11 & 12 (AR \$200)
  15. SSARS No. 2, paras. 14 & 15 (AR \$200)
  16. SSARS No. 2, paras. 16-19 (AR \$200)
  17. SSARS No. 2, paras. 25 & 26 (AR \$200)
  18. SSARS No. 2, para. 28 (AR \$200)
  19. SSARS No. 2, paras. 33-35 (AR \$200)
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➤ *The next page is 8401.* ←



## AAM Section 8400

### *Financial Statements and Notes*

.01 This section is based on material concerning financial statements and notes extracted from the checklist questionnaires<sup>1</sup> used in the technical standards consulting review of the AICPA voluntary quality control review program for CPA firms. However, this section has been updated by the staff of the AICPA technical information division and has not been reviewed by any senior technical committee of the AICPA.

.02 Following the checklist questionnaire is a cross reference table<sup>1</sup> indicating references to related pronouncements.

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<sup>1</sup> Based on *AICPA Technical Practice Aids*, Part B of QCR sections 20,100, 20,110, and 20,120.

Checklist Questionnaire

.03

NOTE: ARB=Accounting Research Bulletin  
 APB=Accounting Principles Board Opinion  
 FASB=Statement of the Financial Accounting Standards Board  
 SAS=Statement on Auditing Standards  
 FASBI=Interpretations by the Financial Accounting Standards Board

To determine the applicability of cross-referenced pronouncements their effective dates should be considered. Cross-references are contained in a table at the end of the checklist.

GENERAL

1. Are comparative financial statements presented?
2. Is a statement of changes in financial position presented for each period for which an income statement is presented?
3. Do all the statements presented include a general reference such as "the accompanying notes are an integral part of these financial statements," and are the notes numbered and referenced from the statements or appropriately captioned?
4. For financial statements issued by development stage enterprises for the years beginning on or after January 1, 1976:

YES NO N/A REMARKS

YES	NO	N/A	REMARKS

Checklist Questionnaire (Continued)

REMARKS

YES	NO	N/A	REMARKS

a. Are financial position, changes in financial position, and results of operations presented in conformity with generally accepted accounting principles that apply to established operating enterprises?

• For development stage enterprises included in a consolidated group FASBI No. 7, paragraphs 4 and 5

b. In addition to the basic financial statements does disclosure include amounts of cumulative revenue, expenses, net losses, changes in financial position and stockholders' equity since inception?

c. Do the financial statements identify the enterprise as a "development stage enterprise" and include a description of the nature of its development stage activities?

Checklist Questionnaire (Continued)

	YES	NO	N/A	REMARKS
5. For an enterprise in its first fiscal year in which it is no longer considered to be in the development stage, is there disclosure that in prior years it had been in the development stage?				
6. Are the financial statements adjusted for any changes in estimates resulting from subsequent events that provided additional evidence with respect to conditions that existed at the date of the balance sheet?				
7. If the entity is a subchapter S corporation for federal income tax purposes, do the disclosures appear adequate?				
8. Does the statement of changes in financial position: a. Include a presentation for each period for which an income statement is presented?				

- 5. For an enterprise in its first fiscal year in which it is no longer considered to be in the development stage, is there disclosure that in prior years it had been in the development stage?
- 6. Are the financial statements adjusted for any changes in estimates resulting from subsequent events that provided additional evidence with respect to conditions that existed at the date of the balance sheet?
- 7. If the entity is a subchapter S corporation for federal income tax purposes, do the disclosures appear adequate?
- 8. Does the statement of changes in financial position:
  - a. Include a presentation for each period for which an income statement is presented?



Checklist Questionnaire (Continued)

REMARKS	N/A	NO	YES
b. Disclose all important aspects of financing and investing activities regardless of whether cash or other elements of working capital are directly affected?			
c. Begin with income or loss before extraordinary items?			
d. Include or be accompanied by a presentation of net changes in each element of working capital?			
9. Are the financial statements suitably titled? (Certain titles are generally understood to be applicable only to statements that present information in conformity with generally accepted accounting principles)			
10. Based on the reviewer's study of the workpapers and other evidential matter, does it appear that disclosures in the financial statements are reasonably adequate? (i.e., do they comply to the third standard of reporting)			

Checklist Questionnaire (Continued)

YES	NO	N/A	REMARKS

11. Oil and gas producing companies only: For fiscal years beginning after December 15, 1978, do the financial statements reflect the accounting practices promulgated in FASB No. 19 and 25?

STATEMENT OF FINANCIAL POSITION  
Current Assets:

12. Is restricted cash appropriately segregated from other cash items and properly classified?

13. Are the current portions of various assets and liabilities classified as current items if applicable?

- For short-term debt paid after the balance sheet date but prior to refinancing FASBI No. 8, paragraph 3

Checklist Questionnaire (Continued)

	YES	NO	N/A	REMARKS
14. Are items not expected to be realized during the current operating cycle included under non-current asset captions?				
15. Is there adequate disclosure of the separate classes of inventory (e.g. raw materials work in process, finished goods, etc.) if material?				
16. Are inventories stated at the lower of cost as defined, or market? (If "no" does the practice of the industry allow other methods?)  ● For foreign currency translated financial statements FASB No. 8, paragraph 14 and FASBI No. 17 paragraphs 5, 6 and 10				
17. Is interest on receivables and payables (including premium and discount) presented properly?				

Checklist Questionnaire (Continued)

YES	NO	N/A	REMARKS

18. For a marketable equity securities portfolio is the carrying amount the lower of aggregate cost or market value, and is the amount by which aggregate cost exceeds market value accounted for as a valuation allowance?

- For previously established allowance accounts FASBI No. 12, paragraphs 3 and 4

19. Are capitalized interest costs determined and reported in conformity with FASB No. 34?

Other Assets:

Checklist Questionnaire (Continued)

YES NO N/A REMARKS

YES	NO	N/A	REMARKS

20. If there are any investments in common stock accounted for by the equity method, are the income taxes on the investor's share of the investee's earnings reflected properly?

- For tax benefits realized on disposition of investments in certain subsidiaries and other investees, FASBI No. 29, paragraphs 2-4.

21. Are research and development costs charged to expense when incurred, and appropriately disclosed?

- For business combinations accounted for as a purchase FASBI No. 4, paragraphs 4 and 5,
- For computer software FASBI No. 6, paragraphs 4-9

Checklist Questionnaire (Continued)

YES	NO	N/A	REMARKS

22. If a decline in market value below cost of a given marketable security is judged to be other than temporary, and changes in carrying amounts are included in stockholders' equity rather than net income, is the cost basis of the security written down to a new cost basis and the amount of the write down accounted for as a realized loss?

- For unrealized losses deemed other than temporary FASBI No. 11, paragraphs 3 and 4

23. Liabilities and Contingencies: Are short-term obligations that are both intended to be refinanced on a long-term basis, and accompanied by evidence of ability to consummate the refinancing, excluded from current liabilities and accompanied by adequate footnote disclosure?

Checklist Questionnaire (Continued)

YES	NO	N/A	REMARKS

- For short-term debt paid after the balance sheet date but prior to refinancing FASBI No. 8, paragraph 3
24. Are the current portions of various assets and liabilities classified as current items if applicable?
- For short-term debt paid after the balance sheet date but prior to refinancing FASBI No. 8, paragraph 3
25. Is interest on receivables and payables (including premium and discount) presented properly?
26. Is interperiod tax allocation employed for oil and gas producing companies with respect to intangible drilling and development cost and other costs associated with the exploration for and development of oil and gas revenues?

Checklist Questionnaire (Continued)

REMARKS

N/A

NO

YES


27. Are income tax effects for unrealized gains and losses on marketable securities accounted for according to APB No. 11?

28. For unrealized capital losses of marketable securities are tax effects recognized only when there exits assurance beyond a reasonable doubt that the benefit will be realized by an offset of loss against capital gains?

Capital Accounts:  
29. Are appropriations of retained earnings for loss contingencies clearly identified and included within the stockholders' equity section of the balance sheet?



Checklist Questionnaire (Continued)

YES NO N/A REMARKS

YES	NO	N/A	REMARKS

30. If a decline in market value below cost of a given marketable security is judged to be other than temporary, and changes in carrying amounts are included in stockholders' equity rather than net income, is the cost basis of the security written down to a new cost basis and the amount of the write down accounted for as a realized loss?

- For unrealized losses deemed other than temporary FASBI No. 11, paragraphs 3 and 4

31. Are stock subscriptions receivable appropriately identified and presented as a deduction from capital, or, if presented as an asset, stated separately, clearly labeled, and their status clearly described to distinguish them from any other type of asset?

Checklist Questionnaire (Continued)

INCOME STATEMENT

	YES	NO	N/A	REMARKS
32. If there are nonmonetary trans- actions of either a nonreciprocal or exchange nature, are they recorded in accordance with APB No. 29? ● For involuntary conversions of nonmonetary assets FASBI No. 30				
33. If there is an early extinguish- ment of debt, is the accounting proper and are all necessary disclosures made?				
34. If a segment of the business is sold, abandoned, spun off, or otherwise disposed of (or, although still operating, is the subject of a formal plan for disposal): a. Are discontinued operations and earnings per share cor- rectly reflected in the income statement? ● For subleases entered into as part of a disposal FASBI No. 27, paragraph 3				

Checklist Questionnaire (Continued)

YES NO N/A REMARKS

YES	NO	N/A	REMARKS

b. Are disclosures made in notes describing the identity of the segment sold, the date and manner of disposal, the assets and liabilities remaining, if any, and the income or loss from operations from measurement date to the date of the balance sheet?

35. Are extraordinary items properly disclosed and classified and did they meet the criteria for consideration as extraordinary items?

36. Are material events or transactions that are either unusual in nature, or of infrequent occurrence but not both (and therefore not meeting both criteria for classification as an extraordinary item) reported as a separate component of income from continuing operations?

37. Are research and development costs charged to expense when incurred and appropriately disclosed?

Checklist Questionnaire (Continued)

REMARKS

YES NO N/A

YES	NO	N/A	REMARKS

- For business combinations accounted for as a purchase FASBI No. 4, paragraphs 4 and 5,

- For computer software FASBI No. 6, paragraphs 4-9

38. Are required disclosures made of aggregate exchange gains or losses and effects of rate changes on reported results of operations?

- When applying lower of cost or market rule, the resulting loss should be charged to cost of sales FASBI No. 17, paragraphs 5, 6 and 10

Checklist Questionnaire (Continued)

DISCLOSURES AND NOTES	YES	NO	N/A	REMARKS
39. Is a summary description of the significant accounting policies presented?				
40. Are related party transactions adequately disclosed in the financial statements and accompanying notes?				
41. Reserved.				
42. Are subsequent events that provide evidence with respect to conditions that did not exist at the date of the balance sheet but arose subsequent to that date adequately disclosed to keep the financial statements from being misleading?				
43. For marketable equity securities, except if the equity basis is appropriate, (in statements for periods ending on or after 12/31/75) is there disclosure of the following:				

Checklist Questionnaire (Continued)

REMARKS

YES NO N/A

YES	NO	N/A	REMARKS

- For non-marketable securities FASBI No. 16, paragraph 4
- a. Aggregate cost and market value (each segregated between current and non-current classifications if applicable) as of the date of each balance sheet presented?
- b. As of the date of the latest balance sheet presented, the gross unrealized gains and gross unrealized losses (segregated between current and non-current portfolios if applicable)?
- c. For each period in which an income statement is presented:
  - (i) Net realized gain or loss included in the determination of net income?

Checklist Questionnaire (Continued)

REMARKS

N/A

NO

YES



(ii) Basis on which cost was determined in computing realized gain or loss (i.e., average cost or other method used)?

(iii) Change in the valuation allowance?

44. For marketable equity securities owned at the balance sheet date, if significant net realized and net unrealized gains and losses arose after the balance sheet date but before issuance of the financial statements, are those net realized and net unrealized gains and losses disclosed in the notes to financial statements?

- For unrealized losses deemed other than temporary FASBI No. 11, paragraphs 3 and 4

Checklist Questionnaire (Continued)

REMARKS

YES NO N/A

YES	NO	N/A	REMARKS

- 45. For enterprises in industries having specialized accounting practices with respect to marketable securities does disclosure conform with FASB No. 12, paragraphs 14-17?
- 46. If required, do the financial statements include appropriate segment information?
- 47. Does there appear to be adequate disclosure by footnote or otherwise with respect to:
  - a. Marketable securities?
    - For personal financial statements  
FASBI No. 10, paragraph 2,  
FASBI No. 11, paragraphs  
3 and 4, FASBI No. 12, paragraphs 3 and 4;
    - For consolidated financial statements  
FASBI No. 13, paragraphs  
5, 6 and 7;



Checklist Questionnaire (Continued)

REMARKS	YES	NO	N/A
<ul style="list-style-type: none"> <li>For securities that are temporarily non-marketable FASBI No. 16, paragraphs 4-10</li> </ul>			
<ul style="list-style-type: none"> <li>Notes and accounts receivable due from officers, employees, or affiliated companies?</li> </ul>			
<ul style="list-style-type: none"> <li>Allowance for losses on receivables?</li> </ul>			
<ul style="list-style-type: none"> <li>The method of determining inventory costs (FIFO, LIFO, average, etc.) and recognizing any diminished utility (cost or market, whichever is lower)?</li> </ul>			
<ul style="list-style-type: none"> <li>Assets pledged or assigned?</li> </ul>			
<ul style="list-style-type: none"> <li>Intangible assets and their amortization?</li> </ul>			
<ul style="list-style-type: none"> <li>Liquidation preference of preferred stock in the equity section of the balance sheet?</li> </ul>			

Checklist Questionnaire (Continued)

REMARKS	YES	NO	N/A

- h. Number of shares of various classes of stock authorized, issued and outstanding, and the pertinent rights and privileges of various securities outstanding?
- Stock appreciation and other variable plan awards should be included as common stock equivalents FASBI No. 28, paragraph 6
- i. Option agreements?
- For stock appreciation rights FASBI No. 28, paragraphs 2-5
- j. Restrictions on retained earnings?
- k. Dating of retained earnings after a quasi-reorganization?  
Other Disclosures:
- l. Principles of consolidation?

Checklist Questionnaire (Continued)

	YES	NO	N/A	REMARKS
m. Changes in accounting principles?				
n. Business combinations accounted for as poolings of interest?				
o. Business combinations accounted for as purchases?				
p. Commitments for material amounts of new construction or equipment?				
q. Contingencies?				
r. Carry forward losses for income taxes or other credits available?				
s. Reasons for difference of tax expense shown from customary relationship between income before taxes and tax expenses? <ul style="list-style-type: none"> <li>• For U.K. tax benefits concerning stock relief FASB No. 31</li> </ul>				
t. When renegotiation refunds under government contracts cannot be accurately estimated?				

Checklist Questionnaire (Continued)

	YES	NO	N/A	REMARKS
u. Prior period restatement or adjustment?				
v. Subsequent events?				
w. Investments?				
• For non-marketable securities FASBI No. 16, paragraph 10				
x. Intangible assets and their amortization?				
y. Parents' equity in net assets and net income of unconsolidated subsidiaries and affiliates?				
z. Long-term construction-type contracts?				
aa. Unusual accruals and allowances?				
bb. Assets pledged or assigned?				
cc. Depreciable assets (property, plant and equipment, etc.) and depreciation:				

Checklist Questionnaire (Continued)

REMARKS

YES NO N/A

	YES	NO	N/A	REMARKS
(i) Depreciation expense for each period?				
(ii) Balances of major classes of depreciable assets by nature of function?				
(iii) Accumulated depreciation, either by major classes of assets or in total?				
(iv) The method or methods used in computing depreciation with respect to major classes of depreciable assets?				
(v) Investment credit, method followed and amounts involved when material				
• For unused investment credit FASBI No. 25				
dd. Accrued liabilities?				

Checklist Questionnaire (Continued)

	YES	NO	N/A	REMARKS
ee. Bond indenture and loan agreement provisions?				
ff. Pension plans?				
gg. Leases (including capital, operating, sales, direct financing and leveraged leases)?				
hh. Commitments for material amounts of new construction or equipment?				
ii. Deferred income taxes?				
jj. Translation of foreign currency transactions and foreign currency financial statements?				
kk. Earnings per share on the face of the income statement, accompanied by an explanatory schedule or note that includes the basis of calculations?				
ll. Supplementary disclosures about the effect of changing prices if required by the FASB or elected by management?				

**.04 Cross Reference Table to Pronouncements**

NOTE: ARB=Accounting Research Bulletin  
 APB=Accounting Principles Board Opinion  
 FASB=Statement of the Financial Accounting Standards Board  
 SAS=Statement on Auditing Standards  
 FASBI=Interpretations by the Financial Accounting Standards Board  
 TB=Technical Bulletin issued by the staff of the FASB<sup>2</sup>

To determine the applicability of cross referenced pronouncements their effective dates should be considered

**Section**  
 8400.03

**FINANCIAL STATEMENTS AND NOTES**

1. ARB No. 43, Chapter 2A (AC §2041)
2. APB No. 19, para. 7 (AC §2021)
3. APB Statement No. 4, Chapter 2, para. 10 (AC §1022.02)
4.
  - a FASB No. 7, para. 10 (AC §2062)  
FASBI No. 7, paras. 4 & 5 (AC §2062-1)
  - b FASB No. 7, para. 11 (AC §2062)
  - c FASB No. 7, para. 12 (AC §2062)
5. FASB No. 7, para. 13 (AC §2062)
6. SAS No. 1, secs. 560.03-.04 & 560.07 (AU §560)
8.
  - a APB No. 19, para. 7 (AC §2021)
  - b APB No. 19, para. 8 (AC §2021)
  - c APB No. 19, para. 10 (AC §2021)
  - d APB No. 19, para. 12 (AC §2021)

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<sup>2</sup>The FASB staff issues FASB Technical Bulletins to provide guidance concerning the application of FASB Statements or Interpretations, APB Opinions, or Accounting Research Bulletins. FASB Technical Bulletins do not establish new financial accounting and reporting standards or amend existing standards.

## Cross Reference Table to Pronouncements (Continued)

## Section

8400.03

9. SAS No. 14, para. 7 (AU §621)
11. FASB No. 19 (AC §6021) and FASB No. 25 (AC §6022)
12. ARB No. 43, Chapter 3A, para. 6 (AC §2031-1)
13. ARB No. 43, Chapter 3A, paras. 4-8 (AC §2031) FASB No. 6, para. 15 (AC §2033)  
FASBI No. 8, para. 3 (AC §2033-1)  
TB No. 79-3 (AC §B2033)
14. ARB No. 43, Chapter 3A, paras. 5 & 6 (AC §2031)
15. ARB No. 43, Chapter 3A, paras. 4 and 9 (AC §2031), Chapter 4, Statement 1 (AC §5121)
16. ARB No. 43, Chapter 4, Statements 3 and 7 (AC §5121)  
FASB No. 8, para. 14 (AC §1083)  
FASBI No. 17, paras. 5, 6 & 10 (AC §1083-2)
17. APB No. 21, para. 16 (AC §4111)  
FASB No. 15 (AC §5363)  
TB No. 79-6 (AC §B5363)  
TB No. 79-7 (AC §B5363)
18. FASB No. 12, para. 8 (AC §5132)  
FASBI No. 12, paras. 3 & 4 (AC §5132-3)
19. FASB No. 34, paras. 6-23 (AC §5155)
20. APB No. 24, paras. 7-10 (AC §4096)  
FASBI No. 29, paras. 2-4 (AC §4095-1)
21. FASB No. 2, paras. 12-16 (AC §4211)  
FASBI No. 4, paras. 4 & 5 (AC §4211-1)



## Cross Reference Table to Pronouncements (Continued)

**Section**  
8400.03

21. FASBI No. 6, paras. 4-9 (AC §4211-3)  
TB No. 79-2 (AC §B4211)
22. FASB No. 12, para. 21 (AC §5132)  
FASBI No. 11, paras. 3 & 4 (AC §5132-2)
23. FASB No. 6, paras. 10-15 (AC §2033)  
FASBI No. 8, para. 3 (AC §2033-1)  
TB No. 79-3 (AC §B2033)
24. ARB No. 43, Chapter 3A, paras. 4-8  
(AC §2031) FASB No. 6, para. 15 (AC §2033)  
FASBI No. 8, para. 3 (AC §2033-1)  
TB No. 79-3 (AC §B2033)
25. APB No. 21, para. 16 (AC §4111)  
FASBI No. 15 (AC §1083-1)
26. FASB No. 19, paras. 60-64 (AC §6021)  
FASB No. 25, paras. 4-9 (AC §6022)
27. APB No. 11 (AC §4091)  
FASB No. 12, para. 22 (AC §5132)
28. FASB No. 12, para. 22 (AC §5132)
29. FASB No. 5, para. 15 (AC §4311)
30. FASB No. 12, para. 21 (AC §5132)  
FASBI No. 11, paras. 3 & 4 (AC §5132-2)
32. APB No. 29 (AC §1041)  
FASBI No. 30 (AC §1041-1)
33. APB No. 26, paras. 18-21 (AC §5362)  
FASB No. 4, paras. 8-12 (AC §2013)
34. a APB No. 30, paras. 8, 9 & 12 (AC §2012)  
FASBI No. 27, para. 3 (AC §4053-6)  
TB No. 79-18 (AC §B4053)

## Cross Reference Table to Pronouncements (Continued)

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34.           b APB No. 30, para. 18 (AC §2012)
35.           APB No. 9, para. 17 (AC §2010)  
              APB No. 30, paras. 10, 11, 19-25 (AC §2012)  
              FASB No. 16, para. 16c (AC §2014)
36.           APB No. 30, para. 26 (AC §2012)
37.           FASB No. 2, paras. 12-16 (AC §4211)  
              FASBI No. 4, paras. 4 & 5 (AC §4211-1)  
              FASBI No. 6, paras. 4-9 (AC §4211-3)
38.           FASB No. 8, paras. 32-34 (AC §1083)  
              FASBI No. 17, paras. 5,6 & 10 (AC §1083-2)
39.           APB No. 22, paras. 8-15 (AC §2045)
40.           SAS No. 6, paras. 16 & 17 (AU §335)
41.           Reserved.
42.           SAS No. 1, secs. 560.05-.07 and  
              560.09 (AU §560)
43.           FASB No. 12, paras. 12 & 23 (AC §5132)  
              FASBI No. 16, para. 4 (AC §5132-5)
44.           FASB No. 12, para. 13 (AC §5132)  
              FASBI No. 11, paras. 3 & 4 (AC §5132-2)
45.           FASB No. 12, paras. 14-17 (AC §5132)
46.           FASB No. 21, paras. 12-16 (AC §2083)  
              TB No. 79-8 (AC §B2083) re certain  
              brokers and dealers in securities  
              FASB No. 14, paras. 9-39 (AC §2081)  
              TB No. 79-4 (AC §B2081) re Puerto  
              Rican operations  
              TB No. 79-5 (AC §B2081) re health  
              care facilities

## Cross Reference Table to Pronouncements (Continued)

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- 46.
- FASB No. 24, para. 5 (AC §2084)
  - FASB No. 30, para. 6 (AC §2085)
- 47.
- a ARB No. 43, Chapter 3A, para. 9 (AC §2031)  
FASB No. 12, paras. 12, 13, 16, 17,  
19 & 20 (AC §5132)  
FASBI No. 10, para. 2 (AC §5132-1)  
FASBI No. 11, paras. 3 & 4 (AC §5132-2)  
FASBI No. 12, paras. 3 & 4 (AC §5132-3)  
FASBI No. 13, paras. 5-7 (AC §5132-4)  
FASBI No. 16, paras. 4-10 (AC §5132-5)
  - b ARB No. 43, Chapter 1A, para. 5 (AC §5111)  
SAS No. 6, paras. 2, 16 & 17 (AU §335)
  - c APB No. 12, para. 3 (AC §2044)
  - d ARB No. 43, Chapter 4, Statements 3-9  
(AC §5121)  
SAS No. 1, sec. 430.02 (AU §430)
  - e FASB No. 5, paras. 18 & 19 (AC §4311)  
SAS No. 1, sec. 430.02 (AU §430)
  - f APB No. 17, paras. 24-31 (AC §5141)
  - g APB No. 10, paras. 10-11 (AC §5515)  
APB No. 15, para. 19 (AC §2011)
  - h APB No. 10, paras. 10-11 (AC §5515)  
APB No. 15, para. 19 (AC §2011)  
FASBI No. 28, para. 6 (AC §4062-1)
  - i ARB No. 43, Chapter 13B, para. 15  
(AC §4061)  
APB No. 25, paras. 10-19 (AC §4062)  
FASBI No. 28, paras. 2-5 (AC §4062-1)
  - j APB No. 6, para. 13 (AC §5542)  
FASB No. 5, para. 15 (AC §4311)

## Cross Reference Table to Pronouncements (Continued)

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47.

- k ARB No. 43, Chapter 7A, para. 10 (AC §5581)  
ARB No. 46 (AC §5582)
- l ARB No. 51, para. 5 (AC §2051)
- m SAS No. 1, secs. 546.01-.11 and  
546.17 (AU §546)  
APB No. 20, paras. 17-30 (AC §1051)  
FASB No. 3, paras. 9-14 (AC §2072)  
FASB No. 32, paras. 10-11 (AC §1052)
- n APB No. 16, paras. 63-65 (AC §1091)  
SAS No. 1, secs. 546.12-.13  
(AU §546.12-.13)  
SAS No. 15, para. 12 (AU §505)
- o APB No. 16, paras. 95-96 (AC §1091)
- p FASB No. 5, paras. 18 & 19 (AC §4311)  
ARB No. 45, para. 16 (AC §4031)
- q FASB No. 5, paras. 9-13 (AC §4311)
- r APB No. 11, paras. 63(a) and 63(b)  
(AC §4091)
- s APB No. 11, para. 63(c) (AC §4091)  
APB No. 23, para. 14 (AC §4095)  
FASB No. 31, para. 7 (AC §4097)
- t ARB No. 43, Chapter 11B, paras. 4 & 5  
(AC §4042)
- u APB No. 9, para. 26 (AC 2010)  
APB No. 20, paras. 27, 28, 36 & 37  
(AC §1051)  
FASB No. 16, paras. 10-17 (AC §2014)  
FASB No. 32, paras. 10-11 (AC §1052)

## Cross Reference Table to Pronouncements (Continued)

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47.

- v SAS No. 1, secs. 560.01-.12 (AU \$560),  
561.01-.09 (AU \$561)  
FASB No. 5, para. 11 (AC \$4311)
- w APB No. 18, para. 20 (AC \$5131)  
FASB No. 12, paras. 6 & 18 (AC \$5132)  
TB No. 79-19 (AC \$B5132)  
FASBI No. 16, para. 10 (AC \$5132-5)
- x APB No. 17, paras. 24-31 (AC \$5141)
- y ARB No. 51, para. 19 (AC \$2051)
- z ARB No. 45, para. 15 (AC \$4031)  
APB No. 22, para. 13 (AC \$2045)
- aa FASB No. 5, paras. 9-13 (AC \$4311)  
FASB No. 11, para. 10 (AC \$4312)
- bb FASB No. 5, paras. 18 & 19 (AC \$4311)  
SAS No. 1, sec. 430.02 (AU \$430)
- cc (i) APB No. 12, para. 5a (AC \$2043)  
(ii) APB No. 12, para. 5b (AC \$2043)  
(iii) APB No. 12, para. 5c (AC \$2043)  
(iv) APB No. 12, para. 5d (AC \$2043)  
(v) APB No. 4 (AC \$4094)  
FASBI No. 25 (AC \$4094-1)
- dd ARB No. 43, Chapter 4, Statements 3-9  
(AC \$5121)  
SAS No. 1, sec. 430.02 (AU \$430)
- ee APB Statement No. 4, para. 199 (R-9A)  
(AC \$1027.26)  
FASB No. 6, para. 15 (AC \$2033)  
TB No. 79-3 (AC \$B2033)
- ff APB No. 8, para. 46 (AC \$4063)  
FASBI. No. 3, paras. 4 and 5 (AC \$4063-1)

## Cross Reference Table to Pronouncements (Continued)

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47.

- gg FASB No. 13, paras. 16, 23, 47, and 48 (AC §4053). [Note: For amendments of FASB No. 13 see FASB Nos. 17, 22, 23, 26, 27, 28 and 29.]  
TB Nos. 79-10, 79-11, 79-12, 79-13, 79-14, 79-15, 79-16, 79-17, and 79-18 (all in AC §B4053)
  - hh FASB No. 5, paras. 18 & 19 (AC §4311)  
ARB No. 45, para. 16 (AC §4031)
  - ii APB No. 11, paras. 57-62 (AC §4091)
  - jj FASB No. 8, paras. 32-34 (AC §1083)
  - kk APB No. 15, paras. 12-18, 20-23 (AC §2011)
  - ll FASB No. 33, paras. 29-37 (AC §1072)  
TB No. 79-8 (AC §B2083) re certain brokers and dealers in securities
-

## AAM Section 9000

## REVIEW AND REPORT PROCESSING

This manual is a nonauthoritative kit of practice aids and, accordingly, does not include extensive explanation or discussion of authoritative pronouncements. Users of this manual are urged to refer directly to applicable authoritative pronouncements when appropriate.

The exhibits are for illustrative purposes only. They are included as conveniences for users of this manual who may want points of reference when reviewing the working papers or preparing the report.

The material in this section has been extracted from the MAP Handbook and has been edited for this manual.

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»»» → *The next page is 9101.* ← «««





## AAM Section 9100

### **Review Procedures**

#### **Introduction**

.01 The material presented in this chapter has been taken from the MAP Handbook.<sup>1</sup> It is presented as an aid to interested parties. The number and complexity of the forms used will vary from firm to firm, engagement to engagement. Their use should be based on the needs of the client, the needs of the firm and the complexity of the engagement.

.02 The various exhibits are presented for guidance only. They are not intended to be a definitive statement of what is required for each engagement, since every engagement might require a greater or lesser degree of documentation.

.03 Auditors should consider the requirements of SAS No. 22, Planning and Supervision, particularly paragraphs 9-12 (AU Section 311.09-12) in deciding on the review procedures appropriate to their practice.

#### **Importance of the Review**

.04 The supervision and review of work are requirements far more vital and demanding than a mere obligation to perform an agreed assignment satisfactorily. These higher requirements stem directly from the fact that CPAs are engaged by clients to perform personal services of a professional character. The accountant must be sure that the service rendered is performed according to the explicit standards of the profession. Performance of various phases of an engagement may be delegated to subordinates, but responsibility for competence cannot be. When tasks are delegated, comprehensive internal supervision and review are essential.

.05 SAS No. 22 states: "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."

.06 It is obvious that there is a need to review the work on the engagement, since responsibility for its performance rests upon the individual practitioner or the accounting firm issuing the report. The reviewer should check that the performance of duties delegated to subordinates has been accurate and thorough, that the engagement has been completed in accord with the terms governing it, and that

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<sup>1</sup> *Management of an Accounting Practice Handbook* (AICPA, New York), 1978.

significant accounting and auditing questions raised during the examination have been properly dealt with.

.07 A review also serves to guard against errors of principle, judgment, and mathematics. Accountants are subject to the ever-present chance of error; guarding against it must always be uppermost in their minds. This gives added importance to the use of certain formal and standard review procedures.

### **Review Organization**

.08 With respect to review responsibilities, practices are not uniform. Some firms have one partner review all reports issued from the office. In such cases, this partner rarely participates in the field work. Other firms hold each partner responsible for certain engagements and this responsibility, depending upon the size of the firm, can range from field supervision to reviewing and signing the reports.

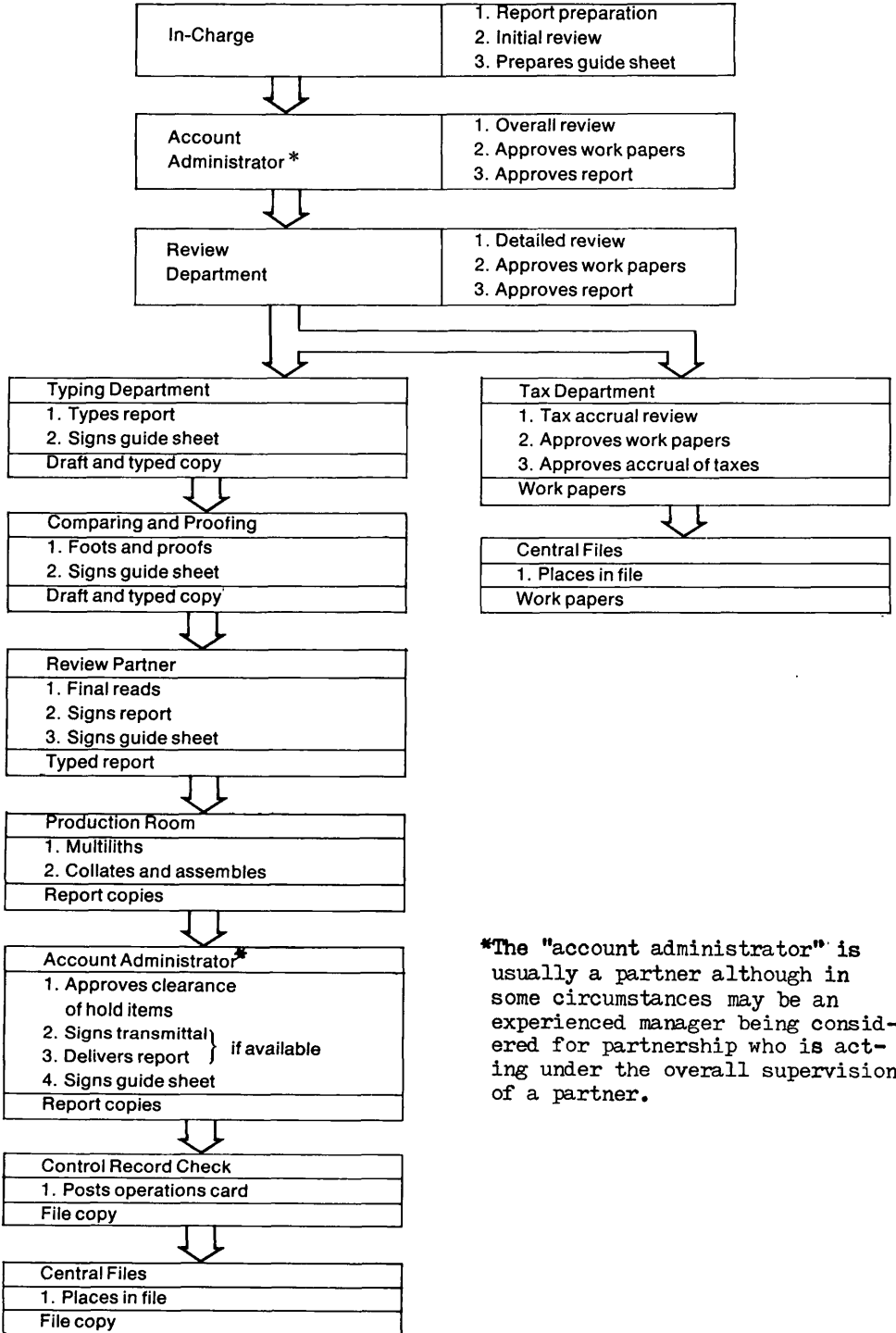
.09 In many firms, responsibility for the adequacy of accounting work exists at different levels. Employee competence and integrity are reviewed after each engagement as well as periodically. This should reveal the qualifications of persons performing work for the firm and, along with the complexity of the subject matter, provide a basis for determining the extent of supervision and review appropriate in a given instance.

.10 Some firms can justify a separate review department. While others cannot afford this functional division of duties, neither can they afford to omit any of the review procedures, including some form of final reading of reports before they are typed.

.11 An example of the complete work and paper flow of a fully departmentalized firm, including both review and processing controls, could be diagrammed as shown in paragraph .12, on the following page.

.12

**Report Processing  
(Flow Chart)**



\*The "account administrator" is usually a partner although in some circumstances may be an experienced manager being considered for partnership who is acting under the overall supervision of a partner.

## Auditors' Reports—Review Control

.13 There are several important techniques used to control audit engagements through all stages of review and production. Most of these come into use from the very start of the assignment.

.14 The first review control procedure is the adoption of a standard working paper index system. There are many such systems in use, usually based on some variation of numerical designations. Standard working paper index systems are discussed in the sections on working papers.

.15 The second review control procedure is the report guide sheet, on which basic information is noted at the start of the engagement. While varying from firm to firm, the information usually includes the following:

1. Client's name.
2. Audit date.
3. Engagement partner and account administrator.
4. Date audit commenced.
5. Date audit completed.
6. Date report submitted for review.
7. Date review completed.
8. Date submitted for typing.
9. Date submitted for checking.
10. Date sent to client.
11. Special comments, such as "rush," "date promised client," and "hold for confirmation."

.16 A report guide sheet usually accompanies all reports submitted for processing. The following procedures are used in its preparation.

*Engagement information.* The in-charge accountant enters the engagement information, delivery instructions, and "hold items" (items to be cleared prior to releasing report). He signs the report guide sheet as initial reviewer.

*Review.* The report is approved at various levels of review. If there is more than one reviewer (for example, two department reviewers for phases of a large job), the primary reviewer should sign the report guide sheet. If the account administrator was assisted in his review by another person, the account administrator should sign the report guide sheet as overall reviewer. If another partner or manager performed the entire review in the absence of the account administrator, then such other reviewer should sign the report guide sheet as overall reviewer.

*Processing.* The various processing levels are signed off. If more than one typist is involved, the head of the typing department or the

primary typist may sign the report guide sheet. If more than one person is involved in comparing and proofing, the person primarily responsible should sign the report guide sheet. The review partner or his delegate should sign as final reader.

*Final release.* The person who signs for final release must ascertain that all other required signatures are on the report guide sheet before releasing the report.

*Report production.* The reverse side of the report guide sheet is usually completed by the in-charge accountant. A photocopy may be given to the report production department as advance notice of production requirements (for example, where numerous printed covers will be needed).

.17 The report guide sheet is bound with the operating office's file copy of the report. With the busy atmosphere prevailing at most firms, it is of vital importance that all work as it moves through the production process be under tight control independent of the work product and its guide sheet.

.18 A simple schedule can be maintained to control the flow of work from the date an audit engagement is begun to the date the report is finally mailed to the client. The schedule has key items arranged in columnar form and can be maintained by the office manager or another person in charge of staff assignments. Frequent references to the schedule should reveal any unusual delays in completing an engagement or typing a report.

.19 To account for each report from the time it is placed for typing to the time it is mailed or delivered to the client, some firms maintain a record in the typing department, in place of or as a supplement to the foregoing record. (See Report Production Control.)

.20 If this record indicates any time lags, the matter should be investigated; it may indicate either an abnormal backlog of work or some other problem.

.21 In preparing the report production control form, the following procedures are suggested:

- It should be manually prepared and updated daily by a control clerk.
- It should be retained in a notebook in a readily accessible location so that audit personnel can check report status without interfering with review and production operations.

- When a report and related work papers are received by the reviewer, the client name, report description, fiscal year end, report-letter date, and due date should be entered.
- The review partner should assign a reviewer and record the date forwarded to the reviewer and the forwarding date for tax review.
- The person's name to whom the report is given for rework (if required) should be entered and the dates forwarded for tax and audit reviews of rework are recorded (if required).
- Other dates should be recorded through final release.

.22 Periodic distribution of photocopies of the current report production control forms to the department heads will enable them to spot processing delays and to raise appropriate administrative questions.

.23

Report Guide Sheet

(To be bound with the — colored copy of report)

Engagement Information

Client \_\_\_\_\_ Date due \_\_\_\_\_

Assignment number \_\_\_\_\_ Assignment name \_\_\_\_\_

Account administrator \_\_\_\_\_ Manager \_\_\_\_\_ In-charge accountant \_\_\_\_\_

Compiled Financial Statements Period \_\_\_\_\_

Reviewed Financial Statements Period \_\_\_\_\_

Audited Statements Period \_\_\_\_\_

Review of Interim Financial Information Period \_\_\_\_\_

Other Unaudited Financial Statements Period \_\_\_\_\_

Special Reports — Date \_\_\_\_\_

Description: \_\_\_\_\_

Delivery Instructions:

Name —attention of: \_\_\_\_\_  Mail

Address: \_\_\_\_\_  Delivery by:

Hold Items (describe):

Hold Items (describe):	Cleared by	Date
_____	_____	_____
_____	_____	_____
_____	_____	_____

Report Review:

	Signature	Date
In-charge	_____	_____
Account Administrator	_____	_____
Review Department	_____	_____
Tax Department	_____	_____
Review Partner	_____	_____

Reporting Processing:

	Signature	Date
Typing department	_____	_____
Comparing and proofing	_____	_____
Final reading	_____	_____

Final Release:

The report(s) described above were released by me after all hold items were cleared. All appropriate levels of review were signed off, and all processing steps completed.

\_\_\_\_\_  
(Signature) (Date)

Report Guide Sheet (Continued)

Report Description (Exactly as it will appear):

- Financial Statements and Accountant's (Compilation) (Review) Report
- Financial Statements and Auditor's Report
- Unaudited (Interim) Financial (Statements) (Information) (and Accountant's Review Report)
- Other Title \_\_\_\_\_

Client \_\_\_\_\_ Date \_\_\_\_\_

Report Production:

Covers:  Printed  Typed Report:  Multilith  Other \_\_\_\_\_

Report Copies:

In covers	Client	Issuing office <sup>a</sup>	Regional office <sup>b</sup>	Executive office <sup>c</sup>			Totals
Standard form	_____	_____	_____	_____	_____	_____	_____
Long form	_____	_____	_____	_____	_____	_____	_____
SEC	_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____	_____
Uncovered <sup>d</sup>	Work paper copies (at least two)		Extra file copies		_____	_____	_____
Standard form	_____	_____	_____	_____	_____	_____	_____
Long form	_____	_____	_____	_____	_____	_____	_____
SEC stapled	_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____	_____
Grand total							_____

- a. One copy of each report should be bound in a \_\_\_\_\_ colored cover with a completed report guide sheet.
- b. The regional office should be sent only the following:
  1. All filings and reports for publicly held clients.
  2. All audit reports expressing a qualified opinion, a denial of opinion, or an adverse opinion.
  3. Special purpose reports.
  4. All unaudited reports where a reservation is expressed.
  5. Budgets and forecasts.
  6. Pro forma financial statements.
- c. The executive office should be sent only filings and reports on publicly held clients.
- d. Except as required for regulatory purposes, uncovered stapled copies should not be released to clients or third parties.

Other Production Instructions:

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_





## **Auditors' Reports—Review Procedures**

.25 Although many firms combine some steps, the review process may have several steps:

1. On larger assignments, the initial review, sometimes called the field review, may be handled by the in-charge accountant. On smaller assignments it may be combined with the second review and handled by the account administrator (who may be a partner or a manager being considered for partnership).
2. The overall review (which may be partly in the field) may be handled by the account administrator or partner.
3. The detailed office review may be done by the review department. Where there is no such department, it usually is handled by another partner not directly connected with the engagement.
4. The income tax review may be made by the tax department. Where there is no separate department, it is usually handled by a partner who is knowledgeable in tax matters.
5. The final review of the report may be made by the engagement partner or another audit partner particularly (a) when the engagement partner's field of specialization is not auditing or (b) when the client is a public company.
6. A post-review is frequently made after reports are issued. Sometimes this is done by the managing partner of the office. In a multi-office firm the executive office may appoint specific partners to conduct post-reviews.

.26 Each person responsible for any phase of review should know the exact nature and extent of his responsibilities. Many firms prepare manuals detailing the steps to be taken by each reviewer, including a review questionnaire. While the details of the review procedures are technical matters covered in-depth in technical publications, some examples are included on the following pages to guide firms in formalizing their procedures.

## **Responsibilities of the In-Charge Accountant**

.27 Before the in-charge accountant is satisfied that the initial or field review is complete, he or she should—

- Determine that all phases of the work have been concluded in accord with the engagement plan.
- Determine that the engagement has been conducted in accord with generally accepted auditing standards, and that the report has been prepared in conformity with the standards of reporting.
- Review, initial, and date all working papers prepared by others.

- Resolve all questions raised in the working papers.
- Determine that the working papers contain only information related to the specific engagement and that all nonevidential matter has been disposed of.
- Review journal entries to check that they have been properly prepared and approved by the client.
- Obtain the account administrator's approval of the journal entries (preferably before leaving the field) before submitting them to the client.
- Prepare and sign the report guide sheet.
- Obtain the account administrator's approval that the field work is, in fact, complete.
- Evaluate the performance of those assisting in the engagement.

### **Responsibilities of the Account Administrator**

.28 The second phase of the review is usually an overall review by the account administrator. Because this person makes visits to the field, this review tends to overlap with the field review by the in-charge accountant. Nevertheless, there are certain things for which the account administrator is responsible.

.29 The account administrator conducts an overall review of each engagement as part of the ultimate responsibility for each of the firm's clients assigned to him or her. Knowledge of the client's transactions provides an informed basis for appraising the adequacy of procedures and the adherence to proper accounting principles. The overall review also alerts the account administrator to pertinent matters relating to his consulting activities.

.30 The account administrator's review is a continuing matter not restricted to the period immediately following the fieldwork phase of the engagement. He should periodically visit the client's offices during the course of the engagement to review progress and to determine that all questions have been satisfactorily answered.

.31 Only in rare instances would an account administrator delegate his overall review function to another and, in such cases, only to a partner or to a manager familiar with the account. However, in all instances the account administrator should remain responsible for the overall review and should ascertain that the review has been properly performed before the report and working papers are forwarded to the review department.

.32 Where feasible, the overall review should take place in the field during the final stages of the audit. This permits the account admin-

istrator to resolve more easily any questions which arise and permits him to extend audit procedures if necessary.

.33 In his overall review, the account administrator, in addition to his technical review, should be responsible for the following:

- Analyzing the financial statements and notes to make certain that representations and amounts in the report are appropriate from a business standpoint.
- Initialing key working papers. For example, he may initial those working papers where his knowledge of the client's affairs is particularly applicable.
- Resolving all questions raised in the review performed by the in-charge accountant.
- Determining the adequacy of explanations for substantial variances between current and prior-year report balances.
- Signing the report guide sheet.
- Evaluating the performance of the in-charge accountant and assistants.

.34 The degree of detail in which the account administrator's review is performed depends on various factors pertinent to the circumstances of the engagement and is influenced by the degree of reliance he can place on the staff executing the assignment as well as by the extent of preliminary review. However, the account administrator should *not* perform such review procedures as tracing figures and mechanical accuracy; these procedures should be performed by the review department.

.35 The account administrator should be responsible for reviewing the report with the client after it has been approved by the office reviewer.

### **Responsibilities of the Review Department**

.36 The responsibilities of the review department, if there is one, vary between firms. The prime responsibility, however, is to insure compliance with policies of the firm and with applicable accounting, auditing, and SEC pronouncements.

### **Review Outline**

.37 Outlines, either formal or informal, may be used by reviewers as guides for conducting a review. They provide only general boundaries for the review and require professional experience and technical competence on the part of the reviewer. The use of a review outline

does not diminish the need for technical literature to be available on each engagement.

.38 Review outlines such as the illustration which follows should be used by persons having expert knowledge of generally accepted accounting principles and auditing standards and preferably by someone who has had experience in reviewing reports and working papers. Reviewers must use professional judgment in applying such aids in actual circumstances; accordingly it may be appropriate to modify specific steps or prepare supplementary materials.

.39

### **Illustrative Review Outline**

#### **Overall Objectives**

The reviewer determines that the working papers and financial statements, standing alone, demonstrate and document compliance with:

1. Generally accepted auditing standards.
2. Generally accepted accounting principles.
3. Policies and procedures of the firm as set forth in its manuals.

#### **Mechanical Accuracy**

The following steps are performed to assure the mechanical and arithmetical accuracy of the report and related working papers.

1. For supporting schedules which arrive at account balances, trace balances to lead schedules.
2. Trace lead schedules to working trial balances.
3. Trace all figures in report to working papers.
4. Intercheck all figures appearing in more than one place in the report.
5. Test important calculations in the working papers, such as:
  - a. Accruals for interest income and expense.
  - b. Accruals and provisions for state and federal income taxes.
  - c. Accruals for pension and profit sharing plans.
  - d. Accrued bonuses.
  - e. Depreciation.
  - f. Inventory price testing.
  - g. Installment sale income.
  - h. Calculations with respect to leases.
6. The following calculations should be recomputed.
  - a. Earnings per share.

**Illustrative Review Outline (continued)**

- b. Compliance with loan agreement restrictions.
- c. Figures included in notes.

**Audit Scope and Execution**

The reviewer should satisfy himself as to the following:

1. Proper treatment of areas which may lead to or are susceptible to material misstatement of the financial report. Adequacy of administrator's review of such areas and consideration of the peculiarities of the client and its industry during his review.
2. Adequacy of review, documentation, and tests of compliance of the system of internal accounting control. Scope of the audit procedures performed was based on the auditor's evaluation of internal accounting control.
3. The audit program used was appropriate for the particular circumstances.
4. Scope, basis of selection, and results of such procedures as:
  - a. Voucher tests
  - b. Payroll test
  - c. Sales test
  - d. Cut-off tests
5. Scope, basis of selection, and results of accounts receivable confirmation and supplementary procedures. Adequacy of allowance for doubtful accounts.
6. Adequacy of tests of inventory, including validity of conclusions as to price testing, physical inventory observations, and factors relating to possible obsolescence. Reliability of confirmations of inventory held for and by third parties. Conformity of cost accounting procedures to generally accepted accounting principles. Proper use and documentation of "lower of cost or market value."
7. Valuation of investments.
8. Valuation and amortization of intangibles.
9. Scope, basis of selection, and results of liability tests.
10. Adequacy of accrued liabilities.
11. Adequacy of auditing procedures on long-term debt including confirmations and review of indenture restrictions.
12. Adequacy of examination of capital accounts.
13. Adequacy of provision for income taxes.
14. Proper period for reporting of income and expense.

15. Adequacy of explanations of material variations in income and expense accounts from prior year.
16. Completeness of representation letters.
17. Propriety of reporting of transactions with related parties.
18. Adequacy of support for and accuracy of all material year-end adjusting journal entries.

### **Report Review**

The reviewer should satisfy himself that:

1. The report complies with the AICPA Statements on Auditing Standards or Statements on Standards for Accounting and Review Services, as applicable.
2. Accounting principles conform to Opinions of the Accounting Principles Board and Statements of the Financial Accounting Standards Board.

### **Concluding the Review**

In concluding his review, the reviewer does the following:

1. Clears all questions with the account administrator. Controversial points that cannot be resolved are referred to the appropriate person for a decision.
2. Communicates any suggested changes in the report or the financial statements to the account administrator. The reviewer should not make the changes himself.
3. Communicates suggestions (in addition to those developed by the in-charge accountant) for the following year to the account administrator. Such suggestions would typically include cycle testing, statistical sampling, assistance of client's personnel to prepare schedules, use of computer audit specialists and computer audit programs, and possible reduction of test scope.
4. If necessary, communicates comments about adequacy of initial review by the in-charge accountant and overall review by the account administrator to managing partner.
5. Ascertains that all "hold" items have been properly noted. (It is the responsibility of the partner signing for final release on the report guide sheet to ascertain that all hold items have been cleared.)
6. Signs the appropriate form as reviewer.
7. Records review time on the time analysis form.

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»»»→ *The next page is 9501.* ←«««





## ***Report Processing***

### **Drafting the Report**

.01 The only tangible evidence a client receives of the CPA's work is the written report. Since weeks or months of effort may have been spent in its preparation (for which the client pays a substantial fee), it is only prudent that every effort be made to insure the superior quality of its presentation.

.02 While most financial statements do not offer the opportunity for creativity in writing style, the effectiveness of many special reports is influenced by the quality of the writing. Clarity and dignity in an accountant's report are not achieved through use of long words, technical language or complicated reasoning, but through simple language used to present important thoughts, supported by documentation. Proper grammar and sentence structure improve readability. Effective use of forceful words with smooth transitions between sentences will help hold the reader's interest. If the subject matter is of deep concern to management and if management has respect for the auditor's opinion, it is likely that the recommendations will be followed by action, especially if the author communicates effectively. This is particularly true where the report is to be the basis for a management decision.

### **Uniformity**

.03 Strict uniformity may stifle creative thinking, but a consistent format adds quality to the written report.

1. The client's name should appear at the top of every statement with identical spelling and punctuation. The certificate of incorporation should be inspected to determine the exact name of the corporation. Accuracy in seemingly small matters, such as whether "the" is part of the name, the word "Company" or "Incorporated" is abbreviated or spelled out, or commas are part of the name, is important to the accountant's reputation.
2. Descriptive phraseology should be uniform. If the phrase "cost of goods sold" is used in the income statement, then a schedule of these costs should show "cost of goods sold," not "cost of sales."
3. The manner in which the date or period covered is indicated should also be uniform. If the income statement is headed "for the year ended December 31, 19—," then all supporting schedules should be headed that way, rather than "for the year 19—."

4. Schedule and statement headings should conform to a pattern. For example, if "schedule of cost of goods sold" is used, then all other schedules should begin with "schedule of."
5. Statement and schedule headings should be the same in the letter, table of contents, index, and other references.

### **Exposure Draft**

.04 In some cases an exposure draft of the report, clearly identified as a draft, can be used effectively to afford the client an opportunity to comment on the report before it is in final form.

### **Report Production**

.05 A report should be typed as indicated in the firm's manuals, but additional care should be exercised in planning the overall format. Each page should be well balanced, paragraphs should break in the right places, tables should be centered and not broken except when a table is longer than a page, page numbers should be in the same place on each sheet, type should be clean and alignment even, and there should be no "strikeovers" or visible erasures.

.06 Typists must know that they are expected to do each job perfectly. The report represents the firm, and there can be no compromise with excellence. If a finished page is not up to standard, it should be retyped before it goes through proofreading, computing, and checking. The following should be standardized:

Title page	Captions
Indexing	Spacing
Salutation	Indentation
Page numbering	Paragraphing
Closing and signing	Capitalization
Dating	Underscoring
Whole dollar reporting	Punctuation
Headings	Dollar signs

Double or single spacing

### **Proofreading**

.07 Before the pencil copy of the report or financial statement is typed, it should be reviewed and initialed. Proofreading should be done by someone other than the typist. In larger offices this may be a full-time job for one or more employees. In other firms, staff assistants or college students (on a part-time basis) may do the proofreading.

.08 One proofreading procedure involves the use of a Routing Form (or Processing Control Form). In this example an editor reviews the report or financial statement to insure (1) that all other quality control checks (footing, proofing, etc.) have been completed, (2) that all firm policies and formats have been followed, (3) that all AICPA, FASB, and SEC pronouncements have been observed, and (4) that no obvious errors or omissions have been made.

.09

Routing Form for Financial Statements

Date wanted \_\_\_\_\_  
 For the fiscal year ended \_\_\_\_\_ Last possible date \_\_\_\_\_

Client name \_\_\_\_\_ Client no. \_\_\_\_\_  
 Address \_\_\_\_\_

Prepared by \_\_\_\_\_ Tax returns to accompany financial statements? Yes  No

Date completed \_\_\_\_\_ Date tax returns due \_\_\_\_\_

Draft reviewed \_\_\_\_\_

Date turned in for typing \_\_\_\_\_ Statements to be:  
 Delivered \_\_\_\_\_  
 Picked up by client \_\_\_\_\_  
 Mailed \_\_\_\_\_

Number of copies \_\_\_\_\_

Statements to be duplicated by:  
 Multilith \_\_\_\_\_ Telephone \_\_\_\_\_  
 Photocopy \_\_\_\_\_ Card \_\_\_\_\_

Special Instructions: \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

Typing, Proofing and Duplicating Route (initial and date each line)

	Assigned to	Completed
Typing .....	_____	_____
Proofing .....	_____	_____
Retyping .....	_____	_____
Rechecking .....	_____	_____
Supervisor's review .....	_____	_____
Review partner's review and OK for duplicating .....	_____	_____
Duplicate financial statements .....	_____	_____
Does supervisor want to review duplicated financial statements before assembling? Yes <input type="checkbox"/> No <input type="checkbox"/>		
Assemble financial statements .....	_____	_____
Account administrator's final review, sign and OK .....	_____	_____
Delivered by _____ Date _____		
Picked up by _____ Date _____		
Mailed by _____ Date _____		



## Signing Reports

.10 After the report has been reviewed, typed, proofread, and corrected, it is usually submitted to a partner for final reading and signature.

.11 Some firms do not bind the report until after it is signed. This saves unbinding in case the signing partner orders any revisions. In offices where the reports have been sufficiently and systematically reviewed and referenced before or after typing, they may be submitted to the partner for his signature in final bound form. This saves time and additional handling.

.12 The transmittal letters and addressed envelopes should be submitted to the partner with the reports. This gives him an opportunity to review the mailing directions, so that reports are directed to the proper person.

.13 Report letters are usually signed by a partner using the firm name. Where reproducing equipment is used, a signature on the original is sufficient. There is no complimentary closing. It is important to establish rules applying to report signatures since all reports (and correspondence) issued to clients carry with them the reputation, authority, and responsibility of the firm.

## Delivery of Completed Work

.14 Audit reports are rightfully considered by clients to be confidential documents. For this reason, care should be taken to address them to a responsible person, usually the treasurer or principal executive, in an envelope clearly marked "confidential." Where there is some question as to the person or persons to whom the report should be delivered, address it to the specific source of authority authorizing the report. In a majority of cases, especially for recurring engagements, the reports are mailed. However, some firms make it a practice to have a partner deliver the report personally and discuss it with the client.

.15 The report should be mailed in envelopes or boxes sturdy enough to withstand the rough treatment they may receive in transit.

.16 Many firms send separate transmittal letters with their reports. The letter should contain no comments on the report because it might be construed as a modification of the opinion on the report. It is advisable to write a letter requesting that a printer's proof be submitted to the accounting firm for review before any printed reports are released by the client to stockholders or the public.

.17 Reports are generally issued only to the client who engaged the services. The unauthorized distribution of a report represents a violation of the confidential relationship between a firm and its client. Firms are sometimes asked by clients to mail copies of their reports

directly to third parties. Clients should be discouraged from making such requests. In rare instances, where a firm assumes this added responsibility, distributions are made only upon specific written instruction from the client, and reference to the client's instructions should be included in the transmittal to the third party. Printed annual reports to shareholders, prospectuses, and other reports that are a matter of public record, such as those filed with certain governmental agencies, are obvious exceptions to this rule.

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## AAM Section 10,000

## ACCOUNTANTS' REPORTS

These examples are for illustrative purposes only. They are included as conveniences for users of this manual who may want points of departure when drafting reports to meet their individual needs. This manual is a nonauthoritative kit of practice aids and accordingly, does not include extensive explanation or discussion of authoritative pronouncements. Users of this manual are urged to refer directly to applicable authoritative pronouncements when appropriate.

These examples illustrate the body of various reports. For comment on the heading, addressing and dating of the report, see section 10,100.

Examples which are assembled from illustrative reporting language set forth in Statements on Auditing Standards (SAS) and Statements on Standards for Accounting and Review Services (SSARS) include citation of the particular source and its location in *AICPA Professional Standards*.

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**»»»→ The next page is 10,101.←«««**



## AAM Section 10,100

# Format of Accountants' Reports

### Heading (Title) of the Report

.01 The following table, extracted from the 1978 edition of *Accounting Trends & Techniques*,<sup>1</sup> shows the descriptive titles used in 600 stockholders' reports to identify the auditor's report:

**TABLE 6-1: TITLE OF AUDITORS' REPORT**

	1977	1976	1975	1974
<i>Independent accountants' report</i> ....	127	113	103	106
<i>Auditors' report</i> .....	121	129	123	125
<i>Accountants' report</i> .....	115	127	159	158
<i>Independent auditors' report</i> .....	56	41	N/C	N/C
<i>Certified public accountants' report</i> ..	51	39	42	42
<i>Independent certified public accountants' report</i> .....	33	34	28	27
<i>Auditors' opinion</i> .....	31	28	10	11
<i>Accountants' opinion</i> .....	11	12	30	28
<i>Independent accountants' opinion</i> ....	5	5	15	15
<i>Independent certified public accountants' opinion</i> .....	5	6	9	9
Other titles .....	3	20	33	30
No title .....	42	46	48	49
Total Companies .....	600	600	600	600

N/C—Not Compiled.

### Addressing the Report

.02 The accountant or auditor addresses his report to the client which retained his service.

.03 When the client is a corporation, the report may be addressed to the corporation, its board of directors or its stockholders. In practice, reports on financial statements of publicly traded corporations are usually addressed to the board of directors and shareholders.<sup>1</sup>

.04 When the client is not incorporated, the circumstances will dictate how the report should be addressed. For example, the report may be addressed to the partners, to the general partner, or to the proprietor.

<sup>1</sup> Source: *Accounting Trends and Techniques* (AICPA, New York, 1978), page 375.

.05 Occasionally, an auditor is retained to examine the financial statements of an entity that is not his client. In such instances, the report is addressed to the client and not to the board of directors, stockholders or proprietor of the entity whose financial statements are being examined.

.06 For authoritative guidance on addressing the report, see SAS No. 2, paragraph 8 (*AICPA Professional Standards*, AU section 509.08).

### **Dating the Report**

.07 The date on an auditor's report generally indicates when the auditor completed the field work on which the report is based. Likewise, the date of an accountant's compilation report on the financial statements of a nonpublic entity, would be the date of completion of the compilation work. The date of a review report on such financial statements would be the date of completion of the accountant's inquiry and analytical procedures. Report dating involves additional considerations when the auditor becomes aware of events that occurred after completion of field work but before issuance of the report, when the report is on comparative financial statements, or when a report on prior year financial statements is reissued.

.08 When an event which is disclosed in the financial statements occurs after completion of field work but before issuance of the report, the auditor may use "dual dating," for example, "February 15, 19X1, except for Note 10 as to which the date is March 1, 19X1." In this instance, the auditor's responsibility for events occurring after February 15, 19X1 is limited to the specific event referred to in Note 10. The auditor may also date the report as of March 1, 19X1; this, however, would extend the auditor's responsibility for subsequent events to March 1, 19X1.

.09 For an auditor's report which covers financial statements of one or more prior periods (which he audited) presented on a comparative basis with those of the current period, the auditor would ordinarily date the report on the financial statements of all periods presented as of the date of his report on the most recent financial statements.

.10 When an auditor, as a predecessor, reissues a report on prior year financial statements for presentation with the report of a successor auditor on current-year financial statements, the predecessor would use the date of his previous report on his reissued report to avoid the implication that he has performed any additional field work. If the predecessor auditor revises his report or if the financial statements are restated, he would dual date his report.



.11 For authoritative guidance on dating reports, see SAS No. 1, section 530; SAS No. 15, paragraphs 2 and 11; SAS No. 24, paragraph 17; and SSARS No. 1, paragraphs 15 and 33 (*AICPA Professional Standards*, AU sections 530, 505.02, 505.11, 727.17, and AR section 100.15 and 100.33).

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**AAM Section 10,210*****Unqualified Opinions*****.010 Auditor's Standard Report—Comparative Financial Statements**

We have examined the balance sheets of ABC Company as of [at] December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and changes in financial position for the years then ended. Our examinations were 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.

In our opinion, the financial statements referred to above present fairly the financial position of ABC Company as of [at] December 31, 19X2 and 19X1, and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

[Source: SAS No. 15, paragraph 3 (*AICPA Professional Standards*, AU section 505.03).]

**.020 Auditor's Standard Report—Single Year Financial Statements**

We have examined the balance sheet of X Company as of [at] December 31, 19XX, and the related statements of income, retained earnings and changes in financial position 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.

In our opinion, the financial statements referred to above present fairly the financial position of X Company as of [at] December 31, 19XX, and the results of its operations and the changes in its financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

[Source: SAS No. 2, paragraph 7 (*AICPA Professional Standards*, AU section 509.07).]

**.030 Report on a Single Statement (Balance Sheet)**

We have examined the balance sheets of ZYX Company as of [at] December 31, 19X2 and 19X1. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and other auditing procedures as we considered necessary in the circumstances.

In our opinion, the balance sheets referred to above present fairly the financial position of ZYX Company as of [at] December 31, 19X2 and 19X1 in conformity with generally accepted accounting principles applied on a consistent basis.

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**NOTE:**

The auditor should consider the need for disclosure in his report of a loss or similar operating problems if not already adequately disclosed in the balance sheets or accompanying footnotes.

**.040 Reference to Other Auditors—Successor Auditor's Report when Predecessor's Report (Unqualified) Is Not Presented**

We have examined the balance sheet of ABC Company as of December 31, 19X2, and the related statements of income, retained earnings, and changes in financial position 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. The financial statements of ABC Company for the year ended December 31, 19X1, were examined by other auditors whose report dated March 1, 19X2, expressed an unqualified opinion on those statements.

In our opinion, the 19X2 financial statements referred to above present fairly the financial position of ABC Company as of December 31, 19X2, and the results of its operations and the changes in its financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

[Source: SAS No. 15, paragraph 12 (*AICPA Professional Standards*, AU section 505.12).]

**.050 Reference to Other Auditors in Report**

We have examined the consolidated balance sheet of X Company and subsidiaries as of December 31, 19XX, and the related consolidated statements of income and retained earnings and changes in financial position 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. We did not examine the financial statements of B Company, a consolidated subsidiary, which statements reflect total assets and revenues constituting 20 percent and 22 percent, respectively, of the related consolidated totals. These statements were examined by other auditors whose report thereon has been furnished to us, and our opinion expressed herein, insofar as it relates to the amounts included for B Company, is based solely upon the report of the other auditors.

In our opinion, based upon our examination and the report of other auditors, the accompanying consolidated balance sheet and consolidated statements of income and retained earnings and changes in financial position present fairly the financial position of X Company and subsidiaries as of [at] December 31, 19XX, and the results of their operations and the changes in their financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

[Source: SAS No. 1, section 543.09 (*AICPA Professional Standards*, AU section 543.09).]

**.060 Reference to Other Auditors—Successor Auditor's Unqualified Report when Predecessor's (Qualified) Report Is Not Presented**

We have examined the balance sheet of ABC Company as of December 31, 19X2, and the related statements of income, retained earnings, and changes in financial position 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. The financial statements of ABC Company for the year ended December 31, 19X1, were examined by other auditors whose opinion, dated March 1, 19X2, on those statements was qualified as being subject to the effects on the 19X1 financial statements of such adjustments, if any, as might have been required had the outcome of the litigation discussed in Note X to the financial statements been known.

In our opinion, the 19X2 financial statements referred to above present fairly the financial position of ABC Company as of December 31, 19X2, and the results of its operations and the changes in its financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

[Source: SAS No. 15, paragraph 12 (*AICPA Professional Standards*, AU section 505.12).]

## **.070 Reference to Other Auditors—Prior Year Financial Statements Restated Following a Pooling of Interests**

We have examined the consolidated balance sheet of XYZ Company and subsidiaries as of [at] December 31, 19X2, and the related consolidated statements of income, retained earnings and changes in financial position 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.

In our opinion, the financial statements referred to above present fairly the consolidated financial position of XYZ Company and subsidiaries as of [at] December 31, 19X2, and the consolidated results of their operations and the changes in their consolidated financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

We previously examined and reported upon the consolidated statements of income and changes in financial position of XYZ Company and subsidiaries for the year ended December 31, 19X1, prior to their restatement for the 19X2 pooling of interests. The contribution of XYZ Company and subsidiaries to revenues and net income represented . . . . percent and . . . . percent of the respective restated totals. Separate financial statements of the other companies included in the 19X1 restated consolidated statements of income and changes in financial position were examined and reported upon separately by other auditors. We also have reviewed, as to compilation only, the accompanying consolidated statements of income and changes in financial position for the year ended December 31, 19X1, after restatement for the 19X2 pooling of interests; in our opinion, such consolidated statements have been properly compiled on the basis described in Note A of notes to consolidated financial statements.

[Source: SAS No. 1, section 543.16 (*AICPA Professional Standards*, AU section 543.16).]

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### NOTE:

The auditor uses this form of reporting when he concludes he cannot serve as principal auditor for the restated financial statements. See SAS No. 1, section 543.16—.17 (AU section 543.16—.17), for guidance.

**.080 Comparative Financial Statements—Unqualified Opinion on the Current Year's Financial Statements with Disclaimer of Opinion on the Prior Year's Statements of Income, Retained Earnings, and Changes in Financial Position**

We have examined the balance sheets of ABC Company as of [at] December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and changes in financial position for the years then ended. Except as explained in the following paragraph, our examinations were 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.

We did not observe the taking of the physical inventory as of December 31, 19X0, since that date was prior to our appointment as auditors for the Company, and we were unable to satisfy ourselves regarding inventory quantities by means of other auditing procedures.

In our opinion, the balance sheets of ABC Company as of December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and changes in financial position for the year ended December 31, 19X2, present fairly the financial position of ABC Company as of December 31, 19X2 and 19X1, and the results of its operations and the changes in its financial position for the year ended December 31, 19X2, in conformity with generally accepted accounting principles applied on a consistent basis.

Because of the matter discussed in the second paragraph, the scope of our work regarding inventories as of December 31, 19X0, was not sufficient to enable us to express, and we do not express, an opinion on the statements of income, retained earnings, and changes in financial position for the year ended December 31, 19X1.

[Source: SAS No. 15, paragraph 5 (*AICPA Professional Standards*, AU section 505.05).]



**.090 Comparative Financial Statements—Resolution in the Current Period of an Uncertainty Existing in a Prior Period Requiring No Adjustment of the Financial Statements**

We have examined the balance sheets of ABC Company as of [at] December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and changes in financial position for the years then ended. Our examinations were 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.

In our report dated March 1, 19X2, our opinion on the 19X1 financial statements was qualified as being subject to the effects on the 19X1 financial statements of such adjustments, if any, as might have been required had the outcome of certain litigation been known. As explained in Note X, the litigation was settled as of November 1, 19X2, at no material cost to the Company. Accordingly, our present opinion on the 19X1 financial statements, as presented herein, is different from that expressed in our previous report.

In our opinion, the financial statements referred to above present fairly the financial position of ABC Company as of [at] December 31, 19X2 and 19X1, and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

[Source: SAS No. 15, paragraph 7 (*AICPA Professional Standards*, AU section 505.07).]

**.100 Comparative Financial Statements—Resolution in the Current Period of an Uncertainty Existing in a Prior Period Requiring Recognition in the Current Financial Statements**

We have examined the balance sheets of ABC Company as of [at] December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and changes in financial position for the years then ended. Our examinations were 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.

In our report dated March 1, 19X2, our opinion on the 19X1 financial statements was qualified as being subject to the realization of the investment in DEF Company. As explained in Note X, the carrying amount of that investment has been charged to operations in the current year as required by generally accepted accounting principles. Accordingly, our present opinion on the 19X1 financial statements, as presented herein, is different from that expressed in our previous report.

In our opinion, the financial statements referred to above present fairly the financial position of ABC Company as of [at] December 31, 19X2 and 19X1, and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

[Source: SAS No. 15, paragraph 7 (*AICPA Professional Standards*, AU section 505.07).]

## **.110 Comparative Financial Statements—Subsequent Restatement of Prior Period Financial Statements to Conform with Generally Accepted Accounting Principles**

We have examined the balance sheets of ABC Company as of [at] December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and changes in financial position for the years then ended. Our examinations were 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.

In our report dated March 1, 19X2, we expressed an opinion that the 19X1 financial statements did not fairly present financial position, results of operations, and changes in financial position in conformity with generally accepted accounting principles because of two departures from such principles: (1) the Company carried its property, plant, and equipment at appraisal values, and provided for depreciation on the basis of such values, and (2) the Company did not provide for deferred income taxes with respect to differences between income for financial reporting purposes and taxable income. As described in Note X, the Company has restated its 19X1 financial statements to conform with generally accepted accounting principles. Accordingly, our present opinion on the 19X1 financial statements, as presented herein, is different from that expressed in our previous report.

In our opinion, the financial statements referred to above present fairly the financial position of ABC Company as of [at] December 31, 19X2 and 19X1, and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis, after restatement for the changes referred to in the preceding paragraph.

[Sources: SAS No. 15, paragraph 7 (*AICPA Professional Standards*, AU section 505.07); SAS No. 1, section 546.01—.02 (*AICPA Professional Standards*, AU section 546.01—.02).]

## **.120 Comparative Financial Statements — Current Year's Statements Audited and Prior Year's Statements Reviewed**

We have examined the balance sheet of X Company as of [at] December 31, 19X2, and the related statements of income, retained earnings and changes in financial position 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.

In our opinion, the financial statements referred to above present fairly the financial position of X Company as of [at] December 31, 19X2, and the results of its operations and the changes in its financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

The 19X1 financial statements were reviewed by us (other accountants) and our (their) report thereon, dated March 1, 19X2, stated we (they) were not aware of any material modifications that should be made to those statements for them to be in conformity with generally accepted accounting principles. However, a review is substantially less in scope than an audit and does not provide a basis for the expression of an opinion on the financial statements taken as a whole.

[Sources: SAS No. 26, paragraph 17 (*AICPA Professional Standards*, AU section 504.17) and SAS No. 2, paragraph 7 (*AICPA Professional Standards*, AU section 509.07).]

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### NOTE:

When unaudited financial statements are presented in comparative form with audited financial statements, the unaudited financial statements should be clearly marked to indicate their status.

### **.130 Comparative Financial Statements — Current Year's Statements Audited and Prior Year's Statements Compiled**

We have examined the balance sheet of X Company as of [at] December 31, 19X2, and the related statements of income, retained earnings and changes in financial position 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.

In our opinion, the financial statements referred to above present fairly the financial position of X Company as of [at] December 31, 19X2, and the results of its operations and the changes in its financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

The 19X1 financial statements were compiled by us (other accountants) and our (their) report thereon, dated March 1, 19X2, stated we (they) did not audit or review those financial statements and, accordingly, express no opinion or other form of assurance on them.

[Sources: SAS No. 26, paragraph 17 (*AICPA Professional Standards*, AU section 504.17) and SAS No. 2, paragraph 7 (*AICPA Professional Standards*, AU section 509.07).]

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**NOTE:**

When unaudited financial statements are presented in comparative form with audited financial statements, the unaudited financial statements should be clearly marked to indicate their status.

**.140 Comparative Financial Statements — Current Year's Statements Audited and Disclaimer on Prior Year's Unaudited Statements**

We have examined the balance sheet of X Company as of [at] December 31, 19X2, and the related statements of income, retained earnings and changes in financial position 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.

In our opinion, the financial statements referred to above present fairly the financial position of X Company as of [at] December 31, 19X2, and the results of its operations and the changes in its financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

The 19X1 financial statements were not audited by us and, accordingly, we do not express an opinion on them.

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**NOTES:**

The above report illustrates a disclaimer of opinion as described in SAS No. 26, paragraph 17 (*AICPA Professional Standards*, AU section 504.17) when the financial statements are those of a public entity. For a nonpublic entity, see AAM section 10,210.120 and 10,210.130.

When unaudited financial statements are presented in comparative form with audited financial statements, the unaudited financial statements should be clearly marked to indicate their status.

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## AAM Section 10,220

### Adverse Opinions

.01 We have examined the balance sheet of X Company as of [at] December 31, 19XX, and the related statements of income, retained earnings and changes in financial position 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.

As discussed in Note X to the financial statements, the Company carries its property, plant and equipment accounts at appraisal values, and provides depreciation on the basis of such values. Further, the Company does not provide for income taxes with respect to differences between financial income and taxable income arising because of the use, for income tax purposes, of the installment method of reporting gross profit from certain types of sales. Generally accepted accounting principles, in our opinion, require that property, plant and equipment be stated at an amount not in excess of cost, reduced by depreciation based on such amount, and that deferred income taxes be provided. Because of the departures from generally accepted accounting principles identified above, as of December 31, 19XX, inventories have been increased \$. . . . . by inclusion in manufacturing overhead of depreciation in excess of that based on cost; property, plant and equipment, less accumulated depreciation, is carried at \$. . . . . in excess of an amount based on the cost to the Company; and allocated income tax of \$. . . . . has not been recorded; resulting in an increase of \$. . . . . in retained earnings and in appraisal surplus of \$. . . . . For the year ended December 31, 19XX, cost of goods sold has been increased \$. . . . . because of the effects of the depreciation accounting referred to above and deferred income taxes of \$. . . . . have not been provided, resulting in an increase in net income and earnings per share of \$. . . . . and \$. . . . . respectively.

In our opinion, because of the effects of the matters discussed in the preceding paragraph, the financial statements referred to above do not present fairly, in conformity with generally accepted accounting principles, the financial position of X Company as of December 31, 19XX, or the results of its operations and changes in its financial position for the year then ended.

[Source: SAS No. 2, paragraph 43 (*AICPA Professional Standards*, AU section 509.43).]

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**AAM Section 10,230*****Disclaimers of Opinion*****.01 Beginning Inventory Not Observed (First Examination)**

We have examined the balance sheet of X Company as of September 30, 19X2, and the related statements of income and retained earnings and changes in financial position 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, except as stated in the following paragraph.

Because we were not engaged as auditors until after September 30, 19X1, we were not present to observe the physical inventory taken at that date and we have not satisfied ourselves by means of other procedures concerning inventory quantities. The amount of the inventory at September 30, 19X1, enters materially into the determination of the results of operations and changes in financial position for the year ended September 30, 19X2. Therefore, we do not express an opinion on the accompanying statements of income and retained earnings and changes in financial position for the year ended September 30, 19X2.

In our opinion, the accompanying balance sheet presents fairly the financial position of X Company at September 30, 19X2, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

[Source: SAS No. 1, section 542.05 (*AICPA Professional Standards*, AU section 542.05).]

**.02 Inadequate Records Preclude Opinion (First Examination)**

We have examined the balance sheet of X Company as of [at] December 31, 19XX, and the related statements of income, retained earnings and changes in financial position for the year then ended. Except as indicated in the following paragraph, 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.

Because of major inadequacies in the Company's accounting records for the previous year, it was not practicable to extend our auditing procedures to enable us to express an opinion on results of operations and changes in financial position for the year ended December 31, 19XX or on the consistency of application of accounting principles with the preceding year.

In our opinion, the accompanying balance sheet presents fairly the financial position of X Company as at December 31, 19XX in conformity with generally accepted accounting principles.

[Source: SAS No. 1, section 546.15 (*AICPA Professional Standards*, AU section 546.15).]

**.03 Inadequate Records Preclude Restatement of Prior Years and Preclude Opinion on Consistency (First Examination)**

We have examined the balance sheet of X Company as of [at] December 31, 19XX, and the related statements of income, retained earnings and changes in financial position for the year then ended. Except as set forth in the following paragraph, 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.

The Company has kept its records and has prepared its financial statements for previous years on the cash basis with no recognition having been accorded accounts receivable, accounts payable, or accrued expenses. At the beginning of the current year the Company adopted the accrual basis of accounting. Although appropriate adjustments have been made to retained earnings as of the beginning of the year, it was not practicable to determine what adjustments would be necessary in the financial statements of the preceding year to restate results of operations and changes in financial position in conformity with the accounting principles used in the current year.

In our opinion, the financial statements referred to above present fairly the financial position of X Company as of [at] December 31, 19XX, and the results of its operations and the changes in its financial position for the year then ended, in conformity with generally accepted accounting principles.

[Source: SAS No. 1, section 546.16 (*AICPA Professional Standards*, AU section 546.16).]

**.04 Limitation of Scope—Evidential Matter**

We have examined the balance sheet of X Company as of [at] December 31, 19X2, and the related statements of income, retained earnings and changes in financial position for the year then ended. Except as set forth in the following paragraph, 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.

The Company did not take a physical inventory of merchandise, stated at \$. . . . . in the accompanying financial statements as of December 31, 19X2, and at \$. . . . . as of December 31, 19X1. Further, evidence supporting the cost of property and equipment acquired prior to December 31, 19X1 is no longer available. The Company's records do not permit the application of adequate alternative procedures regarding the inventories or the cost of property and equipment.

Since the Company did not take physical inventories and we were unable to apply adequate alternative procedures regarding inventories and the cost of property and equipment, as noted in the preceding paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial statements referred to above.

[Source: SAS No. 2, paragraph 47 (*AICPA Professional Standards*, AU section 509.47).]

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**AAM Section 10,240****Qualified Opinions****.010 Scope Limitation—Inventories Not Observed (Assuming Effects Are Such that Qualification Rather than Disclaimer Is Appropriate)**

We have examined the balance sheet of X Company as of [at] December 31, 19X2, and the related statements of income, retained earnings and changes in financial position for the year then ended.

Except as explained in the following paragraph, 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.

We did not observe the taking of the physical inventories as of December 31, 19X2 (stated at \$. . . . .), and December 31, 19X1 (stated at \$. . . . .), since those dates were prior to the time we were initially engaged as auditors for the Company. Due to the nature of the Company's records, we were unable to satisfy ourselves as to the inventory quantities by means of other auditing procedures.<sup>1</sup>

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to observe the physical inventories, the financial statements referred to above present fairly the financial position of X Company as of [at] December 31, 19X2, and the results of its operations and the changes in its financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

[Source: SAS No. 2, paragraph 40 (*AICPA Professional Standards*, AU section 509.40).]

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<sup>1</sup> If the auditor has also been unable to carry out other tests, such as those relating to the pricing and clerical accuracy of the inventories, the language in the middle and opinion paragraphs should be modified accordingly.

**.020 Uncertainty—Litigation**

We have examined the balance sheet of X Company as of [at] December 31, 19XX, and the related statements of income, retained earnings and changes in financial position 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.

As discussed in Note Z to the financial statements, the Company is defendant in a lawsuit alleging infringement of certain patent rights and claiming royalties and punitive damages. The Company has filed a counter action, and preliminary hearings and discovery proceedings on both actions are in progress. Company officers and counsel believe the Company has a good chance of prevailing, but the ultimate outcome of the lawsuits cannot presently be determined, and no provision for any liability that may result has been made in the financial statements.

In our opinion, subject to the effects of such adjustments, if any, as might have been required had the outcome of the uncertainty referred to in the preceding paragraph been known, the financial statements referred to above present fairly the financial position of X Company as of [at] December 31, 19XX, and the results of its operations and the changes in its financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

[Source: SAS No. 2, paragraph 39 (*AICPA Professional Standards*, AU section 509.39).]

**.030 Uncertainty—Litigation, Prior Year Unqualified**

We have examined the balance sheets of ABC Company as of [at] December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and changes in financial position for the years then ended. Our examinations were 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.

As discussed in Note X, during 19X2 the Company became a defendant in a lawsuit relating to the sale in 19X2 of a wholly owned subsidiary. The ultimate outcome of the lawsuit cannot be determined, and no provision for any liability that may result has been made in the 19X2 financial statements.

In our opinion, subject to the effects on the 19X2 financial statements of such adjustments, if any, as might have been required had the outcome of the uncertainty referred to in the preceding paragraph been known, the financial statements referred to above present fairly the financial position of ABC Company as of December 31, 19X2 and 19X1, and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

[Source: SAS No. 15, paragraph 5 (*AICPA Professional Standards*, AU section 505.05).]

**.040 Uncertainty—New Uncertainty Affecting Both the Current and Prior Period Financial Statements**

We have examined the balance sheets of ABC Company as of [at] December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and changes in financial position for the years then ended. Our examinations were 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.

As discussed in Note X, a number of legal actions were filed against the Company subsequent to the date of our report on the 19X1 financial statements. These actions claim substantial damages as a result of alleged violations of antitrust laws during prior years. The Company is in the process of litigating these actions, but the ultimate outcome is uncertain at this time. In our report dated March 1, 19X2, our opinion on the 19X1 financial statements was unqualified; however, in view of the litigation referred to above, our present opinion on the 19X1 financial statements, as presented herein, is different from that expressed in our previous report.

In our opinion, subject to the effects on the 19X2 and 19X1 financial statements of such adjustments, if any, as might have been required had the outcome of the uncertainty referred to in the preceding paragraph been known, the financial statements referred to above present fairly the financial position of ABC Company as of December 31, 19X2 and 19X1, and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

[Source: SAS No. 15, paragraphs 5 and 7 (*AICPA Professional Standards*, AU section 505.05 and 505.07).]



**.050 Departure from GAAP—Leases Not Capitalized**

We have examined the balance sheet of X Company as of [at] December 31, 19XX, and the related statements of income, retained earnings and changes in financial position 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.

The Company has excluded from property and debt in the accompanying balance sheet certain lease obligations, which, in our opinion, should be capitalized in order to conform with generally accepted accounting principles. If these lease obligations were capitalized, property would be increased by \$ . . . . ., long-term debt by \$ . . . . ., and retained earnings by \$ . . . . . as of December 31, 19XX, and net income and earnings per share would be increased (decreased) by \$ . . . . . and \$ . . . . . respectively for the year then ended.

In our opinion, except for the effects of not capitalizing lease obligations, as discussed in the preceding paragraph, the financial statements present fairly the financial position of X Company as of [at] December 31, 19XX, and the results of its operations and the changes in its financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

[Source: SAS No. 2, paragraph 36 (*AICPA Professional Standards*, AU section 509.36).]

**.060 Departure from GAAP—Leases Not Capitalized  
—Pertinent Facts Disclosed in Note**

We have examined the balance sheet of X Company as of [at] December 31, 19XX, and the related statements of income, retained earnings and changes in financial position 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.

As more fully described in Note Z to the financial statements, the Company has excluded certain lease obligations from property and debt in the accompanying balance sheet. In our opinion, generally accepted accounting principles require that such obligations be included in the balance sheet.

In our opinion, except for the effects of not capitalizing lease obligations, as discussed in the preceding paragraph, the financial statements referred to above present fairly the financial position of X Company as of [at] December 31, 19XX, and the results of its operations and the changes in its financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

[Source: SAS No. 2, paragraph 37 (*AICPA Professional Standards*, AU section 509.37).]

**.070 Inadequate Disclosure—Omission of Disclosure of Restriction in Debt Agreement**

We have examined the balance sheet of X Company as of [at] December 31, 19X1 and the related statements of income, retained earnings and changes in financial position 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.

On January 15, 19X2, the company issued debentures in the amount of \$. . . . . for the purpose of financing plant expansion. The debenture agreement restricts the payment of future cash dividends to earnings after December 31, 19X1.

In our opinion, except for the omission of the information in the preceding paragraph, the financial statements referred to above present fairly the financial position of X Company as of [at] December 31, 19X1, and the results of its operations and the changes in its financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

[Source: SAS No. 1, section 545.02 (*AICPA Professional Standards*, AU section 545.02).]

**.080 Inadequate Disclosure—Omission of Statement of Changes in Financial Position**

We have examined the balance sheet of X Company as of December 31, 19XX and the related statements 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.

The company declined to present a statement of changes in financial position for the year ended December 31, 19XX. Presentation of such statement summarizing the company's financing and investing activities and other changes in its financial position is required by Opinion No. 19 of the Accounting Principles Board.

In our opinion, except that the omission of a statement of changes in financial position results in an incomplete presentation as explained in the preceding paragraph, the aforementioned financial statements present fairly the financial position of X Company at December 31, 19XX, and the results of its operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

[Source: SAS No. 1, section 545.05 (*AICPA Professional Standards*, AU section 545.05).]

**.090 Inconsistency—Change in Accounting Principle Requiring Restatement of Prior Years (Single Year Financial Statements)**

We have examined the balance sheet of X Company as of [at] December 31, 19XX, and the related statements of income, retained earnings and changes in financial position 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.

In our opinion, the financial statements referred to above present fairly the financial position of X Company as of [at] December 31, 19XX, and the results of its operations and the changes in its financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year after giving retroactive effect to the change, with which we concur, in the method of accounting for long-term construction contracts as described in Note X to the financial statements.

[Source: SAS No. 1, section 546.02 (*AICPA Professional Standards*, AU section 546.02).]

**.100 Inconsistency—Change in Accounting Principle Requiring Restatement of Prior Years (Comparative Financial Statements)**

We have examined the balance sheets of ABC Company as of [at] December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and changes in financial position for the years then ended. Our examinations were 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.

In our opinion, the financial statements referred to above present fairly the financial position of ABC Company as of [at] December 31, 19X2 and 19X1, and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis after restatement for the change, with which we concur, in the method of accounting for long-term construction contracts as described in Note X to the financial statements.

[Source: SAS No. 1, section 546.02 (*AICPA Professional Standards*, AU section 546.02).]

**.110 Inconsistency—Change in Accounting Principle Not Requiring Restatement of Prior Years (Single Year Financial Statements)**

We have examined the balance sheet of X Company as of [at] December 31, 19XX, and the related statements of income, retained earnings and changes in financial position 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.

In our opinion, the financial statements referred to above present fairly the financial position of X Company as of [at] December 31, 19XX, and the results of its operations and the changes in its financial position for the year then ended in conformity with generally accepted accounting principles which, except for the change, with which we concur, in the method of computing depreciation as described in Note X to the financial statements, have been applied on a basis consistent with that of the preceding year.

[Source: SAS No. 1, section 546.03 (*AICPA Professional Standards*, AU section 546.03).]

**.120 Inconsistency—Change in Accounting Principle Not Requiring Restatement of Prior Years (Comparative Financial Statements)**

We have examined the balance sheet of X Company as at December 31, 19X2 and 19X1, and the related statements of income, retained earnings and changes in financial position for the years 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.

In our opinion, the financial statements referred to above present fairly the financial position of X Company as at December 31, 19X2 and 19X1 and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied during the periods except for the change, with which we concur, in the method of computing depreciation as described in Note X to the financial statements.

[Source: SAS No. 1, section 546.03 (*AICPA Professional Standards*, AU section 546.03).]

**.130 Inconsistency—Change in Accounting Principle Not Requiring Restatement of Prior Years (Comparative Financial Statements when Change Is as of the Beginning of the Earliest Year Reported Upon)**

We have examined the balance sheets of ABC Company as of [at] December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and changes in financial position for the years then ended. Our examinations were 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.

In our opinion, the financial statements referred to above present fairly the financial position of ABC Company as of [at] December 31, 19X2 and 19X1, and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied during the periods subsequent to the change, with which we concur, made as of January 1, 19. . . ., in the method of computing depreciation as described in Note X to the financial statements.

[Source: SAS No. 1, section 546.03 (*AICPA Professional Standards*, AU section 546.03).]

**.140 Inconsistency—Change in Accounting Principle Without Reasonable Justification**

We have examined the balance sheet of X Company as of [at] December 31, 19XX, and the related statements of income, retained earnings and changes in financial position 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.

As disclosed in Note X to the financial statements, the Company has adopted (description of newly adopted method), whereas it previously used (description of previous method). Although use of the (description of newly adopted method) is in conformity with generally accepted accounting principles, in our opinion the Company has not provided reasonable justification for making a change as required by Opinion No. 20 of the Accounting Principles Board.

In our opinion, except for the change in accounting principles as stated above, the financial statements referred to above present fairly the financial position of X Company as of [at] December 31, 19XX, and the results of its operations and the changes in its financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

[Source: SAS No. 1, section 546.06 (*AICPA Professional Standards*, AU section 546.06).]

**.150 Inconsistency—Change to an Accounting Principle Not in Conformity with Generally Accepted Accounting Principles**

We have examined the balance sheet of X Company as of [at] December 31, 19XX, and the related statements of income, retained earnings and changes in financial position 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.

The company previously recorded its land at cost but adjusted the amounts to appraised values during the year, with a corresponding increase in stockholders' equity in the amount of \$. . . . . In our opinion, the new basis on which land is recorded is not in conformity with generally accepted accounting principles.

In our opinion, except for the change to recording appraised values as described above, the aforementioned financial statements present fairly the financial position of X Company at December 31, 19XX, and the results of its operations and changes in its financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

[Source: SAS No. 1, section 546.05 (*AICPA Professional Standards*, AU section 546.05).]



**.160 More than One Reason—Qualified Opinion on Prior Year's Financial Statements with the Current Year Qualified for the Same Reason and an Additional Reason**

We have examined the balance sheets of ABC Company as of [at] December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and changes in financial position for the years then ended. Our examinations were 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.

The Company has excluded from property and debt in the accompanying 19X2 balance sheet certain lease obligations that were entered into in 19X2, which, in our opinion, should be capitalized in order to conform with generally accepted accounting principles. If these lease obligations were capitalized, property would be increased by \$....., long-term debt by \$....., and retained earnings by \$..... as of December 31, 19X2, and net income and earnings per share would be increased (decreased) by \$..... and \$....., respectively, for the year then ended.

As discussed in Note X, the Company is involved in continuing litigation relating to patent infringement. The ultimate outcome of this litigation cannot be determined, and no provision for any liability that may result has been made in the 19X2 or 19X1 financial statements.

In our opinion, except for the effects on the 19X2 financial statements of not capitalizing certain lease obligations, as described in the second paragraph, and subject to the effects on the 19X2 and 19X1 financial statements of such adjustments, if any, as might have been required had the outcome of the uncertainty referred to in the preceding paragraph been known, the financial statements referred to above present fairly the financial position of ABC Company as of December 31, 19X2 and 19X1, and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

[Source: SAS No. 15, paragraph 5 (*AICPA Professional Standards*, AU section 505.05).]

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**AAM Section 10,245****Information Accompanying Audited  
Financial Statements****.010 Omission of Supplementary Information Re-  
quired by the FASB**

We have examined the balance sheets of ABC Company as of [at] December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and changes in financial position for the years then ended. Our examinations were 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.

In our opinion, the financial statements referred to above present fairly the financial position of ABC Company as of [at] December 31, 19X2 and 19X1, and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

ABC Company has not presented (describe the supplementary information required by the FASB in the circumstances) that the Financial Accounting Standards Board has determined is necessary to supplement, although not required to be part of, the basic financial statements.

[Source: SAS No. 27, paragraph 8 (*AICPA Professional Standards*, AU section 553.08).]

**.020 Material Departures from FASB Guidelines on Supplementary Information**

We have examined the balance sheets of ABC Company as of [at] December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and changes in financial position for the years then ended. Our examinations were 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.

In our opinion, the financial statements referred to above present fairly the financial position of ABC Company as of [at] December 31, 19X2 and 19X1, and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

The (specifically identify the supplementary information) on page xx is not a required part of the basic financial statements, and we did not audit and do not express an opinion on such information. However, we have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. As a result of such limited procedures, we believe that the (specifically identify the supplementary information) is not in conformity with guidelines established by the Financial Accounting Standards Board because (describe the material departure(s) from the FASB guidelines).

[Source: SAS No. 27, paragraph 8 (*AICPA Professional Standards*, AU section 553.08).]

**NOTE:**

Ordinarily, the supplementary information required by the FASB should be distinct from the audited financial statements and separately identifiable from other information outside the financial statements that is not required by the FASB. However, management may choose not to place the required supplementary information outside of the basic financial statements. In such circumstances, the information should be clearly marked as unaudited.

**.030 Prescribed Procedures Not Completed Regarding  
Supplementary Information Required by the  
FASB**

We have examined the balance sheets of ABC Company as of [at] December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and changes in financial position for the years then ended. Our examinations were 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.

In our opinion, the financial statements referred to above present fairly the financial position of ABC Company as of [at] December 31, 19X2 and 19X1, and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

The (specifically identify the supplementary information) on page xx is not a required part of the basic financial statements, and we did not audit and do not express an opinion on such information. Further, we were unable to apply to the information certain procedures prescribed by professional standards because (state the reasons).

[Source: SAS No. 27, paragraph 8 (*AICPA Professional Standards*, AU section 553.08).]

NOTES:

Even though he is unable to complete the prescribed procedures, if, on the basis of facts known to him, the auditor concludes that the supplementary information has not been measured or presented within FASB guidelines, he suggests appropriate revision; failing that, he describes the nature of any material departure(s) in his report.

Ordinarily, the supplementary information required by the FASB should be distinct from the audited financial statements and separately identifiable from other information outside the financial statements that is not required by the FASB. However, management may choose not to place the required supplementary information outside of the basic financial statements. In such circumstances, the information should be clearly marked as unaudited.

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**AAM Section 10,250****Reports on Internal Control****.010 Form for Reports on Internal Control Based on Audits**

We have examined the financial statements of ABC Company for the year ended December 31, 19X1, and have issued our report thereon dated February 23, 19X2.<sup>1</sup> As a part of our examination, we made a study and evaluation of the Company's system of internal accounting control to the extent we considered necessary to evaluate the system as required by generally accepted auditing standards. Under these standards, the purposes of such evaluation are to establish a basis for reliance on the system of internal accounting control in determining the nature, timing, and extent of other auditing procedures that are necessary for expressing an opinion on the financial statements and to assist the auditor in planning and performing his examination of the financial statements.

The objective of internal accounting control is to provide reasonable, but not absolute, assurance as to the safeguarding of assets against loss from unauthorized use or disposition, and the reliability of financial records for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance recognizes that the cost of a system of internal accounting control should not exceed the benefits derived and also recognizes that the evaluation of these factors necessarily requires estimates and judgments by management.

There are inherent limitations that should be recognized in considering the potential effectiveness of any system of internal accounting control. In the performance of most control procedures, errors can result from misunderstanding of instructions, mistakes of judgment, carelessness, or other personal factors. Control procedures whose effectiveness depends upon segregation of duties can be circumvented by collusion. Similarly, control procedures can be circumvented intentionally by management either with respect to the execution and recording of transactions or with respect to the estimates and judgments required in the preparation of financial statements.

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<sup>1</sup> If the report on an examination of the financial statements is qualified because of a restriction on the scope of the examination, the restriction and its effect on the evaluation of the system of internal accounting control should be indicated in the report thereon.

Further, projection of any evaluation of internal accounting control to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions and that the degree of compliance with the procedures may deteriorate.

Our examination of the financial statements made in accordance with generally accepted auditing standards, including the study and evaluation of the Company's system of internal accounting control for the year ended December 31, 19X1, that was made for the purposes set forth in the first paragraph of this report, would not necessarily disclose all weaknesses in the system because it was based on selective tests of accounting records and related data. However, such study and evaluation disclosed the following conditions that we believe to be material weaknesses. (A description of the material weaknesses that have come to the auditor's attention would follow; see comment below.)

The foregoing conditions were considered in determining the nature, timing, and extent of audit tests to be applied in our examination of the financial statements, and this report of such conditions does not modify our report dated February 23, 19X2, on such financial statements.

#### Comment

The description of material weaknesses should indicate whether the weaknesses relate to the prescribed procedures or to compliance with them. The report may also include recommendations for improvements, comments concerning corrective action taken or in process, or other comments appropriate in the circumstances. The basis for any comments concerning subsequent corrective action should be indicated, including the scope of any review and tests by the auditor. Although the first and fifth paragraphs of the foregoing form of report clearly indicate that weaknesses in the system are considered in determining the nature, timing, and extent of auditing procedures necessary for expressing an opinion on financial statements, some auditors may want to include further comments in this respect.

[Source: SAS No. 1, section 640.12 (AU section 640.12), as amended by SAS No. 20 (AU section 323).]

In some cases, the auditor may conclude that for certain weaknesses corrective action by management is not practicable in the circumstances and he may decide to exclude such weaknesses from his report.<sup>2</sup> If such weaknesses are excluded, the last sentence of the fourth paragraph of the above form of report should be modified as follows:

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<sup>2</sup> If the auditor is aware of a material weakness, it should be communicated to management, whether or not corrective action is practicable (see SAS No. 20 (AU section 323), "Required Communication of Material Weaknesses in Internal Accounting Control").



However, such study and evaluation disclosed the following conditions that we believe to be material weaknesses for which corrective action by management may be practicable in the circumstances.

Such a report should include appropriate description of material weaknesses for which the auditor has either (1) concluded that corrective action by management is practicable or (2) formed no conclusion in this respect.

[Source: SAS No. 1, section 640.13 (AU section 640.13), as amended by SAS No. 20 (AU section 323).]

**NOTE:**

See section 640.18 of SAS No. 1 (AU section 640.18) for guidance on reports on internal control issued solely for the internal information of management.

## **.020 Pre-Award Survey—Government Grant Program (Criteria Established by Governmental Agencies)**

We understand that (applicant) has applied for a grant of \$. . . . . from (agency) for the period from . . . . . through . . . . . for use in accordance with the (title or description of program). We have made a study of those internal accounting control and administrative control procedures of (applicant) that we considered relevant to the criteria established by (agency) as set forth in section . . . . . of its Audit Guide issued (date). Since our study related to procedures (applicant) proposes to follow if the grant is awarded, it did not include tests of compliance with such procedures. Our study did not constitute an audit of any financial statements prepared by the (applicant).

The objective of internal accounting control is to provide reasonable, but not absolute, assurance as to the safeguarding of assets against loss from unauthorized use or disposition, and the reliability of financial records for preparing financial statements and maintaining accountability for assets. We understand that the objective of those administrative control procedures comprehended in the (agency's) criteria is to provide similar assurance as to compliance with its related requirements. The concept of reasonable assurance recognizes that the cost of a system of internal control should not exceed the benefits derived and also recognizes that the evaluation of these factors necessarily requires estimates and judgments by management.

There are inherent limitations that should be recognized in considering the potential effectiveness of any system of internal control. In the performance of most control procedures, errors can result from misunderstanding of instructions, mistakes of judgment, carelessness or other personal factors. Control procedures whose effectiveness depends upon segregation of duties can be circumvented by collusion. Similarly, control procedures can be circumvented intentionally by management either with respect to the execution and recording of transactions or with respect to the estimates and judgments required in the preparation of financial statements. Further, projection of any evaluation of internal control to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions, and that the degree of compliance with the procedures may deteriorate.

We understand that procedures in conformity with the criteria referred to in the first paragraph of this report are considered by the (agency) to be adequate for its purposes in accordance with the (name of act) and related regulations, and that procedures not in conformity therewith indicate some inadequacy for such purposes. Based on this understanding and on our study, we believe the (applicant's) proce-

dures would be adequate for the agency's purposes, assuming satisfactory compliance, except for the conditions described (reference to appropriate section of report) which we believe would be material weaknesses in relation to the grant to which this report refers.<sup>3</sup> In addition to such weaknesses, other conditions which we believe would not be in conformity with the criteria referred to above are described (reference to appropriate section of report).

This report is intended for use in connection with the grant to which it refers and should not be used for any other purpose.

[Source: *AICPA Professional Standards*, AU section 9641.02 an interpretation of SAS No. 1, section 641.]

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<sup>3</sup> If the auditor is aware of a material weakness in internal accounting control, whether or not he is specifically engaged by the client to review and report on the system of internal accounting control, a communication as described in SAS No. 20 (AU section 323), "Required Communication of Material Weaknesses in Internal Accounting Control", is required.

### **.030 Post-Award Survey—Government Grant Program (Criteria Established by Governmental Agencies)**

We understand that (recipient) has been awarded a grant of \$..... from (agency) for the period from ..... through ..... for use in accordance with the (title or description of program). We have made a study of those internal accounting control and administrative control procedures of (recipient) that we considered relevant to the criteria established by (agency) as set forth in section ..... of its Audit Guide issued (date). Our study included tests of compliance with such procedures during the period from ..... through ..... Our study did not constitute an audit of any financial statements prepared by the (recipient).

The objective of internal accounting control is to provide reasonable, but not absolute, assurance as to the safeguarding of assets against loss from unauthorized use or disposition, and the reliability of financial records for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance recognizes that the cost of a system of internal accounting control should not exceed the benefits derived and also recognizes that the evaluation of these factors necessarily requires estimates and judgments by management.

There are inherent limitations that should be recognized in considering the potential effectiveness of any system of internal accounting control. In the performance of most control procedures, errors can result from misunderstanding of instructions, mistakes of judgment, carelessness, or other personal factors. Control procedures whose effectiveness depends upon segregation of duties can be circumvented by collusion. Similarly, control procedures can be circumvented intentionally by management either with respect to the execution and recording of transactions or with respect to the estimates and judgments required in the preparation of financial statements. Further, projection of any evaluation of internal accounting control to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions and that the degree of compliance with the procedures may deteriorate.

We understand that procedures in conformity with the criteria referred to in the first paragraph of this report are considered by the (agency) to be adequate for its purposes in accordance with the (name of act) and related regulations, and that procedures not in conformity therewith indicate some inadequacy for such purposes. Based on this understanding and on our study, we believe the (applicant's) procedures would be adequate for the agency's purposes, assuming satisfactory compliance, except for the conditions described

(reference to appropriate section of report) which we believe would be material weaknesses in relation to the grant to which this report refers.<sup>4</sup> In addition to such weaknesses, other conditions which we believe would not be in conformity with the criteria referred to above are described (reference to appropriate section of report).

This report is intended for use in connection with the grant to which it refers and should not be used for any other purpose.

[Sources: *AICPA Professional Standards*, AU section 9641.02 and AU section 9641.05, interpretations of SAS No. 1, section 641.]

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<sup>4</sup> If the auditor is aware of a material weakness in internal accounting control, whether or not he is specifically engaged by the client to review and report on the system of internal accounting control, a communication as described in SAS No. 20 (AU section 323), "Required Communication of Material Weaknesses in Internal Accounting Control," is required.

### **.040 Reports Made in Conjunction with Audit—Government Grant Program (Criteria Established by Governmental Agencies)**

We understand that (recipient) has been awarded a grant of \$. . . . . from (agency) for the period from . . . . . through . . . . . for use in accordance with the (title or description of program). We have made a study of those internal accounting control and administrative control procedures of (recipient) that we considered relevant to the criteria established by (agency) as set forth in section . . . . . of its Audit Guide issued (date). Our study included tests of compliance with such procedures during the period from . . . . . through . . . . . We have examined the financial statements of (recipient) for the year ended . . . . . and have issued our report thereon dated . . . . .

The objective of internal accounting control is to provide reasonable, but not absolute, assurance as to the safeguarding of assets against loss from unauthorized use or disposition, and the reliability of financial records for preparing financial statements and maintaining accountability for assets. We understand that the objective of those administrative control procedures comprehended in the (agency's) criteria is to provide similar assurance as to compliance with its related requirements. The concept of reasonable assurance recognizes that the cost of a system of internal control should not exceed the benefits derived and also recognizes that the evaluation of these factors necessarily requires estimates and judgments by management.

There are inherent limitations that should be recognized in considering the potential effectiveness of any system of internal control. In the performance of most control procedures, errors can result from misunderstanding of instructions, mistakes of judgment, carelessness or other personal factors. Control procedures whose effectiveness depends upon segregation of duties can be circumvented by collusion. Similarly, control procedures can be circumvented intentionally by management either with respect to the execution and recording of transactions or with respect to the estimates and judgments required in the preparation of financial statements. Further, projection of any evaluation of internal control to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions, and that the degree of compliance with the procedures may deteriorate.

We understand that procedures in conformity with the criteria referred to in the first paragraph of this report are considered by the (agency) to be adequate for its purposes in accordance with the (name of act) and related regulations, and that procedures not in conformity therewith indicate some inadequacy for such purposes.

Based on this understanding and on our study, we believe the (applicant's) procedures would be adequate for the agency's purposes, assuming satisfactory compliance, except for the conditions described (reference to appropriate section of report) which we believe would be material weaknesses in relation to the grant to which this report refers.<sup>5</sup> In addition to such weaknesses, other conditions which we believe would not be in conformity with the criteria referred to above are described (reference to appropriate section of report).

This report is intended for use in connection with the grant to which it refers and should not be used for any other purpose.

[Source: *AICPA Professional Standards*, AU section 9641.07, an interpretation of SAS No. 1, section 641.]

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»»»→ *The next page is 10,521.* ←«««

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<sup>5</sup> If the auditor is aware of a material weakness in internal accounting control, whether or not he is specifically engaged by the client to review and report on the system of internal accounting control, a communication as described in SAS No. 20 (AU section 323), "Required Communication of Material Weaknesses in Internal Accounting Control," is required.





**AAM Section 10,260*****Special Reports*****.010 Cash Basis Statements**

We have examined the statement of assets and liabilities arising from cash transactions of XYZ Company as of December 31, 19XX, and the related statement of revenue collected and expenses paid 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.

As described in Note X, the Company's policy is to prepare its financial statements on the basis of cash receipts and disbursements; consequently, certain revenue and the related assets are recognized when received rather than when earned, and certain expenses are recognized when paid rather than when the obligation is incurred. Accordingly, the accompanying financial statements are not intended to present financial position and results of operations in conformity with generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly the assets and liabilities arising from cash transactions of XYZ Company as of December 31, 19XX, and the revenue collected and expenses paid during the year then ended, on the basis of accounting described in Note X, which basis has been applied in a manner consistent with that of the preceding year.

[Source: SAS No. 14, paragraph 8 (*AICPA Professional Standards*, AU section 621.08).]

**.020 Income Tax Basis Statements**

We have examined the statement of assets, liabilities, and capital— income tax basis of ABC Partnership as of December 31, 19XX, and the related statements of revenue and expenses— income tax basis and of changes in partners' capital accounts— income tax basis 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.

As described in Note X, the Partnership's policy is to prepare its financial statements on the accounting basis used for income tax purposes; consequently, certain revenue and the related assets are recognized when received rather than when earned, and certain expenses are recognized when paid rather than when the obligation is incurred. Accordingly, the accompanying financial statements are not intended to present financial position and results of operations in conformity with generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly the assets, liabilities, and capital of ABC Partnership as of December 31, 19XX, and its revenue and expenses and changes in its partners' capital accounts for the year then ended, on the basis of accounting described in Note X, which basis has been applied in a manner consistent with that of the preceding year.

[Source: SAS No. 14, paragraph 8 (*AICPA Professional Standards*, AU section 621.08).]

**.030 Regulatory (Statutory) Basis Statements**

We have examined the statement of admitted assets, liabilities, and surplus—statutory basis of XYZ Insurance Company as of December 31, 19XX, and the related statements of income—statutory basis and changes in surplus—statutory basis 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.

As described in Note X, the Company's policy is to prepare its financial statements on the basis of accounting practices prescribed or permitted by the Insurance Department of [State]. These practices differ in some respects from generally accepted accounting principles. Accordingly, the accompanying financial statements are not intended to present financial position and results of operations in conformity with generally accepted accounting principles. This report is intended solely for filing with regulatory agencies and is not intended for any other purpose.

In our opinion, the financial statements referred to above present fairly the admitted assets, liabilities and surplus of XYZ Insurance Company as of December 31, 19XX, and the results of its operations and changes in its surplus for the year then ended, on the basis of accounting described in Note X, which basis has been applied in a manner consistent with that of the preceding year.

[Source: SAS No. 14, paragraph 8 (*AICPA Professional Standards*, AU section 621.08).]

### **.040 Pension Plan Statements with Scope Restrictions Elected by Plan Administrator**

We have examined the financial statements and schedules of XYZ Pension Plan as of December 31, 19XX and for the year then ended, as listed in the accompanying index. Except as stated in the following paragraph, 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.

The plan administrator has elected the method of compliance permitted by section 2520.103-8 of the Department of Labor Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. Accordingly, as permitted under such election, the plan administrator instructed us not to perform, and we did not perform, any auditing procedures with respect to the information certified by the ABC Bank, the trustee of the plan, except for comparing such information, which is summarized in note X, to the related information included in the financial statements and schedules. We have been informed by the plan administrator that the trustee holds the plan's investment assets and executes transactions therein. The plan administrator has obtained a certification from the trustee that the information provided to the plan administrator by the trustee is complete and accurate.<sup>1</sup>

Because of the significance of the information that we did not audit, we are unable to, and do not, express an opinion on the accompanying financial statements and schedules taken as a whole. The form and content of the information included in the financial statements and schedules, other than that derived from the information certified by the trustee, has been examined by us and, in our opinion, is presented in compliance with the Department of Labor Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974.<sup>2</sup>

[Source: *AICPA Professional Standards*, AU section 9621.04, an interpretation of SAS No. 14.]

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<sup>1</sup> Certain data furnished and certified by a bank or similar institution or insurance carrier are based on information supplied by the plan administrator. Accordingly, the auditor should satisfy himself that the amounts reported by the trustee as being received from, and disbursed at the direction of, the plan administrator or other authorized party have been properly determined in accordance with the terms of the plan and that the information included in the financial statements and schedules have been presented in compliance with the Department of Labor Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974.

If the auditor is precluded from performing these procedures, he should issue a disclaimer of opinion in accordance with SAS No. 26 (AU section 504).

<sup>2</sup> Section 2520.103-1(b)(3) of the rules and regulations requires that the financial statements include a footnote describing the accounting principles and practices reflected in the financial statements, and, if applicable, variances from generally accepted accounting principles.

**.050 Rental Computation Report Based on Gross Sales**

Board of Directors

ABC Company

We have examined the schedule of gross sales (as defined in the lease agreement dated March 4, 19XX, between ABC Company, as lessor, and XYZ Stores Corporation, as lessee) of XYZ Stores Corporation at its Main Street store, [City], [State], for the year ended December 31, 19XX. 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.

In our opinion, the schedule of gross sales referred to above presents fairly the gross sales of XYZ Stores Corporation at its Main Street store, [City], [State], for the year ended December 31, 19XX, on the basis specified in the lease agreement referred to above.

[Source: SAS No. 14, paragraph 14 (*AICPA Professional Standards*, AU section 621.14).]

**.060 Royalties**

Board of Directors  
XYZ Corporation

We have examined the schedule of royalties applicable to engine production of the Q Division of XYZ Corporation for the year ended December 31, 19XX, under the terms of a license agreement dated May 14, 19XX, between ABC Company and XYZ Corporation. 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.

We have been informed that, under XYZ Corporation's interpretation of the agreement referred to above, royalties were based on the number of engines produced after giving effect to a reduction for production retirements that were scrapped, but without a reduction for field returns that were scrapped, even though the field returns were replaced with new engines without charge to customers. This treatment is consistent with that followed in prior years.

In our opinion, the schedule of royalties referred to above presents fairly the number of engines produced by the Q Division of XYZ Corporation during the year ended December 31, 19XX, and the amount of royalties applicable thereto under the license agreement referred to above, on the basis indicated in the preceding paragraph.

[Source: SAS No. 14, paragraph 14 (*AICPA Professional Standards*, AU section 621.14).]

**.070 Profit Participation**<sup>3</sup>

Mr. John Smith

We have examined XYZ Company's schedule of John Smith's profit participation for the year ended December 31, 19X1. 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. We have examined the financial statements of XYZ Company for the year ended December 31, 19X1, and have issued our report thereon dated March 10, 19X2.

We have been informed that the documents that govern the determination of John Smith's profit participation are (a) the employment agreement between John Smith and XYZ Company dated February 1, 19X0, (b) the production and distribution agreement between XYZ Company and Television Network Incorporated dated March 1, 19X0, and (c) the studio facilities agreement between XYZ Company and QRX Studios dated April 1, 19X0, as amended November 1, 19X0.

In our opinion, the schedule of profit participation referred to above presents fairly John Smith's participation in the profits of XYZ Company for the year ended December 31, 19X1, in accordance with the provisions of the agreements referred to in the preceding paragraph.

[Source: SAS No. 14, paragraph 14 (*AICPA Professional Standards*, AU section 621.14).]

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<sup>3</sup> A report on an examination of a schedule of profit participation should be issued only if the auditor has examined the financial statements on which the participation is based.

**.080 Report Relating to the Adequacy of a Provision for Income Taxes in Financial Statements <sup>4</sup>**

We have examined the financial statements of XYZ Company, Inc., for the year ended June 30, 19XX, and have issued our report thereon dated August 15, 19XX. 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.

In the course of our examination, we examined the provision for federal and state income taxes for the year ended June 30, 19XX, included in the Company's financial statements referred to in the preceding paragraph. We also reviewed the federal and state income tax returns filed by the Company that are subject to examination by the respective taxing authorities.

In our opinion, the Company has paid or has provided adequate accruals in the financial statements referred to above for the payment of all federal and state income taxes, and has provided for related deferred income taxes, applicable to fiscal 19XX and prior fiscal years, that could be reasonably estimated at the time of our examination of the financial statements of XYZ Company, Inc., for the year ended June 30, 19XX.

[Source: SAS No. 14, paragraph 14 (*AICPA Professional Standards*, AU section 621.14).]

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<sup>4</sup> A report relating to the adequacy of a provision for income taxes in financial statements should be issued only if the auditor has examined the financial statements in which the provision appears.

If a significant period of time has elapsed between the date of the auditor's report on the financial statements and the date he is reporting on the provision for income taxes, the auditor may wish to include the following paragraph in his report:

Because we have not examined any financial statements of XYZ Company, Inc., as of any date or for any period subsequent to June 30, 19XX, we have no knowledge of the effects, if any, on the income tax provision of events that may have occurred subsequent to the date of our examination.



**.090 Proposed Acquisition**

Board of Directors

X Company

We have applied certain agreed-upon procedures, as discussed below, to accounting records of Y Company, Inc., as of December 31, 19XX, solely to assist you in connection with the proposed acquisition of Y Company, Inc. It is understood that this report is solely for your information and is not to be referred to or distributed to anyone not a member of management of X Company for any purpose. Our procedures and findings are as follows:

- a. We reconciled cash on deposit with the following banks to the balances in the respective general ledger accounts and obtained confirmation of the related balances from the banks.

<u>Bank</u>	<u>Balance Per General Ledger</u>
ABC National Bank .....	\$ 5,000
DEF State Bank .....	13,776
XYZ Trust Company—regular account.....	86,912
XYZ Trust Company—payroll account.....	5,000

- b. We obtained an aged trial balance of the accounts receivable subsidiary records; traced the age and amounts of approximately 10 percent of the accounts to the accounts receivable ledger; added the trial balance and compared the total with the balance in the general ledger control account. We mailed requests for positive confirmation of balances to 150 customers; differences disclosed in confirmation replies were minor in amount and nature, and we reconciled them to our satisfaction. The results are summarized as follows:

	<u>Accounts Receivable Aging and Confirmation</u>		
	<u>Account</u>	<u>Confirmation Results</u>	
	<u>Balance</u>	<u>Requested</u>	<u>Received</u>
Current .....	\$156,000	\$ 76,000	\$ 65,000
Past due:			
Less than one month .....	60,000	30,000	19,000
One to three months .....	36,000	18,000	10,000
Over three months .....	48,000	48,000	8,000
	<u>\$300,000</u>	<u>\$172,000</u>	<u>\$102,000</u>

Because the above procedures were not sufficient to constitute an examination made in accordance with generally accepted auditing standards, we do not express an opinion on any of the specific accounts referred to above. In connection with the procedures referred to above, no matters came to our attention that caused us to believe that the [specified elements, accounts, or items] should be adjusted. Had we performed additional procedures or had we made an examination of the financial statements in accordance with generally accepted auditing standards, matters might have come to our attention that would have been reported to you. This report should not be associated with the financial statements of Y Company, Inc., for the year ended December 31, 19XX.

[Source: SAS No. 14, paragraph 17 (*AICPA Professional Standards*, AU section 621.17).]

## .100 Claims of Creditors

Trustee  
XYZ Company

At your request, we have performed the procedures enumerated below with respect to the claims of creditors of XYZ Company as of May 31, 19XX, set forth in the accompanying schedules. Our review was made solely to assist you in evaluating the reasonableness of those claims, and our report is not to be used for any other purpose. The procedures we performed are summarized as follows:

- a. We compared the total of the trial balance of accounts payable at May 31, 19XX, prepared by the Company, to the balance in the Company's related general ledger account.
- b. We compared the claims received from creditors to the trial balance of accounts payable.
- c. We examined documentation submitted by the creditors in support of their claims and compared it to documentation in the Company's files, including invoices, receiving records, and other evidence of receipt of goods or services.

Except as is set forth in Schedule B, we found that amounts claimed by creditors and amounts shown in the Company's records were the same. Our findings are presented in the accompanying schedules. Schedule A lists claims that are in agreement with the Company's records. Schedule B lists claims that are not in agreement with the Company's records and sets forth the differences in amounts.

Because the above procedures were not sufficient to constitute an examination made in accordance with generally accepted auditing standards, we do not express an opinion on the accounts payable balance as of May 31, 19XX. In connection with the procedures referred to above, except as set forth in Schedule B, no matters came to our attention that caused us to believe that the accounts payable might require adjustment. Had we performed additional procedures or had we made an examination of the financial statements in accordance with generally accepted auditing standards, other matters might have come to our attention that would have been reported to you. This report should not be associated with the financial statements of XYZ Company for the year ended May 31, 19XX.

[Source: SAS No. 14, paragraph 17 (*AICPA Professional Standards*, AU section 621.17).]

### **.110 Compliance with Contractual Provisions (Separate Report)**

We have examined the balance sheet of XYZ Company as of December 31, 19X1, and the related statements of income, retained earnings, and changes in financial position for the year then ended, and have issued our report thereon dated February 16, 19X2. 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.

In connection with our examination, nothing came to our attention that caused us to believe that the Company was not in compliance with any of the terms, covenants, provisions, or conditions of sections XX to XX, inclusive, of the Indenture dated July 21, 19X0, with ABC Bank. However, it should be noted that our examination was not directed primarily toward obtaining knowledge of such noncompliance.

[Source: SAS No. 14, paragraph 19 (*AICPA Professional Standards*, AU section 621.19).]

### **.120 Compliance with Contractual Provisions (Auditor's Report Accompanying Financial Statements)**

We have examined the balance sheet of XYZ Company as of December 31, 19X1, and the related statements of income, retained earnings, and changes in financial position 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.

In our opinion, the financial statements referred to above present fairly the financial position of XYZ Company as of December 31, 19X1, and the results of its operations and changes in its financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

In connection with our examination, nothing came to our attention that caused us to believe that the Company was not in compliance with any of the terms, covenants, provisions, or conditions of sections XX to XX, inclusive, of the Indenture dated July 21, 19X0, with ABC Bank. However, it should be noted that our examination was not directed primarily toward obtaining knowledge of such noncompliance.

[Source: SAS No. 14, paragraph 19 (*AICPA Professional Standards*, AU section 621.19).]

### **.130 Compliance with Regulatory Requirements**

We have examined the balance sheet of XYZ Company as of December 31, 19X1, and the related statements of income, retained earnings, and changes in financial position for the year then ended, and have issued our report thereon dated March 5, 19X2. 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.

In connection with our examination, nothing came to our attention that caused us to believe that the Company had failed to comply with the limitation and increased investment requirement in section 993(d)(2) and (3) of the Internal Revenue Code of 1954. However, it should be noted that our examination was not directed primarily toward obtaining knowledge of noncompliance with such requirements.

[Source: SAS No. 14, paragraph 19 (*AICPA Professional Standards*, AU section 621.19).]

**.140 Special Purpose Financial Statements Prepared Pursuant to a Loan Agreement—Effects of Departures from Generally Accepted Accounting Principles Disclosed in a Note to the Statements**

We have examined the special-purpose balance sheet of ABC Company as of December 31, 19X1, and the related special-purpose statements of income, retained earnings, and changes in financial position 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.

The accompanying special-purpose financial statements have been prepared for the purpose of complying with, and on the basis of accounting practices specified in, Section 4 of a loan agreement between DEF Bank and the Company dated (date). These practices differ, as described in Note X, from generally accepted accounting principles. Accordingly, the financial statements are not intended to present and, in our opinion, do not present fairly the financial position, results of operations and changes in financial position of ABC Company in conformity with generally accepted accounting principles.

In our opinion, however, the accompanying special-purpose financial statements of ABC Company are presented fairly on the basis of accounting described in Note X, which basis has been applied in a manner consistent with that of the preceding year.

[Source: *AICPA Professional Standards*, AU section 9621.25, an interpretation of SAS No. 14 (AU section 621).]

**.141 Special Purpose Financial Statements Prepared Pursuant to a Loan Agreement—Effects of Departures from Generally Accepted Accounting Principles Disclosed by Referring to Coexisting Audited Financial Statements**

We have examined the special-purpose balance sheet of ABC Company as of December 31, 19X1, and the related special-purpose statements of income, retained earnings, and changes in financial position 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.

The accompanying special-purpose financial statements have been prepared for the purpose of complying with, and on the basis of accounting practices specified in, section 4 of a loan agreement between DEF Bank and the Company dated (date). These practices differ, as described in Note X, from generally accepted accounting principles. Accordingly, the financial statements are not intended to present and, in our opinion, do not present fairly the financial position, results of operations and changes in financial position of ABC Company in conformity with generally accepted accounting principles. The monetary effects of the departures from generally accepted accounting principles can be determined by comparing the special-purpose financial statements with the financial statements of ABC Company for the year ended December 31, 19X1, prepared in conformity with generally accepted accounting principles on which we issued our report dated February 14, 19X2.

In our opinion, however, the accompanying special-purpose financial statements of ABC Company are presented fairly on the basis of accounting described in Note X, which basis has been applied in a manner consistent with that of the preceding year.

[Source: *AICPA Professional Standards*, AU section 9621.25, an interpretation of SAS No. 14 (AU section 621).]

### **.142 Special Purpose Financial Statements Prepared Pursuant to an Acquisition Agreement—Effects of Departures from Generally Accepted Accounting Principles Have Not Been Determined**

We have examined the special-purpose balance sheet of ABC Company as of June 30, 19XX, and the related special-purpose statements of income, retained earnings, and changes in financial position 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.

The accompanying special-purpose financial statements have been prepared for the purpose of complying with, and on the basis of accounting practices specified in, an acquisition agreement dated May 15, 19XX, between ABC Company and DEF Company. These practices differ, as described in Note X, from generally accepted accounting principles; the monetary effects on the accompanying financial statements of such differences have not been determined. Accordingly, we are unable to and do not express an opinion on whether the accompanying special-purpose financial statements fairly present the financial position, results of operations and changes in financial position of ABC Company in conformity with generally accepted accounting principles.

In our opinion, however, the accompanying special-purpose financial statements of ABC Company are presented fairly on the basis of accounting described in Note X.

[Source: *AICPA Professional Standards*, AU section 9621.25, an interpretation of SAS No. 14 (AU section 621).]

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### **.150 Special Purpose Financial Presentation—Schedule of Gross Income and Certain Expenses**

We have examined the accompanying Historical Summary of Gross Income and Direct Operating Expenses of ABC Apartments, City, State, for each of the three years in the period ended December 31, 19XX. Our examinations were 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.

The accompanying historical summary was prepared for the purpose of complying with the rules and regulations of the Securities and Exchange Commission (for inclusion in the registration statement on Form S-11 of DEF Corporation) and excludes certain material expenses, described in Note X, that would not be comparable to those resulting from the proposed future operations of the property.

In our opinion, the historical summary referred to above presents fairly the gross income and direct operating expenses described in Note X of ABC Apartments for each of the three years in the period ended December 31, 19XX, in conformity with generally accepted accounting principles applied on a consistent basis.

[Source: *AICPA Professional Standards*, AU section 9621.31, an interpretation of SAS No. 14 (AU section 621).]

**.151 Special Purpose Financial Presentation—Statement of Assets Sold and Liabilities Transferred**

We have examined the statement of net assets of ABC Company as of June 8, 19XX, sold pursuant to the Purchase Agreement as described in Note X, between ABC Company and XYZ Corporation dated May 8, 19XX. 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.

In our opinion, the accompanying statement presents fairly the net assets of ABC Company as of June 8, 19XX, sold pursuant to the purchase agreement referred to above, in conformity with generally accepted accounting principles.

[Source: *AICPA Professional Standards*, AU section 9621.31, an interpretation of SAS No. 14 (AU section 621).]

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**AAM Section 10,270*****Unaudited Financial Statements  
of a Public Entity*****.01 Disclaimer**

The accompanying balance sheet of X Company as of December 31, 19X1, and the related statements of income, retained earnings, and changes in financial position for the year then ended were not audited by us, and, accordingly, we do not express an opinion on them.

(Signature and date)

[Source: SAS No. 26, paragraph 5 (*AICPA Professional Standards*, AU section 504.05).]

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**NOTES:**

- The disclaimer may accompany the unaudited financial statements or it may be placed directly on them. In addition, each page of the financial statements should be clearly and conspicuously marked as unaudited.
- If the unaudited financial statements are those of a privately held (nonpublic) company, this example is not appropriate. See AAM sections 10,400 and 10,500.

**.02 Current Period Financial Statements Unaudited  
—Prior Period Financial Statements Audited**

The accompanying balance sheet of ABC Company as of December 31, 19X2, and the related statements of income, retained earnings, and changes in financial position for the year then ended were not audited by us and, accordingly, we do not express an opinion on them.

The financial statements for the year ended December 31, 19X1, were examined by us (other accountants) and we (they) expressed an unqualified opinion on them in our (their) report dated March 1, 19X2, but we (they) have not performed any auditing procedures since that date.

[Source: SAS No. 26, paragraph 16 (*AICPA Professional Standards*, AU section 504.16).]

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**NOTES:**

- The disclaimer may accompany the unaudited financial statements or it may be placed directly on them. In addition, each page of the financial statements should be clearly and conspicuously marked as unaudited.
- If the unaudited financial statements are those of a privately held (nonpublic) company, this example is not appropriate. See AAM sections 10,400 and 10,500.

**.03 Disclaimer—Cash Basis Statements**

The accompanying statement of assets and liabilities resulting from cash transactions of XYZ Corporation as of December 31, 19X1, and the related statement of revenues collected and expenses paid during the year then ended were not audited by us and, accordingly, we do not express an opinion on them.

(Signature and date)

[Source: SAS No. 26, paragraph 7 (*AICPA Professional Standards*, AU section 504.07).]

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**NOTES:**

- A note to the financial statements should describe how the basis of presentation differs from generally accepted accounting principles, but the monetary effect of such differences need not be stated.
- The disclaimer may accompany the unaudited financial statements or it may be placed directly on them. In addition, each page of the financial statements should be clearly and conspicuously marked as unaudited.

**.04 Disclaimer—Regulatory (Statutory) Basis Statements**

The accompanying statement of admitted assets, liabilities, and surplus (statutory basis) of XYZ Insurance Company as of December 31, 19XX, and the related statements of income (statutory basis) and changes in surplus (statutory basis) for the year then ended were not audited by us and, accordingly, we do not express an opinion on them.  
(Signature and date)

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**NOTES:**

- A note to the financial statements should describe how the basis of presentation differs from generally accepted accounting principles, but the monetary effect of such differences need not be stated.
  - The disclaimer may accompany the unaudited financial statements or it may be placed directly on them. In addition, each page of the financial statements should be clearly and conspicuously marked as unaudited.
  - The above sample report was prepared to illustrate matters presented in SAS No. 26, paragraph 7 (*AICPA Professional Standards*, AU section 504.07).
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**AAM Section 10,280*****Lack of Independence*****.01 Disclaimer**

We are not independent with respect to XYZ Company, and the accompanying balance sheet as of December 31, 19X1, and the related statements of income, retained earnings, and changes in financial position for the year then ended were not audited by us and, accordingly, we do not express an opinion on them.

[Source: SAS No. 26, paragraph 10 (*AICPA Professional Standards*, AU section 504.10).]

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**NOTES:**

- When an accountant is not independent, any procedures he might perform would not be in accordance with generally accepted auditing standards and he would be precluded from expressing an opinion on the financial statements. Accordingly, he would disclaim an opinion with respect to the financial statements and state specifically that he is not independent. The accountant should not include in his disclaimer the reasons for the lack of independence or any description of the procedures he has performed; including such matters might confuse readers concerning the importance of the lack of independence.
- If the statements are those of a nonpublic entity, see Statement on Standards for Accounting and Review Services No. 1, paragraphs 22 and 38 (AR section 100.22 and 100.38). See AAM sections 10,400 and 10,500.

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**AAM Section 10,300*****Review of Interim Financial Information*****.01 Accountant's Report**

We have made a review of (describe the information or statements reviewed) of ABC Company and consolidated subsidiaries as of September 30, 19X1 and for the three-month and nine-month periods then ended, in accordance with standards established by the American Institute of Certified Public Accountants.

A review of interim financial information consists principally of obtaining an understanding of the system for the preparation of interim financial information, applying analytical review procedures to financial data, and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial (information or statements) for them to be in conformity with generally accepted accounting principles.

[Source: SAS No. 24, paragraph 18 (*AICPA Professional Standards*, AU section 721.18).]

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**NOTE:**

SAS No. 24 (AU section 721) applies to reviews of interim financial information presented alone of a publicly-traded company; for this purpose the term interim includes financial statements or information of a twelve-month period ending on a date other than the company's normal year-end.

**.02 Accountant's Report—Comparative**

We have made a review of (describe the information or statements reviewed) of ABC Company and consolidated subsidiaries as of September 30, 19X1 and 19X0 and for the three-month and nine-month periods then ended, in accordance with standards established by the American Institute of Certified Public Accountants.

A review of interim financial information consists principally of obtaining an understanding of the system for the preparation of interim financial information, applying analytical review procedures to financial data, and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial (information or statements) for them to be in conformity with generally accepted accounting principles.

[Source: SAS No. 24, paragraph 18 (*AICPA Professional Standards*, AU section 721.18).]

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**NOTE:**

SAS No. 24 (AU section 721) applies to reviews of interim financial information presented alone of a publicly-traded company; for this purpose the term interim includes financial statements or information of a twelve-month period ending on a date other than the company's normal year-end.

### **.03 Reference to Other Accountants**

We have made a review of (describe the information or statements reviewed) of ABC Company and consolidated subsidiaries as of September 30, 19X1, and for the three-month and nine-month periods then ended, in accordance with standards established by the American Institute of Certified Public Accountants. We were furnished with the report of other accountants on their review of the interim financial information of the ADE subsidiary, whose total assets and revenues constitute 20 percent and 22 percent, respectively, of the related consolidated totals.

A review of interim financial information consists principally of obtaining an understanding of the system for the preparation of interim financial information, applying analytical review procedures to financial data, and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review and the report of other accountants, we are not aware of any material modifications that should be made to the accompanying financial (information or statements) for them to be in conformity with generally accepted accounting principles.

[Source: SAS No. 24, paragraph 19 (*AICPA Professional Standards*, AU section 721.19).]

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**NOTE:**

SAS No. 24 (AU section 721) applies to reviews of interim financial information presented alone of a publicly-traded company; for this purpose the term interim includes financial statements or information of a twelve-month period ending on a date other than the company's normal year-end.

**.04 Departure from GAAP**

We have made a review of (describe the information or statements reviewed) of ABC Company and consolidated subsidiaries as of September 30, 19X1 and for the three-month and nine-month periods then ended, in accordance with standards established by the American Institute of Certified Public Accountants.

A review of interim financial information consists principally of obtaining an understanding of the system for the preparation of interim financial information, applying analytical review procedures to financial data, and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on information furnished us by management, we believe that the Company has excluded from property and debt in the accompanying balance sheet certain lease obligations that should be capitalized in order to conform with generally accepted accounting principles. This information indicates that if these lease obligations were capitalized at September 30, 19X1, property would be increased by \$....., and long-term debt by \$....., and net income and earnings per share would be increased (decreased) by \$....., \$....., \$....., and \$....., respectively, for the three-month and nine-month periods then ended.

(Concluding paragraph)

Based on our review, with the exception of the matter(s) described in the preceding paragraph(s), we are not aware of any material modifications that should be made to the accompanying financial (information or statements) for them to be in conformity with generally accepted accounting principles.

[Source: SAS No. 24, paragraph 21 (*AICPA Professional Standards*, AU section 721.21).]

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NOTE:

SAS No. 24 (AU section 721) applies to reviews of interim financial information presented alone of a publicly-traded company; for this purpose the term interim includes financial statements or information of a twelve-month period ending on a date other than the company's normal year-end.

## **.05 Inadequate Disclosure**

We have made a review of (describe the information or statements reviewed) of ABC Company and consolidated subsidiaries as of September 30, 19X1 and for the three-month and nine-month periods then ended, in accordance with standards established by the American Institute of Certified Public Accountants.

A review of interim financial information consists principally of obtaining an understanding of the system for the preparation of interim financial information, applying analytical review procedures to financial data, and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Management has informed us that the Company is presently contesting deficiencies in federal income taxes proposed by the Internal Revenue Service for the years 19XX through 19XX in the aggregate amount of approximately \$....., and that the extent of the Company's liability, if any, and the effect on the accompanying (information or statements) are not determinable at this time. The (information or statements) fail to disclose these matters, which we believe are required to be disclosed in conformity with generally accepted accounting principles.

(Concluding paragraph)

Based on our review, with the exception of the matter(s) described in the preceding paragraph(s), we are not aware of any material modifications that should be made to the accompanying financial (information or statements) for them to be in conformity with generally accepted accounting principles.

[Source: SAS No. 24, paragraph 22 (*AICPA Professional Standards*, AU section 721.22).]

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NOTE:

SAS No. 24 (AU section 721) applies to reviews of interim financial information presented alone of a publicly-traded company; for this purpose the term interim includes financial statements or information of a twelve-month period ending on a date other than the company's normal year-end.

## **.06 Restricted Scope of Review Stated in an Auditor's Report**

We have examined the balance sheets of ABC Company as of [at] December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and changes in financial position for the years then ended. Our examinations were 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.

Note X, "Unaudited Interim Financial Information," contains information that we did not audit and, accordingly, we do not express an opinion on the information. We attempted but were unable to make a review of such interim information in accordance with standards established by the American Institute of Certified Public Accountants because we believe that the Company's system for preparing interim financial information does not provide an adequate basis to enable us to complete such a review.

In our opinion, the financial statements referred to above present fairly the financial position of X Company as of [at] December 31, 19XX, and the results of its operations and the changes in its financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

[Source: SAS No. 24, paragraph 27 (*AICPA Professional Standards*, AU section 721.27).]

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### NOTE:

See paragraphs 24—28 of SAS No. 24 (AU section 721.24—.28) for guidance on reporting on interim financial information presented in a note to audited financial statements.

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➤ *The next page is 10,721.* ←

**AAM Section 10,400*****Accountant's Report on Compilation  
of Financial Statements of a  
Nonpublic Entity*****.01 Accountant's Standard Report**

The accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and changes in financial position for the year then ended have been compiled by me (us).

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

[Source: SSARS No. 1, paragraph 17 (*AICPA Professional Standards*, AR section 100.17).]

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**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

**.02 Omission of Substantially All Disclosures**

The accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and changes in financial position for the year then ended have been compiled by me (us).

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

Management has elected to omit substantially all of the disclosures required by generally accepted accounting principles. If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the company's financial position, results of operations, and changes in financial position. Accordingly, these financial statements are not designed for those who are not informed about such matters.

[Source: SSARS No. 1, paragraph 21 (*AICPA Professional Standards*, AR section 100.21).]

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**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

This form of report is appropriate only for a compilation engagement, not for a review engagement.



### **.03 Omission of Statement of Changes in Financial Position and Substantially All Disclosures**

The accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income and retained earnings, and for the year then ended have been compiled by me (us).

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

Management has elected to omit substantially all of the disclosures and the statement of changes in financial position required by generally accepted accounting principles. If the omitted disclosures and the statement of changes in financial position were included in the financial statements, they might influence the user's conclusions about the company's financial position, results of operations, and changes in financial position. Accordingly, these financial statements are not designed for those who are not informed about such matters.

[Source: SSARS No. 1, paragraph 21 (*AICPA Professional Standards*, AR section 100.21).]

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**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

This form of report is appropriate only for a compilation engagement, not for a review engagement.

**.04 Accountant Not Independent**

The accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and changes in financial position for the year then ended have been compiled by me (us).

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

I am (we are) not independent with respect to XYZ Company.<sup>1</sup>

[Source: SSARS No. 1, paragraphs 17 and 22 (*AICPA Professional Standards*, AR sections 100.17 and 100.22) respectively.]

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**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

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<sup>1</sup> In making a judgment about whether he is independent, the accountant should be guided by the AICPA Code of Professional Ethics. For example, the accountant should be aware that interpretation 101-3 (ET section 101.04) under rule 101 (ET section 101.01) of the rules of conduct indicates that independence is not necessarily impaired when an accountant provides manual or automated bookkeeping or data processing services to a client.

## **.05 Departure from GAAP—Omission of Statement of Changes in Financial Position**

The accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income and retained earnings for the year then ended have been compiled by me (us).

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them. However, I (we) did become aware of a departure from generally accepted accounting principles that is described in the following paragraph.

A statement of changes in financial position for the year ended December 31, 19XX, has not been presented. Generally accepted accounting principles require that such a statement be presented when financial statements purport to present financial position and results of operations.

[Source: SSARS No. 1, paragraph 40 (*AICPA Professional Standards*, AR section 100.40).]

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**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

**.06 Departure from GAAP—Accounting Principles Not Generally Accepted**

The accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and changes in financial position for the year then ended have been compiled by me (us).

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them. However, I (we) did become aware of a departure (certain departures) from generally accepted accounting principles that is (are) described in the following paragraph.

As disclosed in note X to the financial statements, generally accepted accounting principles require that land be stated at cost. Management has informed me (us) that the company has stated its land at appraised value and that, if generally accepted accounting principles had been followed, the land account and stockholders' equity would have been decreased by \$500,000.

[Source: SSARS No. 1, paragraph 40 (*AICPA Professional Standards*, AR section 100.40).]

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**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

## **.07 Cash Basis Statements**

The accompanying statement of assets and liabilities arising from cash transactions of XYZ Company as of December 31, 19X4, and the related statement of revenue collected and expenses paid for the year then ended have been compiled by me (us).

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

The Company's policy is to have its financial statements prepared on the basis of cash receipts and disbursements; consequently, certain revenue and the related assets are recognized when received rather than when earned, and certain expenses are recognized when paid rather than when the obligation is incurred. Accordingly, the accompanying financial statements are not intended to present financial position and results of operations in conformity with generally accepted accounting principles.<sup>2</sup>

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**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

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<sup>2</sup>The accountant may wish to omit this separate paragraph when the statements include a note which adequately discloses the basis of presentation used.

## **.08 Cash Basis Statements—Omission of Substantially All Disclosures**

The accompanying statement of assets and liabilities arising from cash transactions of XYZ Company as of December 31, 19X4, and the related statement of revenue collected and expenses paid for the year then ended have been compiled by me (us).

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

The Company's policy is to have its financial statements prepared on the basis of cash receipts and disbursements; consequently, certain revenue and the related assets are recognized when received rather than when earned, and certain expenses are recognized when paid rather than when the obligation is incurred. Accordingly, the accompanying financial statements are not intended to present financial position and results of operations in conformity with generally accepted accounting principles.<sup>3</sup>

Management has elected to omit substantially all of the informative disclosures ordinarily included in financial statements. If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the Company's assets, liabilities, capital, revenue and expenses. Accordingly, these financial statements are not designed for those who are not informed about such matters.

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### NOTE:

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

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<sup>3</sup>The accountant may wish to omit this separate paragraph when the statements include a note which adequately discloses the basis of presentation used.

## **.09 Income Tax Basis Statements**

The accompanying statement of assets, liabilities, and capital—  
income tax basis of ABC Partnership as of December 31, 19XX, and  
the related statements of revenue and expenses—  
income tax basis and  
of changes in partners' capital accounts—  
income tax basis for the year  
then ended have been compiled by me (us).

A compilation is limited to presenting in the form of financial state-  
ments information that is the representation of management (owners).  
I (we) have not audited or reviewed the accompanying financial state-  
ments and, accordingly, do not express an opinion or any other form  
of assurance on them.

The Partnership's policy is to have its financial statements prepared  
on the accounting basis used for income tax purposes; consequently,  
certain revenue and the related assets are recognized when received  
rather than when earned, and certain expenses are recognized when  
paid rather than when the obligation is incurred. Accordingly, the  
accompanying financial statements are not intended to present finan-  
cial position and results of operations in conformity with generally  
accepted accounting principles.<sup>4</sup>

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NOTE:

Statements on Standards for Accounting and Review Services pro-  
vide guidance to the accountant who performs services in connection  
with unaudited financial statements or other unaudited financial infor-  
mation of a nonpublic entity.

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<sup>4</sup>The accountant may wish to omit this separate paragraph when the state-  
ments include a note which adequately discloses the basis of presentation used.

## **.10 Income Tax Basis Statements—Omission of Substantially All Disclosures**

The accompanying statement of assets, liabilities, and capital—income tax basis of ABC Partnership as of December 31, 19XX, and the related statements of revenue and expenses—income tax basis and of changes in partners' capital accounts—income tax basis for the year then ended have been compiled by me (us).

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

The Partnership's policy is to have its financial statements prepared on the accounting basis used for income tax purposes; consequently, certain revenue and the related assets are recognized when received rather than when earned, and certain expenses are recognized when paid rather than when the obligation is incurred. Accordingly, the accompanying financial statements are not intended to present financial position and results of operations in conformity with generally accepted accounting principles.<sup>5</sup>

Management has elected to omit substantially all of the informative disclosures ordinarily included in financial statements. If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the partnership's assets, liabilities, capital, revenue and expenses. Accordingly, these financial statements are not designed for those who are not informed about such matters.

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### NOTE:

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

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<sup>5</sup>The accountant may wish to omit this separate paragraph when the statements include a note which adequately discloses the basis of presentation used.



## **.11 Compilation Each Period—Comparative Financial Statements**

The accompanying balance sheets of XYZ Company as of December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and changes in financial position for the years then ended have been compiled by me (us).

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

[Source: SSARS No. 2, paragraph 9 (*AICPA Professional Standards*, AR section 200.09).]

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### NOTE:

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

## **.12 Compilation Report on Current Period and Reference to Review Report on Prior Period—Comparative Financial Statements**

The accompanying balance sheet of XYZ Company as of December 31, 19X2, and the related statements of income, retained earnings, and changes in financial position for the year then ended have been compiled by me (us).

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying 19X2 financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

The accompanying 19X1 financial statements of XYZ Company were previously reviewed by me (us) and my (our) report dated March 1, 19X2, stated that I was (we were) not aware of any material modifications that should be made to those statements in order for them to be in conformity with generally accepted accounting principles. I (we) have not performed any procedures in connection with that review engagement after the date of my (our) report on the 19X1 financial statements.

[Sources: SSARS No. 2, paragraph 12 (*AICPA Professional Standards*, AR section 200.12) and SSARS No. 1, paragraph 17 (*AICPA Professional Standards*, AR section 100.17).]

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### NOTE:

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

### **.13 Changed Reference to a Departure from Generally Accepted Accounting Principles<sup>6</sup>—Comparative Financial Statements**

The accompanying balance sheets of XYZ Company as of December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and changes in financial position for the years then ended have been compiled by me (us).

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

In my (our) previous compilation report dated March 1, 19X2, on the 19X1 financial statements, I (we) referred to a departure from generally accepted accounting principles because the company carried its land at appraised values. However, as disclosed in Note X, the company has restated its 19X1 financial statements to reflect its land at cost in accordance with generally accepted accounting principles.

[Sources: SSARS No. 2, paragraph 15 (*AICPA Professional Standards*, AR section 200.15) and SSARS No. 1, paragraph 17 (*AICPA Professional Standards*, AR section 100.17).]

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**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

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<sup>6</sup>A changed reference to a departure from generally accepted accounting principles includes the removal of a prior reference or the inclusion of a new reference.

**.14 Predecessor's Compilation Report on Prior Period Not Presented—Comparative Financial Statements**

The accompanying balance sheet of XYZ Company as of December 31, 19X2, and the related statements of income, retained earnings, and changes in financial position for the year then ended have been compiled by me (us).

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying 19X2 financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

The 19X1 financial statements of XYZ Company were compiled by other accountants whose report dated February 1, 19X2, stated that they did not express an opinion or any other form of assurance on those statements.

[Sources: SSARS No. 2, paragraph 19 (*AICPA Professional Standards*, AR section 200.19) and SSARS No. 1, paragraph 17 (*AICPA Professional Standards*, AR section 100.17).]

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**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

## **.15 Predecessor's Review Report on Prior Period Not Presented—Comparative Financial Statements**

The accompanying balance sheet of XYZ Company as of December 31, 19X2, and the related statements of income, retained earnings, and changes in financial position for the year then ended have been compiled by me (us).

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying 19X2 financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

The 19X1 financial statements of XYZ Company were reviewed by other accountants whose report dated March 1, 19X2, stated that they were not aware of any material modifications that should be made to those statements in order for them to be in conformity with generally accepted accounting principles.

[Sources: SSARS No. 2, paragraph 18 (*AICPA Professional Standards*, AR section 200.18) and SSARS No. 1, paragraph 17 (*AICPA Professional Standards*, AR section 100.17).]

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### NOTES :

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

**.16 Prior Period Audited—Comparative Financial Statements**

The accompanying balance sheet of XYZ Company as of December 31, 19X2, and the related statements of income, retained earnings, and changes in financial position for the year then ended have been compiled by me (us).

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying 19X2 financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

The financial statements for the year ended December 31, 19X1, were examined by me (us) (other accountants) and I (we) (they) expressed an unqualified opinion on them in my (our) (their) report dated March 1, 19X2, but I (we) (they) have not performed any auditing procedures since that date.

[Sources: SSARS No. 2, paragraph 28 (*AICPA Professional Standards*, AR section 200.28) and SSARS No. 1, paragraph 17 (*AICPA Professional Standards*, AR section 100.17).]

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**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

**.17 Omission of Substantially All Disclosures Including Those for Prior Period Previously Not Omitted—Comparative Financial Statements**

The accompanying balance sheets of XYZ Company as of December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and changes in financial position for the years then ended have been compiled by me (us).

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

Management has elected to omit substantially all of the disclosures required by generally accepted accounting principles. If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the company's financial position, results of operations, and changes in financial position. Accordingly, these financial statements are not designed for those who are not informed about such matters.

The accompanying 19X1 financial statements were compiled by me (us) from financial statements that did not omit substantially all of the disclosures required by generally accepted accounting principles and that I (we) previously compiled (reviewed) as indicated in my (our) report dated March 1, 19X2.

[Source: SSARS No. 2, paragraph 30 (*AICPA Professional Standards*, AR section 200.30).]

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**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

**.18 Prior Period Disclaimed Pursuant to SAS No. 1, Section 516 \*—Comparative Financial Statements**

The accompanying balance sheet of XYZ Company as of December 31, 19X2, and the related statements of income, retained earnings, and changes in financial position for the year then ended have been compiled by me (us).

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying 19X2 financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

The 19X1 financial statements of XYZ Company were reported upon by me (us) in accordance with standards then in effect and my (our) report dated March 1, 19X2 stated that I (we) had not audited those financial statements and, accordingly, did not express an opinion on them.<sup>7</sup>

[Sources: SSARS No. 2, paragraph 34 (*AICPA Professional Standards*, AR section 200.34) and SSARS No. 1, paragraph 17 (*AICPA Professional Standards*, AR section 100.17).]

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**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

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\* SAS No. 1, section 516 is superseded by SAS No. 26 issued in November 1979 (*AICPA Professional Standards*, AU section 504).

<sup>7</sup> As indicated in SSARS No. 2, paragraph 33, the continuing accountant may also reissue his previous report or comply with the compilation or review standards in SSARS No. 1 (or perform an audit) with respect to unaudited financial statements for periods ending before July 1, 1979.



**.19 Predecessor's Disclaimer Pursuant to SAS No. 1,  
Section 516 \* Not Presented—Comparative Finan-  
cial Statements**

The accompanying balance sheet of XYZ Company as of December 31, 19X2, and the related statements of income, retained earnings, and changes in financial position for the year then ended have been compiled by me (us).

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying 19X2 financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

The 19X1 financial statements of XYZ Company were reported upon by other accountants in accordance with standards then in effect and their report dated February 1, 19X2 stated that they had not audited those financial statements and, accordingly, did not express an opinion on them.

[Sources: SSARS No. 2, paragraph 34 (*AICPA Professional Standards*, AR section 200.34) and SSARS No. 1, paragraph 17 (*AICPA Professional Standards*, AR section 100.17).]

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NOTE:

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

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\* SAS No. 1, section 516 is superseded by SAS No. 26 issued in November 1979 (*AICPA Professional Standards*, AU section 504).

**.20 Personal Financial Statements \***

The accompanying statement of assets and liabilities of Mr. and Mrs. Individual on the cost basis (Column A) and estimated value basis (Column B) as of December 31, 19XX, and the related statement of changes in net assets for the year then ended have been compiled by me (us).

A compilation is limited to presenting in the form of financial statements information that is the representation of the individuals. I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

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**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

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\* The financial statements referred to in the above illustration are from the AICPA Industry Audit Guide, *Audits of Personal Financial Statements* (1968), pages 22-25. Those statements are not included herein.

**AAM Section 10,500*****Accountant's Report on Review  
of Financial Statements of  
a Nonpublic Entity*****.01 Accountant's Standard Report**

I (we) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and changes in financial position for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

[Source: SSARS No. 1, paragraph 35 (*AICPA Professional Standards*, AR section 100.35).]

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**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

## **.02 Departure from GAAP—Accounting Principle Not Generally Accepted**

I (we) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and changes in financial position for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, with the exception of the matter described in the following paragraph, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

As disclosed in note X to the financial statements, generally accepted accounting principles require that inventory cost consist of material, labor, and overhead. Management has informed me (us) that the inventory of finished goods and work in process is stated in the accompanying financial statements at material and labor cost only, and that the effects of this departure from generally accepted accounting principles on financial position, results of operations, and changes in financial position have not been determined.

[Source: SSARS No. 1, paragraph 40 (*AICPA Professional Standards*, AR section 100.40).]

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### NOTE:

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

### **.03 Departure from GAAP—Change in Accounting Principle Without Reasonable Justification**

I (we) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and changes in financial position for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, with the exception of the matter described in the following paragraph, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

As disclosed in note X to the financial statements, the company has adopted (description of newly adopted method), whereas it previously used (description of previous method). Although the (description of newly adopted method) is in conformity with generally accepted accounting principles, the company does not appear to have reasonable justification for making a change as required by Opinion No. 20 of the Accounting Principles Board.

[Source: SSARS No. 1, paragraph 40 (*AICPA Professional Standards*, AR section 100.40).]

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**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

#### **.04 Departure from GAAP—Omission of Statement of Changes in Financial Position**

I (we) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, and retained earnings, for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, with the exception of the matter described in the following paragraph, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

A statement of changes in financial position for the year ended December 31, 19XX, has not been presented. Generally accepted accounting principles require that such a statement be presented when financial statements purport to present financial position and results of operations.

[Source: SSARS No. 1, paragraph 40 (*AICPA Professional Standards*, AR section 100.40).]

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**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

## **.05 Cash Basis Statements**

I (we) have reviewed the accompanying statement of assets and liabilities arising from cash transactions of XYZ Company as of December 31, 19XX, and the related statement of revenue collected and expenses paid for the year ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

As described in Note X, the Company's policy is to prepare its financial statements on the basis of cash receipts and disbursements; consequently, certain revenue and the related assets are recognized when received rather than when earned, and certain expenses are recognized when paid rather than when the obligation is incurred. Accordingly, the accompanying financial statements are not intended to present financial position and results of operations in conformity with generally accepted accounting principles.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with the basis of accounting described in Note X.

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**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

**.06 Income Tax Basis Statements**

I (we) have reviewed the accompanying statement of assets, liabilities, and capital—income tax basis of XYZ Company as of December 31, 19XX and the related statements of revenue and expenses—income tax basis, and of changes in assets, liabilities, and capital—income tax basis, for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

As described in Note X, the Company's policy is to prepare its financial statements on the accounting basis used for income tax purposes; consequently, certain revenue and the related assets are recognized when received rather than when earned, and certain expenses are recognized when paid rather than when the obligation is incurred. Accordingly, the accompanying financial statements are not intended to present financial position and results of operations in conformity with generally accepted accounting principles.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with the basis of accounting described in Note X.

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**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.



## **.07 Review Each Period—Comparative Financial Statements**

I (we) have reviewed the accompanying balance sheets of XYZ Company as of December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and changes in financial position for the years then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) reviews, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

[Source: SSARS No. 2, paragraph 9 (*AICPA Professional Standards*, AR section 200.09).]

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### **NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

### **.08 Review Report on Current Period and Reference to Compilation Report on Prior Period—Comparative Financial Statements**

I (we) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 19X2, and the related statements of income, retained earnings, and changes in financial position for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the 19X2 financial statements in order for them to be in conformity with generally accepted accounting principles.

The accompanying 19X1 financial statements of XYZ Company were compiled by me (us). A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the 19X1 financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

[Source: SSARS No. 2, paragraph 10 (*AICPA Professional Standards*, AR section 200.10).]

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#### NOTE:

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

## **.09 Changed Reference to a Departure from Generally Accepted Accounting Principles<sup>1</sup>—Comparative Financial Statements**

I (we) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 19X2, and 19X1, the related statements of income, retained earnings, and changes in financial position for the years then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

In my (our) previous review report dated March 1, 19X2, on the 19X1 financial statements, I (we) referred to a departure from generally accepted accounting principles because the company carried its land at appraised values. However, as disclosed in Note X, the company has restated its 19X1 financial statements to reflect its land in accordance with generally accepted accounting principles.

[Sources: SSARS No. 2, paragraph 15 (*AICPA Professional Standards*, AR section 200.15) and SSARS No. 1, paragraph 35 (*AICPA Professional Standards*, AR section 100.35).]

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### NOTE:

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

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<sup>1</sup>A changed reference to a departure from generally accepted accounting principles includes the removal of a prior reference or the inclusion of a new reference.

**.10 Predecessor's Review Report on Prior Period Not Presented—Comparative Financial Statements**

I (we) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 19X2, and the related statements of income, retained earnings, and changes in financial position for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying 19X2 financial statements in order for them to be in conformity with generally accepted accounting principles.

The 19X1 financial statements of XYZ Company were reviewed by other accountants whose report dated March 1, 19X2, stated that they were not aware of any material modifications that should be made to those statements in order for them to be in conformity with generally accepted accounting principles.

[Sources: SSARS No. 2, paragraph 18 (*AICPA Professional Standards*, AR section 200.18) and SSARS No. 1, paragraph 35 (*AICPA Professional Standards*, AR section 100.35).]

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**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

## **.11 Predecessor's Compilation Report on Prior Period Not Presented—Comparative Financial Statements**

I (we) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 19X2, and the related statements of income, retained earnings, and changes in financial position for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying 19X2 financial statements in order for them to be in conformity with generally accepted accounting principles.

The 19X1 financial statements of XYZ Company were compiled by other accountants whose report dated February 1, 19X2, stated that they did not express an opinion or any other form of assurance on those statements.

[Sources: SSARS No. 2, paragraph 19 (*AICPA Professional Standards*, AR section 200.19) and SSARS No. 1, paragraph 35 (*AICPA Professional Standards*, AR section 100.35).]

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**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

## **.12 Prior Period Audited—Comparative Financial Statements**

I (we) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 19X2, and the related statements of income, retained earnings, and changes in financial position for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying 19X2 financial statements in order for them to be in conformity with generally accepted accounting principles.

The financial statements for the year ended December 31, 19X1, were examined by me (us) (other accountants) and I (we) (they) expressed an unqualified opinion on them in my (our) (their) report dated March 1, 19X2, but I (we) (they) have not performed any auditing procedures since that date.

[Sources: SSARS No. 2, paragraph 28 (*AICPA Professional Standards*, AR section 200.28) and SSARS No. 1, paragraph 35 (*AICPA Professional Standards*, AR section 100.35).]

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### NOTE:

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

**.13 Prior Period Disclaimed Pursuant to SAS No. 1, Section 516 \*—Comparative Financial Statements**

I (we) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 1979, and the related statements of income, retained earnings, and changes in financial position for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying 1979 financial statements in order for them to be in conformity with generally accepted accounting principles.

The 1978 financial statements of XYZ Company were reported upon by me (us) in accordance with standards then in effect and my (our) report dated March 1, 1979 stated that I (we) had not audited those financial statements and, accordingly, did not express an opinion on them.<sup>2</sup>

[Sources: SSARS No. 2, paragraph 34 (*AICPA Professional Standards*, AR section 200.34) and SSARS No. 1, paragraph 35 (*AICPA Professional Standards*, AR section 100.35).]

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**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

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\* SAS No. 1, section 516 is superseded by SAS No. 26 issued in November 1979 (*AICPA Professional Standards*, AU section 504).

<sup>2</sup> As indicated in SSARS No. 2, paragraph 33, the continuing accountant may also reissue his previous report or comply with the compilation or review standards in SSARS No. 1 (or perform an audit) with respect to unaudited financial statements for periods ending before July 1, 1979.

#### **.14 Predecessor's Disclaimer on Prior Period Pursuant to SAS No. 1, Section 516 \* Not Presented—Comparative Financial Statements**

I (we) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 1979, and the related statements of income, retained earnings, and changes in financial position for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying 1979 financial statements in order for them to be in conformity with generally accepted accounting principles.

The 1978 financial statements of XYZ Company were reported upon by other accountants in accordance with standards then in effect and their report dated February 1, 1979 stated that they had not audited those financial statements and, accordingly, did not express an opinion on them.

[Sources: SSARS No. 2, paragraph 34 (*AICPA Professional Standards*, AR section 200.34) and SSARS No. 1, paragraph 35 (*AICPA Professional Standards*, AR section 100.35).]

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#### NOTE:

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

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\* SAS No. 1, section 516 is superseded by SAS No. 26 issued in November 1979 (*AICPA Professional Standards*, AU section 504).



## **.15 Personal Financial Statements \***

I (we) have reviewed the accompanying statement of assets and liabilities of Mr. and Mrs. Individual on the cost basis (Column A) as of December 31, 19XX, and the related statement of changes in net assets for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the individuals.

A review consists principally of inquiries of the individuals and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements on the cost basis (Column A) in order for them to be in conformity with generally accepted accounting principles. The additional information set forth in the accompanying financial statements on the estimated value basis (Column B) has been compiled by me (us). A compilation is limited to presenting in the form of financial statements information that is the representation of the individuals. I (we) have not audited or reviewed the amounts shown as estimated values and, accordingly I (we) do not express an opinion or any other form of assurance on them.

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NOTE:

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

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\* The financial statements referred to in the above illustration are from the AICPA Industry Audit Guide, *Audits of Personal Financial Statements* (1968), pages 22-25. Those statements are not included herein.



## AAM Section 11,000

**FINANCIAL STATEMENTS**

These sections include illustrative financial statement formats and a limited number of illustrative notes for hypothetical and uncomplicated nonpublic entities. Thus, the illustrations do not include examples of disclosures of earnings per share and segment information required for public entities.

Various formats of financial statement presentations are in use. Inclusion of only certain formats in these sections in no way means they are preferable. In addition, these illustrative formats and notes may become of limited use once any complexity is encountered in a particular entity's transactions. This manual is a nonauthoritative kit of practice aids. Users of this manual are urged to refer directly to authoritative pronouncements when appropriate.

Users of this manual should consider other sources of illustrative financial presentations, such as those in authoritative pronouncements, AICPA industry audit guides, *Accounting Trends & Techniques*, library collections of published financial reports, and the AICPA National Automated Accounting Research System (NAARS). Users should also consider the financial statement disclosure checklists included elsewhere in this manual.

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➤➤➤ → *The next page is 11,101.* ← ➤➤➤

**AAM Section 11,100****General Comment on Illustrative  
Financial Statements**

.01 Illustrative financial statement formats are often helpful in developing a consistent style of presentation within a firm. However, the circumstances of engagements vary widely, and no set of illustrative financial statements can cover all situations likely to be encountered in practice, particularly when the client is engaged in a specialized industry. Accordingly, users should refer to the firm's own report files, illustrations in authoritative pronouncements, and other sources such as AICPA industry audit guides and *Accounting Trends & Techniques*, library collections of published financial reports and the AICPA National Automated Accounting Research System (NAARS).

.02 These illustrative financial statements do not include disclosures about related party transactions; users are cautioned to be aware of the requirements of Statement on Auditing Standards No. 6 (AU section 335).<sup>1</sup>

.03 In practice, the classifications in the financial statements often include references to specific notes. However, because of the variations encountered in practice, this is not done in these illustrative financial statements except for the illustrative statement of retained earnings and additional paid-in capital (AAM section 11,400.02).

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»»»→ **The next page is 11,201.** ←«««

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<sup>1</sup> AICPA Professional Standards (New York, AICPA).



## AAM Section 11,200

# *Illustrative Presentations of Financial Position*

### **Comment**

.01 The companies surveyed in *Accounting Trends & Techniques*<sup>1</sup> generally use the title “balance sheet” for their statements of assets, liabilities, and stockholders’ equity. Other titles used by those companies are “statement of financial position” and “statement of financial condition.”

.02 Some entities include in their balance sheets a caption without an amount for commitments and contingent liabilities [see FASB Statement No. 5 (AC section 4311)<sup>2</sup> and interpretations thereof for guidance on accrual and disclosure] with a reference to the applicable note(s).

.03 The illustrative balance sheets include different formats for certain captions to show a few of the various formats used in practice. For example, the inventories caption in the illustrative balance sheet (paragraph .05) includes subclassifications and amounts for raw materials, work in process, and finished goods. In the illustrative statement of net assets (paragraph .06), the inventories presentation includes only total amounts; amounts for subclassifications would appear in a note to the financial statements. Presentations of property and equipment in the two illustrations demonstrate different approaches of a similar nature.

.04 The illustrative statements of financial position and illustrative notes do not include lease transactions because of the complexity of the accounting and disclosure requirements. Users are referred to FASB Statement No. 13 (AC section 4053), which includes examples of disclosures, and to the subsequent amendments and interpretations of that pronouncement.

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<sup>1</sup> *Accounting Trends & Techniques* (New York, AICPA), 1978.

<sup>2</sup> *AICPA Professional Standards* (New York, AICPA).

**.05 Illustrative Balance Sheet—Sample A**

A Private Company and Subsidiaries  
Consolidated Balance Sheet  
December 19X1 and 19X0

Assets	19X1	19X0
<b>Current Assets:</b>		
Cash (including time deposits of \$xx,xxx in 19X1 and \$xx,xxx in 19X0) .....	\$xx,xxx	\$xx,xxx
U. S. Treasury Bills, at cost, which approximates market .....	xx,xxx	xx,xxx
Accounts and notes receivable—		
Trade .....	xx,xxx	xx,xxx
Notes receivable from officer .....	xx,xxx	xx,xxx
	xx,xxx	xx,xxx
Less allowance for doubtful accounts .....	(xx,xxx)	(xx,xxx)
	xx,xxx	xx,xxx
 Inventories, at the lower of cost (first-in, first-out) or market—		
Raw materials .....	xx,xxx	xx,xxx
Work in process .....	xx,xxx	xx,xxx
Finished goods .....	xx,xxx	xx,xxx
	xx,xxx	xx,xxx
Prepaid expenses .....	xx,xxx	xx,xxx
Total current assets .....	xx,xxx	xx,xxx
<b>Property and Equipment, at cost:</b>		
Land .....	xx,xxx	xx,xxx
Buildings .....	xx,xxx	xx,xxx
Furniture and equipment .....	xx,xxx	xx,xxx
	xx,xxx	xx,xxx
Less accumulated depreciation and amortization .....	(xx,xxx)	(xx,xxx)
Net property and equipment .....	xx,xxx	xx,xxx
<b>Intangibles and Other Assets:</b>		
Excess of cost over carrying value of net assets acquired, less accumulated amortization of \$xx,xxx in 19X1 and \$xx,xxx in 19X0 .....	xx,xxx	xx,xxx
Other .....	xx,xxx	xx,xxx
Net intangibles and other assets .....	xx,xxx	xx,xxx
Total Assets .....	\$xx,xxx	\$xx,xxx

The accompanying notes are an integral part  
of these financial statements.



Consolidated Balance Sheet—Continued

Liabilities	19X1	19X0
	<u>          </u>	<u>          </u>
Current Liabilities:		
Notes payable to bank .....	\$xx,xxx	\$xx,xxx
Accounts payable .....	xx,xxx	xx,xxx
Accrued expenses .....	xx,xxx	xx,xxx
Federal and state income taxes payable.....	xx,xxx	xx,xxx
Current portion of long-term debt.....	xx,xxx	xx,xxx
	<u>          </u>	<u>          </u>
Total current liabilities.....	xx,xxx	xx,xxx
Long-Term Debt, less current portion included above.....	xx,xxx	xx,xxx
Deferred income taxes .....	xx,xxx	xx,xxx
	<u>          </u>	<u>          </u>
	xx,xxx	xx,xxx
	<u>          </u>	<u>          </u>
Stockholders' Equity:		
Common stock, \$100 par value; 3,000 shares authorized		
Issued and outstanding — 2,000 shares in 19X1, 1900 shares		
in 19X0 .....	xx,xxx	xx,xxx
Additional paid-in capital .....	xx,xxx	xx,xxx
Retained earnings .....	xx,xxx	xx,xxx
	<u>          </u>	<u>          </u>
Total stockholders' equity .....	xx,xxx	xx,xxx
	<u>          </u>	<u>          </u>
Total Liabilities and Stockholders' Equity .....	<u>\$xx,xxx</u>	<u>\$xx,xxx</u>

The accompanying notes are an integral part of these financial statements.

**.06 Illustrative Statement of Net Assets—Sample B**

A Private Company and Subsidiaries  
 Consolidated Statement of Net Assets  
 December 31, 19X1 and 19X0

Assets	19X1	19X0
<b>Current Assets:</b>		
Cash .....	\$xx,xxx	\$xx,xxx
Marketable securities, at cost (quoted market price—\$xx,xxx in 19X1 and \$xx,xxx in 19X0) .....	xx,xxx	xx,xxx
Accounts receivable, less allowance for doubtful accounts of \$xx,xxx in 19X1 and \$xx,xxx in 19X0 .....	xx,xxx	xx,xxx
Inventories, at the lower of cost (FIFO) or market .....	xx,xxx	xx,xxx
Prepaid expenses .....	xx,xxx	xx,xxx
Total current assets .....	xx,xxx	xx,xxx
Property and equipment, at cost, less accumulated depreciation of \$xx,xxx in 19X1 and \$xx,xxx in 19X0 .....	xx,xxx	xx,xxx
Goodwill, at cost, less accumulated amortization of \$xx,xxx in 19X1 and \$xx,xxx in 19X0 .....	xx,xxx	xx,xxx
Total assets .....	\$xx,xxx	\$xx,xxx
<b>Liabilities</b>		
<b>Current Liabilities:</b>		
Notes payable to banks .....	xx,xxx	xx,xxx
Current maturities of long-term debt .....	xx,xxx	xx,xxx
Accounts payable .....	xx,xxx	xx,xxx
Accrued payroll, interest and other expenses .....	xx,xxx	xx,xxx
Federal and state income taxes payable .....	xx,xxx	xx,xxx
Total current liabilities .....	xx,xxx	xx,xxx
Long-term debt, less current maturities included above .....	xx,xxx	xx,xxx
Total liabilities .....	xx,xxx	xx,xxx
<b>Stockholders' Equity *</b>		
Common stock .....	xx,xxx	xx,xxx
Additional paid-in capital .....	xx,xxx	xx,xxx
Retained earnings .....	xx,xxx	xx,xxx
Total stockholders' equity .....	\$xx,xxx	\$xx,xxx

See notes to consolidated financial statements.

➤ *The next page is 11,301.* ←

\* Stockholders' equity and its components should include reference to notes which present appropriate additional disclosures such as number of shares authorized, issued and outstanding.

**AAM Section 11,300*****Illustrative Presentations of the Results of Operations*****Comment**

.01 The illustrative formats are for relatively uncomplicated commercial entities. The nature of an entity's business and industry will affect the format and classifications. Like the illustrative statements of financial position, the illustrative income statements include different formats and classifications to demonstrate some of the many possible variations.

.02 Some nonpublic entities may use supplementary schedules of the elements comprising such classifications as cost of sales, selling, shipping and administrative expenses. The format and design of these supplementary schedules will vary with the needs of the client.

.03 The companies surveyed for *Accounting Trends & Techniques* generally use the term "income" in the title of their presentations of the results of operations. Other terms used by those companies are "earnings" and "operations."

**.04 Illustrative Statement of Income and Retained Earnings**

A Private Company and Subsidiaries  
 Consolidated Statement of Income and Retained Earnings  
 For the Years Ended December 31, 19X1 and 19X0

	19X1	19X0
Net sales .....	\$xx,xxx	\$xx,xxx
Cost of sales .....	xx,xxx	xx,xxx
	Gross profit .....	xx,xxx
	Selling, general and administrative expenses.....	xx,xxx
	Income from operations .....	xx,xxx
Other income:		
Interest income .....	xx,xxx	xx,xxx
Interest expense .....	(xx,xxx)	(xx,xxx)
Miscellaneous .....	xx,xxx	xx,xxx
	xx,xxx	xx,xxx
	Income before income taxes .....	xx,xxx
Provision for federal and state income taxes:		
Current .....	xx,xxx	xx,xxx
Deferred .....	xx,xxx	xx,xxx
	Net income .....	xx,xxx
Retained earnings, beginning of year.....	xx,xxx	xx,xxx
Retained earnings, end of year.....	\$xx,xxx	\$xx,xxx

The accompanying notes are an integral part  
of these financial statements.

**.05 Illustrative Income Statement—Sample A**

A Private Company and Subsidiaries  
 Consolidated Statement of Operations  
 For the Years Ended December 31, 19X1 and 19X0

	<u>19X1</u>	<u>19X0</u>
Revenue:		
Sales .....	\$xx,xxx	\$xx,xxx
Returns and allowances.....	xx,xxx	xx,xxx
	<u>xx,xxx</u>	<u>xx,xxx</u>
Net sales .....	xx,xxx	xx,xxx
	<u>xx,xxx</u>	<u>xx,xxx</u>
Costs and expenses:		
Cost of goods sold, exclusive of depreciation..	xx,xxx	xx,xxx
Depreciation and amortization.....	xx,xxx	xx,xxx
Selling, general and administrative.....	xx,xxx	xx,xxx
Research, development and engineering.....	xx,xxx	xx,xxx
Interest on debt.....	xx,xxx	xx,xxx
	<u>xx,xxx</u>	<u>xx,xxx</u>
	xx,xxx	xx,xxx
Other income .....	xx,xxx	xx,xxx
Settlement of lawsuit in 19X1 * .....	xx,xxx	—
	<u>xx,xxx</u>	<u>xx,xxx</u>
Income before income taxes.....	xx,xxx	xx,xxx
	<u>xx,xxx</u>	<u>xx,xxx</u>
Provision for income taxes:		
Current .....	xx,xxx	xx,xxx
Deferred .....	xx,xxx	xx,xxx
	<u>xx,xxx</u>	<u>xx,xxx</u>
Net income .....	<u>\$xx,xxx</u>	<u>\$xx,xxx</u>

See notes to consolidated financial statements.

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\* Included above as an example of an unusual expense.

**.06 Illustrative Income Statement—Sample B**

A Private Company and Subsidiaries  
Consolidated Statement of Operations  
For the Years Ended December 31, 19X1 and 19X0

	19X1	19X0
Net sales .....	\$xx,xxx	\$xx,xxx
Cost of goods sold.....	xx,xxx	xx,xxx
Gross profit .....	xx,xxx	xx,xxx
Selling, general and administrative expenses.....	xx,xxx	xx,xxx
Research, development and engineering expenses..	xx,xxx	xx,xxx
	xx,xxx	xx,xxx
Income from operations.....	xx,xxx	xx,xxx
Other income (expense):		
Dividend income .....	xx,xxx	xx,xxx
Interest income .....	xx,xxx	xx,xxx
Interest expense .....	(xx,xxx)	(xx,xxx)
Other .....	xx,xxx	xx,xxx
	(xx,xxx)	(xx,xxx)
Income before income taxes.....	xx,xxx	xx,xxx
Provision for incomes taxes:		
Current .....	xx,xxx	xx,xxx
Deferred .....	xx,xxx	xx,xxx
	xx,xxx	xx,xxx
Net income .....	\$xx,xxx	\$xx,xxx

See notes to consolidated financial statements.

➤➤➤→ The next page is 11,401. ←➤➤➤

## AAM Section 11,400

## Illustrative Presentations of Ownership Equity

### .01 Illustrative Statement of Stockholders' Equity

A Private Company and Subsidiaries  
Consolidated Statement of Stockholders' Equity  
For the Years Ended December 31, 19X2 and 19X1

	Common stock		Additional paid-in capital	Retained earnings
	Number of share	Amount		
Balance, December 31, 19X0.....	xxx	\$x,xxx	\$ xx,xxx	\$ xx,xxx
Net income for the year.....				xx,xxx
Cash dividends, \$xx per share.....				(xx,xxx)
Balance, December 31, 19X1.....	xxx	x,xxx	xx,xxx	xx,xxx
Net income for the year.....				xx,xxx
Sale of xx shares of common stock....	xx	xxx	x,xxx	
Cash dividends, \$xx per share.....				(xx,xxx)
Balance, December 31, 19X2.....	xxx	\$x,xxx	\$ xx,xxx	\$ xx,xxx

See notes to the consolidated financial statements

## .02 Illustrative Statement of Retained Earnings and Additional Paid-In Capital

A Private Company and Subsidiaries  
 Consolidated Statement of Retained Earnings  
 and Additional Paid-In Capital  
 For the Years Ended December 31, 19X1 and 19X0

Retained Earnings	19X1	19X0
Balance, beginning of year.....	\$ xx,xxx	\$ xx,xxx
Net income .....	xx,xxx	xx,xxx
Dividends declared on common stock, \$xx and \$xx per share in 19X1 and 19X0, respectively.....	(xx,xxx)	(xx,xxx)
Balance, end of year.....	<u>\$ xx,xxx</u>	<u>\$ xx,xxx</u>
Additional Paid-In Capital (Note.....) <sup>1</sup>		
Balance, beginning of year.....	\$ xx,xxx	\$ xx,xxx
Excess of proceeds from the sale of xx shares of common stock over the par value thereof.....	xx,xxx	_____
Balance, end of year.....	<u>\$ xx,xxx</u>	<u>\$ xx,xxx</u>

The accompanying notes are an integral part of  
 the consolidated financial statements.

➤➤➤→ *The next page is 11,501.* ←➤➤➤

<sup>1</sup> Comment: Additional paid-in capital includes reference to a note which would present a summary of the changes in the common shares issued and outstanding.



## AAM Section 11,500

## Illustrative Presentations of Changes in Financial Position

### .01 Illustrative Statement of Changes in Financial Position (Presents Changes in Working Capital)

A Private Company and Subsidiaries  
Consolidated Statement of Changes in Financial Position  
For the Years Ended December 31, 19X1 and 19X0

	<u>19X1</u>	<u>19X0</u>
<b>Funds Provided:</b>		
Net income .....	\$ xx,xxx	\$ xx,xxx
Items included in net income not affecting working capital:		
Depreciation and amortization .....	xx,xxx	xx,xxx
Deferred income taxes .....	xx,xxx	xx,xxx
Funds provided by operations .....	xx,xxx	xx,xxx
Additional borrowings .....	xx,xxx	—
Proceeds from sale of common stock .....	xx,xxx	—
Disposition of property and equipment .....	xx,xxx	xx,xxx
Total funds provided .....	<u>xx,xxx</u>	<u>xx,xxx</u>
<b>Funds Applied:</b>		
Additions to property and equipment .....	xx,xxx	xx,xxx
Reduction of long-term debt .....	xx,xxx	xx,xxx
Cash dividends .....	xx,xxx	xx,xxx
Total funds applied .....	<u>xx,xxx</u>	<u>xx,xxx</u>
Increase (decrease) in working capital .....	<u>\$ xx,xxx</u>	<u>(\$ xx,xxx)</u>
<b>Changes in Working Capital</b>		
Increase (decrease) in current assets—		
Cash .....	\$ xx,xxx	(\$ xx,xxx)
Marketable securities .....	xx,xxx	( xx,xxx)
Accounts and notes receivable .....	xx,xxx	xx,xxx
Inventories .....	xx,xxx	( xx,xxx)
Prepaid expenses .....	( xx,xxx)	xx,xxx
Increase (decrease) in current assets .....	<u>xx,xxx</u>	<u>( xx,xxx)</u>
Increase (decrease) in current liabilities—		
Notes payable .....	( xx,xxx)	xx,xxx
Accounts payable .....	xx,xxx	xx,xxx
Accrued expenses .....	xx,xxx	xx,xxx
Federal and state income taxes payable .....	xx,xxx	xx,xxx
Current portion of long-term debt .....	xx,xxx	( xx,xxx)
Increase (decrease) in current liabilities .....	<u>xx,xxx</u>	<u>xx,xxx</u>
Increase (decrease) in working capital .....	<u>\$ xx,xxx</u>	<u>(\$ xx,xxx)</u>

The accompanying notes are an integral part of these financial statements.

**.02 Illustrative Statement of Changes in Financial Position  
(Presents Changes in Cash and Temporary Cash Investments)**

A Private Company and Subsidiaries  
Consolidated Statement of Changes in Financial Position  
For the Years Ended October 31, 19X1 and 19X0

	<u>19X1</u>	<u>19X0</u>
<b>Funds Provided:</b>		
Net income .....	\$ xx,xxx	\$ xx,xxx
Charges to income not requiring outlay of funds:		
Depreciation and amortization.....	xx,xxx	xx,xxx
Deferred income taxes.....	xx,xxx	xx,xxx
	<hr/>	<hr/>
Funds provided by operations.....	xx,xxx	xx,xxx
Increase in deferred revenue.....	xx,xxx	xx,xxx
Disposal of property and equipment.....	xx,xxx	—
Additional long-term debt.....	xx,xxx	—
Proceeds from sale of capital stock.....	xx,xxx	xx,xxx
Increase in:		
Notes payable to bank.....	—	xx,xxx
Accounts payable .....	xx,xxx	xx,xxx
Federal and state income taxes payable.....	xx,xxx	xx,xxx
Current portion of long-term debt.....	xx,xxx	xx,xxx
	<hr/>	<hr/>
	xx,xxx	xx,xxx
<b>Funds Applied:</b>		
Cash dividends .....	xx,xxx	xx,xxx
Acquisition of XYZ & Sons, Inc.....	—	xx,xxx
Additions to property and equipment.....	xx,xxx	xx,xxx
Decrease in long-term debt.....	—	xx,xxx
Acquisition of treasury stock.....	—	xx,xxx
Decrease in notes payable to bank.....	xx,xxx	—
Increase in:		
Accounts receivable .....	xx,xxx	xx,xxx
Inventories .....	xx,xxx	xx,xxx
	<hr/>	<hr/>
	xx,xxx	xx,xxx
Increase (decrease) in cash and temporary cash investments..	<u>\$ xx,xxx</u>	<u>(\$ xx,xxx)</u>

The accompanying notes are an integral part of the financial statements.

➤ *The next page is 11,601.* ←

## AAM Section 11,600

# *Illustrative Notes to Financial Statements*

### **Comment on Disclosure of Significant Accounting Policies**

.01 The summary of significant accounting policies typically includes disclosure about matters such as principles of consolidation, inventory pricing, property and depreciation policies, amortization policies, interperiod tax allocation, employee benefits, and changes in accounting policies, if any. The summary should not duplicate details disclosed elsewhere as part of the financial statements. The example included illustrates some disclosures for a hypothetical, noncomplex private company.

### **Comment on Other Notes to Financial Statements**

.02 The information contained in notes varies widely depending on the company's circumstances and on the extent of information presented on the face of the financial statements and in the summary of significant accounting policies. The few sample notes that follow illustrate some simple situations. Readers are urged to consult appropriate authoritative pronouncements, AICPA industry audit guides, *Accounting Trends & Techniques*, financial statements issued by companies in the same industry, and the financial statement disclosure checklist in this manual (AAM section 8000) in drafting notes.

## ILLUSTRATIVE NOTES TO FINANCIAL STATEMENTS

### **.03 Illustrative Note: Summary of Significant Accounting Policies**

Note . . . Summary of Significant Accounting Policies:

- Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, after elimination of all significant intercompany balances and transactions.

- Inventories

Inventories are stated at the lower of cost (determined on a first-in, first-out basis) or market, and include material, labor, and factory overhead.

- Property and Depreciation

Property and equipment are recorded at cost. Depreciation is provided on the straight-line method over the estimated useful lives of the respective assets. Maintenance and repairs are charged to expense as incurred; major renewals and betterments are capitalized. When items of property or equipment are sold or retired, the related cost and accumulated depreciation are removed from the accounts and any gain or loss is included in income (the results of operations).

- Income Taxes

Deferred income taxes are provided on timing differences between financial statement and income tax reporting, principally from the use of accelerated methods of depreciation for income tax purposes. Investment tax credits (\$xxx in 19X1 and \$xxx in 19X0) are recorded as a reduction of the provision for income taxes.

- Employee Benefits

The Company and its wholly-owned subsidiary have pension plans covering substantially all employees. Pension plan expense is determined based on the actuarial cost (entry age normal method) of current service and amortization of prior service costs over a thirty-year period. The Company's policy is to fund pension cost accrued.

- Intangible Assets

The excess of cost over carrying value of net assets acquired is being amortized on a straight-line basis over a forty-year period.

#### **.04 Illustrative Note: Inventories**

Note . . . Inventories:

Inventories at December 31, 19X1 and 19X0 consist of the following:

	19X1	19X0
Raw materials . . . . .	\$xx,xxx	\$xx,xxx
Work in process . . . . .	xx,xxx	xx,xxx
Finished goods . . . . .	xx,xxx	xx,xxx
	<u>          </u>	<u>          </u>
	\$xx,xxx	\$xx,xxx
	<u>          </u>	<u>          </u>

**.05 Illustrative Note: Property and Equipment**

Note . . . Property and Equipment :

Major classifications of property and equipment and their respective depreciable lives are summarized below :

	December 31		Depreciable
	19X1	19X0	Lives
Land . . . . .	\$xx,xxx	\$xx,xxx	
Building . . . . .	xx,xxx	xx,xxx	25 years
Furniture and equipment . . . . .	xx,xxx	xx,xxx	5-10 years
	-----	-----	
	\$xx,xxx	\$xx,xxx	
Accumulated depreciation . . . . .	xx,xxx	xx,xxx	
	-----	-----	
	\$xx,xxx	\$xx,xxx	
	=====	=====	

Depreciation expense aggregated \$xx,xxx in 19X1 and \$xx,xxx in 19X0.

**.06 Illustrative Note: Pension Plans**

Note . . . Pension Plans :

The Company and its wholly-owned subsidiary have noncontributory pension plans covering substantially all employees. Pension plan expense was \$xx,xxx in 19X1 and \$xx,xxx in 19X0. The Company's policy is to fund pension cost accrued. As of September 15, 19X1, the last valuation date, the actuarially computed value of vested benefits exceeded the aggregate market value of the assets in the plan by \$xx,xxx.

**.07 Illustrative Note: Long-term Debt**

Note . . . Long Term Debt :

Long-term debt at December 31, 19X1 and 19X0 consists of the following :

	19X1	19X0
9% mortgage note payable in monthly installments of \$x,xxx (including principal and interest) to April 1, 19X9, secured by land and building . . . . .	\$xx,xxx	\$xx,xxx

	<u>19X1</u>	<u>19X0</u>
13% unsecured loan under credit agreement due in annual installments of \$xx,xxx plus interest on the unpaid balance to October 31, 19X5.....	xx,xxx	xx,xxx
	<u>xx,xxx</u>	<u>xx,xxx</u>
Less current portion.....	xx,xxx	xx,xxx
	<u>\$xx,xxx</u>	<u>\$xx,xxx</u>

The provisions of the unsecured credit agreement require the prior written consent of the creditor for additional borrowings, sale of property and acquisitions of the Company's stock, and limit the payment of cash dividends. At December 31, 19X1, retained earnings of approximately \$xx,xxx were available for the payment of dividends and other purposes under the agreement.

**.08 Illustrative Note: Income Taxes**

Note . . . Income Taxes :

Income tax expense for the years ended December 31, 19X1 and 19X0 consists of the following :

	<u>19X1</u>	<u>19X0</u>
Taxes currently payable:		
Federal .....	\$xx,xxx	\$xx,xxx
State .....	xx,xxx	xx,xxx
	<u>xx,xxx</u>	<u>xx,xxx</u>
Less investment tax credits .... ( xx,xxx)	( xx,xxx)	( xx,xxx)
	<u>xx,xxx</u>	<u>xx,xxx</u>
Deferred taxes:		
Federal .....	xx,xxx	xx,xxx
State .....	xx,xxx	xx,xxx
	<u>xx,xxx</u>	<u>xx,xxx</u>
	<u>\$xx,xxx</u>	<u>\$xx,xxx</u>

Deferred income taxes on the balance sheet will be reflected as a reduction of income tax expense in later years as timing differences reverse.

Income tax expense of each year varies from the amount that would be obtained by applying statutory income tax rates to income before income taxes because income for financial statement purposes includes interest on municipal obligations not subject to Federal income taxes.

### **.09 Comments on Notes Concerning Commitments and Contingent Liabilities**

Financial statements for privately held companies frequently include notes on leases and other commitments and contingencies. No lease note is included above because of the complexity of the accounting and disclosure requirements. Members are referred to FASB Statement No. 13 (AC section 4053) which includes examples of disclosures and subsequent amendments and interpretations of that pronouncement. No notes are included above for other commitments and contingencies because circumstances vary widely.

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**AAM****APPENDIXES**


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Pronouncements cited in the Audit and Accounting Manual are cross-referenced to sections in the text

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Accounting Research Bulletins			Audit and Accounting Manual		
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**Accounting Principles Board  
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4		8400	.03	47(cc) (v)
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	15	8400	.03	47(i)
	16	8400	.03	47(i)
	17	8400	.03	47(i)
	18	8400	.03	47(i)
	19	8400	.03	47(i)
	26	18	8400	.03
19		8400	.03	33
20		8400	.03	33
21		8400	.03	33
28		8300	.02	
29		8400	.03	32
30	8	8400	.03	34(a)
	9	8400	.03	34(a)
	10	8400	.03	35
	11	8400	.03	35
	12	8400	.03	34(a)
	18	8400	.03	34(b)
	19	8400	.03	35
	20	8400	.03	35
	21	8400	.03	35
	22	8400	.03	35
	23	8400	.03	35
	24	8400	.03	35
	25	8400	.03	35
26	8400	.03	36	

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**Accounting Principles Board  
Statements****Audit and Accounting Manual**

No.	Chap.	Par.	Sec.	Par.	Subpar.
4	2	10	8400	.03	3
	7	199	8400	.03	47(ee)

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Statements on Auditing Standards			Audit and Accounting Manual		
No.	Sec.	Par.	Sec.	Par.	Subpar.
1	320		4100	.03	
	320		4100	.02	
	320	.27	4100	.02	
	320	.28	4100	.02	
	320	.28	4400	.020	
	320	.29	4100	.02	
	320	.29	4400	.020	
	320	.30	4400	.020	
	320	.31	4400	.020	
	320	.32	4400	.020	
	320	.33	4400	.020	
	320	.34	4400	.020	
	320	.35	4400	.020	
	320	.36	4400	.020	
	320	.37	4400	.020	
	320	.38	4400	.020	
	320	.39	4400	.020	
	320	.40	4400	.020	
	320	.41	4400	.020	
	320	.42	4400	.020	
	320	.43	4400	.020	
	320	.44	4400	.020	
	320	.45	4400	.020	
	320	.46	4400	.020	
	320	.47	4400	.020	
	320	.48	4400	.020	
	320	.49	4100	.02	
	320	.54	4200	.03	
	320	.55	5400	.050	
	320	.55	5400	.060	
	320	.55	5400	.070	
	320	.55	5400	.080	
	320	.56	5400	.050	
	320	.56	5400	.060	
	320	.56	5400	.070	
	320	.56	5400	.080	
	320	.57	5400	.050	
	320	.57	5400	.060	
	320	.57	5400	.070	
	320	.57	5400	.080	
	320	.58	5400	.050	
	320	.58	5400	.060	
	320	.58	5400	.070	
	320	.58	5400	.080	
	320	.59	5400	.050	
	320	.59	5400	.060	
	320	.59	5400	.070	
	320	.59	5400	.080	
	320	.60	5400	.050	
	320	.60	5400	.060	

Statements on Auditing Standards (continued)			Audit and Accounting Manual (continued)		
No.	Sec.	Par.	Sec.	Par.	Subpar.
1	320	.60	5400	.070	
	320	.60	5400	.080	
	320	.61	5400	.050	
	320	.61	5400	.060	
	320	.61	5400	.070	
	320	.61	5400	.080	
	320	.62	5400	.050	
	320	.62	5400	.060	
	320	.62	5400	.070	
	320	.62	5400	.080	
	320	.63	5400	.050	
	320	.63	5400	.060	
	320	.63	5400	.070	
	320	.63	5400	.080	
	320	.64	4200	.03	
	320	.64	4200	.04	
	320	.64	5400	.050	
	320	.64	5400	.060	
	320	.64	5400	.070	
	320	.65	4200	.03	
	320	.65	4200	.04	
	320	.65	5400	.050	
	320	.65	5400	.060	
	320	.65	5400	.070	
	320	.66	4200	.03	
	320	.66	4200	.04	
	320	.66	5400	.050	
	320	.66	5400	.060	
	320	.66	5400	.070	
	320	.67	4200	.03	
	320	.67	4200	.04	
	320	.67	5400	.050	
	320	.67	5400	.060	
	320	.67	5400	.070	
	320	.68	4200	.03	
	320	.68	4200	.04	
	320	.68	5400	.060	
	320	.68	5400	.070	
	320	.68	4100	.03	
	320A		5100	.03	
	320A		4100	.03	
	320B		5100	.03	
	320B		5400	.170	
	331	.14	5400	.050	
	331	.15	5400	.170	
	338		6100	.01	
	420		8200	.03	4(e)
	420	.20	8200	.03	4(e)

Statements on Auditing Standards (continued)			Audit and Accounting Manual (continued)		
No.	Sec.	Par.	Sec.	Par.	Subpar.
1	420	.21	8200	.03	4(e)
	430	.02	8400	.03	47(d)
	430	.02	8400	.03	47(e)
	430	.02	8400	.03	47(bb)
	430	.02	8400	.03	47(dd)
	516		10,400	.18	
	516		10,500	.13	
	516		10,500	.14	
	516		10,400	.19	
	530		8200	.03	5(a)
	530		10,100	.11	
	542	.05	10,230	.01	
	543		8200	.03	4(a)
	543	.09	10,210	.050	
	543	.16	10,210	.070	
	543	.17	10,210	.070	
	544	.02	8200	.03	4(k)
	545	.02	10,240	.070	
	545	.05	10,240	.080	
	546		8200	.03	4(e)
	546	.01	8400	.03	47(m)
	546	.01	10,210	.110	
	546	.02	8400	.03	47(m)
	546	.02	10,210	.110	
	546	.02	10,240	.090	
	546	.02	10,240	.100	
	546	.03	8400	.03	47(m)
	546	.03	10,240	.110	
	546	.03	10,240	.120	
	546	.03	10,240	.130	
	546	.04	8400	.03	47(m)
	546	.05	8400	.03	47(m)
	546	.05	10,240	.150	
	546	.06	8400	.03	47(m)
	546	.06	10,240	.140	
	546	.07	8400	.03	47(m)
	546	.08	8400	.03	47(m)
	546	.09	8400	.03	47(m)
	546	.10	8400	.03	47(m)
	546	.11	8400	.03	47(m)
	546	.12	8400	.03	47(n)
	546	.13	8400	.03	47(n)
	546	.15	10,230	.02	
	546	.16	10,230	.03	
	546	.17	8400	.03	47(m)
	560	.01	8400	.03	47(v)
	560	.02	8400	.03	47(v)
	560	.03	8400	.03	6



<b>Statements on Auditing Standards (continued)</b>	<b>Audit and Accounting Manual (continued)</b>
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No.	Sec.	Par.	Sec.	Par.	Subpar.
2		14	8200	.03	4(a)
		15	8200	.03	4(b)
		15	8200	.03	9
		15	8200	.03	13(b)
		16	8200	.03	4(b)
		16	8200	.03	13(b)
		17	8200	.03	4(b)
		18	8200	.03	4(b)
		18	8200	.03	4(c)
		19	8200	.03	4(b)
		19	8200	.03	4(c)
		20	8200	.03	4(e)
		21	8200	.03	4(f)
		22	8200	.03	4(f)
		23	8200	.03	4(f)
		24	8200	.03	4(f)
		25	8200	.03	4(f)
		26	8200	.03	4(f)
		27	8200	.03	4(d)
		29	8200	.03	9
		30	8200	.03	9
		31	8200	.03	9
		32	8200	.03	9
		33	8200	.03	9
		34	8200	.03	9
		35	8200	.03	9
		36	8200	.03	9
		36	10,240	.050	
		37	8200	.03	9
		37	10,240	.060	
		38	8200	.03	4(e)
		38	8200	.03	9
		39	8200	.03	9
		39	10,240	.020	
		40	8200	.03	9
		40	10,240	.010	
		41	8200	.03	9
		42	8200	.03	9
		43	8200	.03	9
		43	10,220	.01	
		44	8200	.03	9
		45	8200	.03	4(f)
		45	8200	.03	9
		46	8200	.03	9
		47	8200	.03	9
		47	10,230	.04	
		48	8200	.03	10
		50	8200	.03	10

Statements on Auditing Standards (continued)			Audit and Accounting Manual (continued)		
No.	Sec.	Par.	Sec.	Par.	Subpar.
3			4100	.03	
6			5400	.040	
			5400	.400	
			7400	.01	
			11,100	.02	
		2	8400	.03	47(b)
		16	8400	.03	40
		16	8400	.03	47(b)
		17	8400	.03	40
		17	8400	.03	47(b)
		18	8200	.03	13(a)
		18	8200	.03	13(b)
7			8200	.03	4(i)
11			5400	.170	
		9	8200	.03	14
		10	8200	.03	14
		11	8200	.03	14
		12	8200	.03	14
12			5400	.440	
			7300	.01	
14			8200	.03	4(k)
			8200	.03	8
		2	8200	.03	8(a)
		3	8200	.03	8(a)
		4	8200	.03	8(a)
		5	8200	.03	8(a)
		6	8200	.03	8(a)
		7	8200	.03	8(a)
		7	8400	.03	9
		8	8200	.03	8(a)
		8	10,260	.010	
		8	10,260	.020	
		8	10,260	.030	
		9	8200	.03	8(b)
		10	8200	.03	8(b)
		10	8200	.03	8(e)
		11	8200	.03	8(b)
		11	8200	.03	8(e)
		12	8200	.03	8(b)
		12	8200	.03	8(e)
		13	8200	.03	8(b)
		13	8200	.03	8(e)
		14	8200	.03	8(b)
		14	10,260	.050	
		14	10,260	.060	
		14	10,260	.070	



**Statements on Auditing Standards (continued)**      **Audit and Accounting Manual (continued)**

No.	Sec.	Par.	Sec.	Par.	Subpar.
14		14	10,260	.080	
		15	8200	.03	8(b)
		16	8200	.03	8(b)
		17	8200	.03	8(b)
		17	10,260	.90	
		17	10,260	.100	
		18	8200	.03	8(c)
		19	8200	.03	8(c)
		19	10,260	.110	
		19	10,260	.120	
		19	10,260	.130	
		20	8200	.03	8(d)
		21	8200	.03	8(d)
	15		2	8200	.03
		2	10,100	.11	
		3	8200	.03	1
		3	8200	.03	12
		3	10,210	.010	
		4	8200	.03	12
		5	8200	.03	4(g)
		5	8200	.03	12
		5	10,240	.030	
		5	10,240	.040	
		5	10,210	.080	
		5	10,240	.160	
		6	8200	.03	4(h)
		6	8200	.03	12
		7	8200	.03	4(h)
		7	8200	.03	12
		7	10,240	.040	
		7	10,210	.090	
		7	10,210	.100	
		7	10,210	.110	
		8	8200	.03	4(i)
		8	8200	.03	11
		9	8200	.03	4(i)
		9	8200	.03	11
		10	8200	.03	4(i)
		10	8200	.03	11
	11	8200	.03	4(i)	
	11	8200	.03	11	
	11	10,100	.11		
	12	8200	.03	4(i)	
	12	8200	.03	11	
	12	8400	.03	47(n)	
	12	10,210	.040		
	12	10,210	.060		

Statements on Auditing Standards (continued)			Audit and Accounting Manual (continued)		
No.	Sec.	Par.	Sec.	Par.	Subpar.
16			7400	.01	
17		15	8200	.03	4(b)
		16	8200	.03	4(f)
18		4	8200	.03	16(b)
		5	8200	.03	16(b)
		6	8200	.03	16(b)
		7	8200	.03	16(a)
		8	8200	.03	16(a)
		9	8200	.03	16(a)
		12	8200	.03	16(b)
19			5400	.040	
			5400	.460	
	Appendix		7400	.01	
		3	8200	.03	13(b)
		5	7400	.01	
20			4100	.03	
			4200	.10	
			5400	.040	
			5400	.050	
			5400	.060	
			5400	.070	
			5400	.080	
			5400	.090	
			10,250	.010	
			10,250	.020	
			10,250	.030	
			10,250	.040	
		5	4200	.04	
21		8	8200	.03	4(m)
		9	8200	.03	4(m)
		10	8200	.03	4(m)
		11	8200	.03	4(m)
		12	8200	.03	4(m)
		13	8200	.03	4(m)
		14	8200	.03	4(m)
		15	8200	.03	4(m)
		16	8200	.03	4(m)
		17	8200	.03	8(e)
		18	8200	.03	8(e)
22			3100	.03	
			3100	.06	
			3100	.07	
			3100	.08	
			5200	.01	
			5200	.05	
			9100	.05	

Statements on Auditing Standards (continued)			Audit and Accounting Manual (continued)		
No.	Sec.	Par.	Sec.	Par.	Subpar.
22		5	5100	.02	
		9	9100	.03	
		10	9100	.03	
		11	9100	.03	
		12	9100	.03	
23			6500	.690	
24		17	10,100	.11	
		18	10,300	.01	
		18	10,300	.02	
		19	10,300	.03	
		21	10,300	.04	
		22	10,300	.05	
		24	8200	.03	15
		24	10,300	.06	
		25	8200	.03	15
		25	10,300	.06	
		26	8200	.03	15
		26	10,300	.06	
		27	8200	.03	15
		27	10,300	.06	
		28	8200	.03	15
	28	10,300	.06		
26			10,260	.040	
			10,400	.18	
			10,400	.19	
			10,500	.13	
			10,500	.14	
		5	10,270	.01	
		7	10,270	.03	
		7	10,270	.04	
		10	10,280	.01	
		14	8200	.03	4(j)
		14	8200	.03	11
		15	8200	.03	4(j)
		15	8200	.03	11
		16	8200	.03	4(j)
		16	8200	.03	11
		16	10,270	.02	
		17	8200	.03	4(j)
		17	8200	.03	11
		17	10,210	.120	
		17	10,210	.130	
	17	10,210	.140		
	18	8200	.03	4(1)	
	19	8200	.03	4(1)	
	20	8200	.03	4(1)	

Statements on Auditing Standards (continued)			Audit and Accounting Manual (continued)		
No.	Sec.	Par.	Sec.	Par.	Subpar.
27		8	8200	.03	4(n)
		8	10,245	.010	
		8	10,245	.020	
		8	10,245	.030	
		9	8200	.03	4(n)
		10	8200	.03	4(n)
		11	8200	.03	4(n)

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<b>Audit and Accounting Guides</b>	<b>Audit and Accounting Manual</b>	
<b>Name of Guide</b>	<b>Sec.</b>	<b>Par.</b>
<i>The Auditor's Study and Evaluation of Internal Control in EDP Systems</i>	4100	.04
<i>Audits of Service-Center-Produced Records</i>	4100	.04

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Auditing Interpretations			Audit and Accounting Manual		
SAS No.	AU Sec.	Par.	Sec.	Par.	Subpar.
1	9641	.02	10,250	.020	
	9641	.02	10,250	.030	
	9641	.07	10,250	.040	
14	9621	.04	10,260	.040	
	9621	.25	10,260	.140	
	9621	.25	10,260	.141	
	9621	.25	10,260	.142	
	9621	.31	10,260	.150	
	9621	.31	10,260	.151	
21	9435		8200	.03	8(e)

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**Statements on Standards for  
Accounting and Review  
Services**

**Audit and Accounting Manual**

No.	Sec.	Par.	Sec.	Par.	Subpar.
1			8300	.02	
			10,400	.18	
			10,500	.13	
	8		3200	.01	
	14		8300	.03	1(a)
	14		8300	.03	1(c)
	15		8300	.03	6(a)
	15		10,100	.11	
	17		10,400	.01	
	17		10,400	.04	
	17		10,400	.12	
	17		10,400	.13	
	17		10,400	.14	
	17		10,400	.15	
	17		10,400	.16	
	17		10,400	.18	
	17		10,400	.19	
	19		8300	.03	2(a)
	19		8300	.03	2(b)
	19		8300	.03	12
	20		8300	.03	2(c)
	20		8300	.03	12
	21		8300	.03	2(a)
	21		8300	.03	12
	21		10,400	.02	
	21		10,400	.03	
	22		8300	.03	4
	22		10,280	.01	
	22		10,400	.04	
	31		7400	.02	
	32		8300	.03	1(b)
	32		8300	.03	1(c)
	33		10,100	.11	
	34		8300	.03	6(b)
	35		10,500	.01	
	35		10,500	.09	
	35		10,500	.10	
	35		10,500	.11	
	35		10,500	.12	
	35		10,500	.13	
	35		10,500	.14	
	38		8300	.03	4
	38		10,280	.01	
	39		8300	.03	2(d)
	39		8300	.03	3
	40		8300	.03	2(d)(i)
	40		8300	.03	2(d)(ii)
	40		8300	.03	2(d)(iii)

**Statements on Standards for  
Accounting and Review  
Services (continued)**
**Audit and Accounting Manual  
(continued)**

No.	Sec.	Par.	Sec.	Par.	Subpar.	
1		40	8300	.03	3(a)	
		40	8300	.03	3(b)	
		40	8300	.03	3(c)	
		40	10,400	.05		
		40	10,400	.06		
		40	10,500	.02		
		40	10,500	.03		
		40	10,500	.04		
		43	8300	.03	7	
		49	8300	.03	8	
		Appendix D		7400	.02	
	2		2	8300	.03	9
			5	8300	.03	12
		6	8300	.03	11	
		8	8300	.03	13	
		8	8300	.03	14	
		9	8300	.03	13	
		9	10,400	.11		
		9	10,500	.07		
		10	8300	.03	13	
		10	10,500	.08		
		11	8300	.03	14	
		12	8300	.03	14	
		12	10,400	.12		
		14	8300	.03	15	
		15	8300	.03	15	
		15	10,400	.13		
		15	10,500	.09		
		16	8300	.03	16	
		17	8300	.03	16	
		18	8300	.03	16	
		18	10,400	.15		
		18	10,500	.10		
		19	8300	.03	16	
		19	10,400	.14		
		19	10,500	.11		
		25	8300	.03	17	
		26	8300	.03	17	
		28	8300	.03	18	
		28	10,400	.16		
		28	10,500	.12		
		29	8300	.03	12	
		30	8300	.03	12	
		30	10,400	.17		
	31	8300	.03	10		
	32	8300	.03	10		
	33	8300	.03	19		
	33	10,400	.18			

**Statements on Standards for  
Accounting and Review  
Services (continued)**

**Audit and Accounting Manual  
(continued)**

No.	Sec.	Par.	Sec.	Par.	Subpar.
2		33	10,500	.13	
		34	8300	.03	19
		34	10,400	.18	
		34	10,400	.19	
		34	10,500	.13	
		34	10,500	.14	
		35	8300	.03	19

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➤➤➤ → *The next page is 20,091.* ← ➤➤➤



<b>Accounting and Review Services Interpretations</b>			<b>Audit and Accounting Manual</b>		
<b>SSARS No.</b>	<b>AR Sec.</b>	<b>Par.</b>	<b>Sec.</b>	<b>Par.</b>	<b>Subpar.</b>
1	9100	.03	8300	.02	
	9100	.04	8300	.02	
	9100	.05	8300	.02	

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➤ *The next page is 20,101.* ←



FASB Statements of Financial  
Accounting Standards

## Audit and Accounting Manual

No.	Par.	Sec.	Par.	Subpar.
2	12	8400	.03	21
	12	8400	.03	37
	13	8400	.03	21
	13	8400	.03	37
	14	8400	.03	21
	14	8400	.03	37
	15	8400	.03	21
	15	8400	.03	37
	16	8400	.03	21
	16	8400	.03	37
	3	9	8400	.03
10		8400	.03	47(m)
11		8400	.03	47(m)
12		8400	.03	47(m)
13		8400	.03	47(m)
4	14	8400	.03	47(m)
	8	8400	.03	33
	9	8400	.03	33
	10	8400	.03	33
	11	8400	.03	33
5	12	8400	.03	33
		5400	.440	
		7300	.01	
		7400	.01	
		11,200	.02	
	9	8400	.03	47(q)
	9	8400	.03	47(aa)
	10	8400	.03	47(q)
	10	8400	.03	47(aa)
	11	8400	.03	47(q)
	11	8400	.03	47(v)
	11	8400	.03	47(aa)
	12	8400	.03	47(q)
	12	8400	.03	47(aa)
	13	8400	.03	47(q)
	13	8400	.03	47(aa)
	15	8400	.03	29
	15	8400	.03	47(j)
	18	8400	.03	47(e)
	18	8400	.03	47(p)
	18	8400	.03	47(bb)
	18	8400	.03	47(hh)
	19	8400	.03	47(e)
	19	8400	.03	47(p)
	19	8400	.03	47(bb)
	19	8400	.03	47(hh)
	103	5400	.260	

**FASB Statements of Financial  
Accounting Standards  
(continued)**
**Audit and Accounting Manual  
(continued)**

No.	Par.	Sec.	Par.	Subpar.
6	10	8400	.03	23
	11	8400	.03	23
	12	8400	.03	23
	13	8400	.03	23
	14	8400	.03	23
	15	8400	.03	13
	15	8400	.03	23
	15	8400	.03	24
	15	8400	.03	47(ee)
7	10	8400	.03	4(a)
	11	8400	.03	4(b)
	12	8400	.03	4(c)
	13	8400	.03	5
8	14	8400	.03	16
	32	8400	.03	38
	32	8400	.03	47(jj)
	33	8400	.03	38
	33	8400	.03	47(jj)
	34	8400	.03	38
	34	8400	.03	47(jj)
11	10	8400	.03	47(aa)
12	6	8400	.03	47(w)
	8	8400	.03	18
	12	8400	.03	43
	12	8400	.03	47(a)
	13	8400	.03	44
	13	8400	.03	47(a)
	14	8400	.03	45
	15	8400	.03	45
	16	8400	.03	45
	16	8400	.03	47(a)
	17	8400	.03	45
	17	8400	.03	47(a)
	18	8400	.03	47(w)
	19	8400	.03	47(a)
	20	8400	.03	47(a)
21	8400	.03	22	
21	8400	.03	30	
22	8400	.03	27	
22	8400	.03	28	
23	8400	.03	43	
13		11,200	.04	
		11,600	.09	
	16	8400	.03	47(gg)
	23	8400	.03	47(gg)
	47	8400	.03	47(gg)
	48	8400	.03	47(gg)



**FASB Statements of Financial  
Accounting Standards  
(continued)**
**Audit and Accounting Manual  
(continued)**

No.	Par.	Sec.	Par.	Subpar.
14	9	8400	.03	46
	10	8400	.03	46
	11	8400	.03	46
	12	8400	.03	46
	13	8400	.03	46
	14	8400	.03	46
	15	8400	.03	46
	16	8400	.03	46
	17	8400	.03	46
	18	8400	.03	46
	19	8400	.03	46
	20	8400	.03	46
	21	8400	.03	46
	22	8400	.03	46
	23	8400	.03	46
	24	8400	.03	46
	25	8400	.03	46
	26	8400	.03	46
	27	8400	.03	46
	28	8400	.03	46
	29	8400	.03	46
	30	8400	.03	46
	31	8400	.03	46
	32	8400	.03	46
	33	8400	.03	46
	34	8400	.03	46
	35	8400	.03	46
	36	8400	.03	46
	37	8400	.03	46
	38	8400	.03	46
	39	8400	.03	46
15		8400	.03	17
16		5400	.380	
	10	8400	.03	47(u)
	11	8400	.03	47(u)
	12	8400	.03	47(u)
	13	8400	.03	47(u)
	14	8400	.03	47(u)
	15	8400	.03	47(u)
	16	8400	.03	47(u)
	16c	8400	.03	35
	17	8400	.03	47(u)
17		8400	.03	47(gg)
19		8400	.03	11
	60	8400	.03	26
	61	8400	.03	26
	62	8400	.03	26

**FASB Statements of Financial  
Accounting Standards  
(continued)**
**Audit and Accounting Manual  
(continued)**

No.	Par.	Sec.	Par.	Subpar.
19	63	8400	.03	26
	64	8400	.03	26
21		8300	.02	
	12	8200	.03	4(m)
	12	8200	.03	8(e)
	12	8400	.03	46
	13	8200	.03	4(m)
	13	8200	.03	8(e)
	13	8400	.03	46
	14	8200	.03	4(m)
	14	8200	.03	8(e)
	14	8400	.03	46
	15	8200	.03	4(m)
	15	8200	.03	8(e)
	15	8400	.03	46
	16	8200	.03	4(m)
	16	8200	.03	8(e)
	16	8400	.03	46
22		8400	.03	47(gg)
23		8400	.03	47(gg)
24	5	8200	.03	4(m)
	5	8200	.03	8(e)
	5	8400	.03	46
25		8400	.03	11
	4	8400	.03	26
	5	8400	.03	26
	6	8400	.03	26
	7	8400	.03	26
	8	8400	.03	26
	9	8400	.03	26
26		8400	.03	47(gg)
27		8400	.03	47(gg)
28		8400	.03	47(gg)
29		8400	.03	47(gg)
30		8400	.03	46
31		8400	.03	47(s)
	7	8400	.03	47(s)
32	10	8400	.03	47(m)
	10	8400	.03	47(u)
	11	8400	.03	47(m)
	11	8400	.03	47(u)
33	29	8400	.03	47(II)
	30	8400	.03	47(II)
	31	8400	.03	47(II)

**FASB Statements of Financial  
Accounting Standards  
(continued)**
**Audit and Accounting Manual  
(continued)**

No.	Par.	Sec.	Par.	Subpar.
33	32	8400	.03	47(II)
	33	8400	.03	47(II)
	34	8400	.03	47(II)
	35	8400	.03	47(II)
	36	8400	.03	47(II)
	37	8400	.03	47(II)
	34		8400	.03
6		8400	.03	19
7		8400	.03	19
8		8400	.03	19
9		8400	.03	19
10		8400	.03	19
11		8400	.03	19
12		8400	.03	19
13		8400	.03	19
14		8400	.03	19
15		8400	.03	19
16		8400	.03	19
17		8400	.03	19
18		8400	.03	19
19		8400	.03	19
20		8400	.03	19
21		8400	.03	19
22	8400	.03	19	
23	8400	.03	19	

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FASB Interpretations		Audit and Accounting Manual		
No.	Par.	Sec.	Par.	Subpar.
3	4	8400	.03	47(ff)
	5	8400	.03	47(ff)
4	4	8400	.03	21
	4	8400	.03	37
	5	8400	.03	21
	5	8400	.03	37
6	4	8400	.03	21
	4	8400	.03	37
	5	8400	.03	21
	5	8400	.03	37
	6	8400	.03	21
	6	8400	.03	37
	7	8400	.03	21
	7	8400	.03	37
	8	8400	.03	21
	8	8400	.03	37
	9	8400	.03	21
9	8400	.03	37	
7	4	8400	.03	4(a)
	5	8400	.03	4(a)
8	3	8400	.03	13
	3	8400	.03	23
	3	8400	.03	24
	14	8400	.03	16
10	2	8400	.03	47(a)
11	3	8400	.03	22
	3	8400	.03	30
	3	8400	.03	44
	3	8400	.03	47(a)
	4	8400	.03	22
	4	8400	.03	30
	4	8400	.03	44
4	8400	.03	47(a)	
12	3	8400	.03	18
	3	8400	.03	24
	3	8400	.03	47(a)
	4	8400	.03	18
	4	8400	.03	24
	4	8400	.03	47(a)
13	5	8400	.03	47(a)
	6	8400	.03	47(a)
	7	8400	.03	47(a)
15		8400	.03	25
16	4	8400	.03	43
	4	8400	.03	47(a)
	5	8400	.03	47(a)
	6	8400	.03	47(a)
	7	8400	.03	47(a)

FASB Interpretations (continued)		Audit and Accounting Manual (continued)		
No.	Par.	Sec.	Par.	Subpar.
16	8	8400	.03	47(a)
	9	8400	.03	47(a)
	10	8400	.03	47(a)
	10	8400	.03	47(w)
17	5	8400	.03	16
	5	8400	.03	38
	6	8400	.03	16
	6	8400	.03	38
	10	8400	.03	16
	10	8400	.03	38
25		8400	.03	47(cc)(v)
27	3	8400	.03	34(a)
28	2	8400	.03	47(i)
	3	8400	.03	47(i)
	4	8400	.03	47(i)
	5	8400	.03	47(i)
	6	8400	.03	47(h)
	29	2	8400	.03
3		8400	.03	20
4		8400	.03	20
		8400	.03	32

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**FASB Technical Bulletins****Audit and Accounting Manual**

<b>No.</b>	<b>Sec.</b>	<b>Par.</b>	<b>Subpar.</b>
79-2	8400	.03	21
79-3	8400	.03	23
79-3	8400	.03	24
79-4	8400	.03	46
79-5	8400	.03	46
79-6	8400	.03	17
79-7	8400	.03	17
79-8	8200	.03	4(m)
79-8	8200	.03	8(e)
79-8	8400	.03	46
79-8	8400	.03	47(11)
79-10	8400	.03	47(gg)
79-11	8400	.03	47(gg)
79-12	8400	.03	47(gg)
79-13	8400	.03	47(gg)
79-14	8400	.03	47(gg)
79-15	8400	.03	47(gg)
79-16	8400	.03	47(gg)
79-17	8400	.03	47(gg)
79-18	8400	.03	34(a)
79-18	8400	.03	47(gg)
79-19	8400	.03	47(w)

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