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Classification of Accountancy Services

American Society of Certified Public Accountants

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Classification of Accountancy Services

THE AMERICAN SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS

INTRODUCTION TO SECOND REPORT

The report herewith presented contains a statement classifying, defining, and differentiating the various classes of services rendered by the profession of accountancy. Briefly, it is a Classification of Accountancy Services.

No claim is made for the perfection of the classification. It was evolved from a study of five thousand engagements as they flowed through a practice office. It has been tested by application to twenty thousand additional engagements. Minor changes only resulted from the tests. Therefore, the classification bears the stamp of practicability.

The need for a classification of this character becomes increasingly apparent as accountancy assumes a place of increasing importance in affairs of the business world. So numerous have become the outside interests which are concerned with accountancy and its products, that common understanding as to its functions, capabilities, duties, and responsibilities are vital to the progress, success, and peace of the profession.

A classification of accountancy services affords an intelligent basis for action in the following respects:

1. Negotiating with clients and arriving at a clear understanding as to the service to be rendered.
2. Administering practice: planning and supervising field work, reviewing reports, correspondence, judging performance on the part of members of the staff, compiling statistics of operation.
3. Contact with other professions or lines of activity: attorneys, bankers, credit men, engineers, appraisers, investment houses, etc.
4. Litigation, threatened litigation, controversies with clients concerning negligence, etc.
5. Publicity concerning the certified public accountant and his work.

Instances are numerous of time and effort economized and of friction avoided by partners, principals, and staff, through the use of a common language afforded by the classification.

The classification should serve not only as a means of assistance to the profession, but as a guide in the formulation of study courses designed for students who are preparing to enter the profession.

THIRD REPORT

July 9, 1931.

To the Directors of The
American Society of Certified Public Accountants:

Your Committee on Classification of Accountancy Services herewith renders this report supplementary to its reports of December, 1929, and September, 1930.

Following the publication of the report of September 5, 1930, other professional accounting organizations either continued to study the subject of classification or initiated such studies.

Among such studies was one by a Joint Committee of the New York State Society of Certified Public Accountants. This Joint Committee consisted of the entire membership of the State Society's Committee on Classification of Accountancy Services and the Committee on Practice Procedure, with the Society's President as ex-officio member.

The Joint Committee of the New York State Society considered not only the subject of accountancy service classification but also the very important related topic of auditors' certificates. Recently, this Joint Committee completed its labors and rendered its report to the Directors of the State Society. The following is quoted from the letter of transmittal of the Chairman of the Joint Committee:

"The joint committee recommends adoption of a classification and appropriate forms of certificates, to be promulgated as suggestions for the guidance of members and for such public educational value as the suggestions may have. Such action, the members of the committee feel, would tend to promote uniformity of thought and expression in the profession, to result in clearer understandings between accountants and their clients, to establish better working contacts with prospective clients and with those who have occasion to consider the services, reports, and certificates of public accountants,

and to afford a better basis of judgment in case such services, reports, or certificates ever are questioned. Further, it is believed that the promulgation of a classification, with forms of certificates for the first time accompanying the specifications for various types of services, would have great educational value, not alone to instructors and students, but to all concerned. Finally, such action would mark a progressive stride in the development of the profession."

The Joint Committee's report was received by the Directors and, in mimeographed form, was submitted to the members of the State Society for their information. The Board authorized the appointment of a sub-committee to confer with other accounting organizations with the hope that a report might be presented in the fall carrying the endorsement of both national accounting bodies and several State societies as well. The Joint Committee's report and the recommendations of the sub-committee will be acted upon at the annual fall conference of the New York State Society.

Pursuant to the request of President Herman C. J. Peisch, your Committee responded to a call from the Chairman of the New York State Society's sub-committee. Your Committee has thus had the benefit since the presentation of its second report, of the maturer conclusions reached when a larger number of active committeemen are accessible to each other so that a freer oral exchange of opinion is possible. Your Committee appreciates that an accountancy classification to be effective should be acceptable to the entire profession of certified public accountants. It also appreciates that no two individuals can be in absolute verbal agreement with respect to all phases of so large and important a problem. The New York State Society's report on Classification of Accountancy Services is, in all essentials, similar to your Committee's report. Differences consist only in phraseology and in captions of the major classes of services. The suggested forms of certificates, which

did not form a part of either of your Committee's reports, are a very valuable addition and are really an essential and practical part of a service classification.

Your Committee, therefore, recommends to the Directors of The American Society, both because of the recognized need to secure uniformity among all organizations of professional accountants and because of the intrinsic value of the suggestions and additions made by the Joint Committee of the New York State Society of Certified Public Accountants, the adoption of the report herewith presented in the form in which it will be presented by the New York Committee to the New York State Society. Moreover, it is recommended that either your present Committee or a sub-committee thereof be authorized to cooperate with similar committees of other accounting organizations to the end that uniformity of service classification and appropriate certificates be attained as expeditiously as is consistent with thorough discussion and consideration.

Respectfully submitted,

Committee on Classification of Accountancy Services,

PHILIP F. ALTHER,
FAYETTE H. ELWELL,
SETH HADFIELD,
EDWARD P. MOXEY, JR.
JOHN R. WILDMAN,
JOSEPH J. KLEIN, Chairman.

PART A

CLASSIFICATION

The first five sections below relate to classes of service in which audit and examination procedures are the essential characteristics. Such services constitute the major part of accountancy practice. The sixth section contains information dealing in a more general way with a variety of services which may be rendered.

Auditing, as used in a professional sense, may be defined as the procedure whereby one undertakes to pass judgment on the correctness of financial statements and accounts, by scrutinizing accounts, vouchers, documents, and other supporting records and data, corresponding, if necessary, with independent third parties, and orally questioning officials and employees.

Auditing procedure may be used in connection with financial balances at the end of a given period and the financial transactions, for the period, which culminate in those balances; or it may be used in connection only with the balances at the end of a period.

The term "transactions," as used herein, is intended to mean any changes affecting the accounts during a period. Accounts relating to income, expense, profits, and losses will be referred to as "operating accounts"; the transactions relating thereto as "operations"; those relating to cash receipts and disbursements as "cash transactions."

A report usually is submitted at the conclusion of an audit or examination. A report presents the accountant's findings and conclusions, and may contain an expression of the accountant's opinion in a formal statement commonly known as a certificate, either as part of the report itself or appended to the financial statements.

While the engagements which constitute the major part of accountancy practice probably will fall into the first four classes suggested, it must be recognized that there will be instances in which the wishes of clients will dictate specifications of service which may overlap the clean-cut lines which have been set up to distinguish one type of service from others. It should be obvious, of course, that any suggestions for the guidance of practitioners in arranging undertakings with clients cannot be permitted to interfere with the free operation of a client's wishes with respect to the service to be performed.

Section I. Examination of Financial Condition and Detailed Audit of Transactions for a Period. Short Title—Detailed Audit:

A detailed audit, sometimes referred to as a complete audit, has as its purpose substantiation by audit procedure of the correctness of the assets, liabilities (actual and contingent), reserves, capital, and surplus as at a balance sheet date and of all transactions for a period ended on the balance sheet date.

The audit report, addressed to the client, may take the form of a balance sheet, and a statement or statements of income and surplus for the period together, with comments in which a certificate may be incorporated. The certificate may be appended to the financial statements, provided that any essential qualifications are incorporated in the certificate.

Section II. Examination of Financial Condition and Audit Tests of Transactions for a Period. Short Title—Test Audit:

A test audit has as its purpose substantiation by audit procedure of the correctness of the assets, liabilities (actual and contingent), reserves, capital, and surplus as at a balance sheet date, and selective audit tests of the transactions for a period ended on the balance sheet date. The character and extent of the tests will be governed by the circumstances of each case and should be so designed as to satisfy the auditor of the general correctness of the recorded transactions for the period, although such tests will not necessarily disclose every irregularity.

The audit report, addressed to the client, may take the form of a balance sheet, and a statement or statements of income and surplus for the period, together with comments in which a certificate may be incorporated. The certificate may be appended to the financial statements, provided that any essential qualifications are incorporated in the certificate.

Section III. Examination of Financial Condition and Review of Operations:

An examination of financial condition and review of operations while applicable to engagements other than those involving financing arises frequently in connection with the proposed issuance of securities, as in financings, mergers, consolidations, reorganizations, etc. This type of service has as its purpose substantiation by audit procedure of the correctness of the stated assets, liabilities (actual and contingent), reserves, capital, and surplus as at a balance sheet date, together with analytical review, comparison, investigation of questionable matters, statistical and other tests of the income, expense, profits and losses for a period (usually three to five years) ended on the balance sheet date.

The particular object of this type of service is to substantiate the representations made in respect to the organization under examination, with a view to determining that there is no overstatement of net assets or of net profits; that the net assets and net profits are at least as good as represented. It is not designed to detect lapses of fiduciary integrity or any understatement of assets which may have been concealed in the operating accounts.

An examination of financial condition and review of operations is distinguished from a test audit by omission of the audit of cash transactions, and by analytical study, comparison, investigation, statistical and other tests of the income, expense, profits and losses rather than by selective audit tests of the transactions reflected in those accounts.

The report on an examination of financial condition and review of operations, addressed to the client, usually contains a balance sheet, a statement or statements of income and surplus, a certificate, and, when used in connection with the issuance of securities, usually contains statistical and other explanatory data which will be of assistance in interpreting the financial history and status of the company under review. Such report frequently is supplemented by a statement, or statements,

duly certified, giving effect to financial transactions consummated, or to be consummated, subsequent to the date of the balance sheet. Transactions to which effect is given in the supplementary statements should be adequately confirmed.

Section IV. Examination of Financial Condition:

An examination of financial condition has as its purpose substantiation by audit procedure of the correctness of the stated assets, liabilities (actual and contingent), reserves, and capital at a balance sheet date, and an analysis of surplus, including as an incident to the substantiation of the balance sheet accounts, examination of such transactions at or about the balance sheet date as may affect the stated financial condition.

This type of service, while requiring examination of the records with a view to substantiating the assets as stated and affording reasonable assurance that there are no liabilities (actual or contingent) other than those stated, does not include audit of cash transactions, such as is required in a test audit, or review of the income, expense, profits and losses, as is required in an examination of financial condition and review of operations, and may not be relied upon to disclose lapses of fiduciary integrity or any understatement of assets which may have been concealed in the operating accounts.

A report on an examination of financial condition, addressed to the client, may contain properly a certified balance sheet, but if a statement of income and surplus is included in the report, it should be qualified as having been prepared from the books without audit of the transactions for the period.

Section V. Audits of Specific Accounts:

This class of service may cover any particular account, or accounts, of which the following are examples:

- (a) Cash
- (b) Securities
- (c) Payroll
- (d) Manufacturing cost

An audit report on an account, or accounts, falling in this group, may take the form of a statement of the account or accounts audited, together with comments in which a certificate may be incorporated, or the certificate may be appended to the statement, provided that any essential qualifications are made a part thereof.

Section VI. Other Services:

This section should not be considered as definitive or restrictive, but as containing general information only of various activities which are considered to fall within the field of the public accountant.

Miscellaneous activities in the nature of research, verification or constructive work should be designated in each case with an accurate description of the work undertaken.

(1) Investigations of Specific Matters:

Such investigations comprehend examinations of one or more specific features of a business and are undertaken usually in connection with such matters as suspected fraud, disputes regarding payments of royalties, etc., reasons for increases or decreases of profits, financial policies, determination of possible extent of civil liability, measurement of contract obligations, insolvency, bankruptcy, measurement of rate-making factors of utilities and carriers, and other financial or administrative matters.

In each case the accountant's instructions from his client should be specific as to the object of the investigation.

The scope of each investigation is determined by its objects and the extent to which the accountant considers it necessary to go in order to accomplish those objects.

The accountant's findings in an investigation usually are communicated to his client in the form of a detailed report.

(2) Preparation of Statements from Books or Records without Audit:

Statements prepared from the books or records without audit, should be made preferably on unwatermarked paper, bound (if at all) in a plain back, without any indication in the statements themselves or in anything attached to the statements that they were prepared by public accountants. If, on the other hand, watermarked or regular stationery is used, a footnote should be added to balance sheet or other statements showing that they have been prepared from the books of account without audit.

In cases where it is necessary to include in a report any statements which have been prepared from the books without audit, or only partial audit, such statements should be marked under the descriptive heading and at the bottom, so as clearly to indicate that they were prepared from the books without audit or with only such audit as is indicated opposite the respective items, depending on the situation.

(3) Tax Services:

Tax services may consist of:

Preparing or reviewing tax returns:

(a) From records which have been audited.

(b) From records which have not been audited.

Contesting assessments or prosecuting tax claims before tax officials or boards.

Preparing and rendering opinions on tax claims.

Acting as adviser or agent in tax matters.

(4) System Services:

System services may cover:

(a) General accounting systems:

Conducting surveys.

Devising and installing systems of account and of record.

(b) Cost systems:

Conducting surveys.

Devising and installing cost-finding and reporting systems.

(5) Budgetary Services:

Budgetary services may consist of investigation and survey work, formulating budget policies, designing budget procedures, and offering counsel with reference to budget policies and procedures.

(6) Opinions:

This class of service consists of preparing and rendering opinions having to do with accounting and financial matters.

(7) Miscellaneous:

This class includes services not comprehended in the foregoing classes, such as acting as liquidating trustee, as advocate in the arbitration of commercial disputes, as arbitrator in commercial disputes, as umpire in accounting controversies involving accountants, or clients, or as comptroller, auditor, or bookkeeper, giving testimony in court and arbitration cases, interpreting financial data, rendering advice in accounting matters, preparing and recording bookkeeping entries, instructing bookkeepers, and checking statements, etc., etc.

PART B CERTIFICATES

In making the following suggestions as to certificates, the committee recognizes the necessity of respecting individual tastes and traditional expressions of individuals and firms. There is no desire to do more than offer the results of long and careful thought, guided by legal counsel, for such use and benefit as the results may have to the accountancy profession. It is hoped, however, that the suggested forms and verbiage have sufficient inherent merit so that their general adoption will result in due time.

Variations in the form and application of certificates now in use obviously are numerous. Some certificates are unqualified; others require qualification. In some instances, the certificate

Form of Qualified Certificate

We have examined the accounts of Blank Company for the (period) ended (date), and, subject to (qualifications), in our opinion, the accompanying balance sheet and statement of income and surplus set forth the financial condition of that company at (date), and the results of its operations for the (period) ended on that date.
(Place) (Date)

III. EXAMINATION OF FINANCIAL CONDITION AND REVIEW OF OPERATIONS:

Form of Unqualified Certificate

We have examined the accounts of Blank Company as at (date), and have reviewed its operations for the (period) ended on that date, and, in our opinion, the accompanying balance sheet and statement of income and surplus set forth the financial condition of that company at (date) and the results of its operations for the (period) ended on that date.
(Place) (Date)

Form of Qualified Certificate

We have examined the accounts of Blank Company as at (date) and have reviewed its operations for the (period) ended on that date, and, subject to (qualifications), in our opinion, the accompanying balance sheet and statement of income and surplus set forth the financial condition of that company at (date), and the results of its operations for the (period) ended on that date.
(Place) (Date)

IV. EXAMINATION OF FINANCIAL CONDITIONS:

Form of Unqualified Certificate

We have examined the accounts of Blank Company as at (date), and, in our opinion, the accompanying balance sheet sets forth the financial condition of that company at (date).
(Place) (Date)

Form of Qualified Certificate

We have examined the accounts of Blank Company as at (date), and, subject to (qualifications), in our opinion, the accompanying balance sheet sets forth the financial condition of that company at (date).
(Place) (Date)

SPECIMEN CERTIFICATE GIVING EFFECT TO FINANCING

We have examined the accounts of Blank Company as at December 31, 1930, and have reviewed its operations for three years ended on that date. We have inspected: an agreement dated January 15, 1931, providing for the issuance and sale of \$1,000,000.00 first mortgage five per cent bonds to be dated January 1, 1931; a report of Blank Appraisal Company, dated February 17, 1931, showing the appraised value of the company's property as of December 31, 1930; and minutes of a meeting of the directors of the company, held January 15, 1931 (or the requirements of the underwriting agreement) (or a letter of the president of the company, dated) regarding the proposed application of the proceeds of the bond issue.

In our opinion, the accompanying balance sheet and statement of income and surplus set forth the financial condition of the company at December 31, 1930, and the results of its operations for the three years ended on that date, after giving effect to the aforesaid valuation of property and the proposed financing.
(Place) (Date)

NOTE: If the application of the proceeds of new financing is not clearly disclosed in the heading of the statement, or elsewhere on the face of the statement, the manner of application should be set forth in the certificate.

is appended to the balance sheet; in others, it occupies a separate page in the report; in still others, the certificate is incorporated with the comments in the presentation page of reports. Some certificates are addressed to the clients; others, appended to statements, are unaddressed. One practitioner may wish to refer to the "books and accounts" as having been audited; another, to the "books and records." Some accountants may have used as a part of their standard verbiage the words "set forth"; others may like the sound of "discloses," or "reflects," or "exhibits." The expressions "financial condition" and "financial position" have been used in practice interchangeably. The report practice of some firms requires that income and surplus be shown in two separate exhibits, designated "income account" and "surplus account." Other firms may connect the two factors in a statement entitled "statement of income and surplus."

With these variations which reflect individual tastes, the committee has no concern, inasmuch as no harm is likely to result from the use of different words or expressions which have the same meaning. The committee is advised by counsel, however, that care should be exercised to make no assertion in certificates as to the service rendered which is not sustained strictly by the facts; that a satisfactory expression to be used as to the subject matter audited in the first four classes of service is "accounts"; and, that the redundancy resulting from the use of both "certify" and "in our opinion" may be overcome without detriment by omitting from certificates the word "certify."

The committee desires to recommend the omission from certificates of descriptive or explanatory matter which leaves the reader in doubt as to whether such matter constitutes qualification, and the inclusion only of such qualifications as are pertinent and clearly indicated as qualifications. This, however, is not intended to discourage full and frank statements of the ground covered by the service where such elucidation is considered desirable.

Two forms of certificates are suggested with respect to each of the first four classes of service: One unqualified; the other qualified. Certificates, if indicated or required in connection with audits of specific accounts, or with investigations of specific matters, obviously must depend for their wording upon the circumstances of each case.

I. DETAILED AUDIT:

Form of Unqualified Certificate

We have examined the accounts of Blank Company for the (period) ended (date), and, in our opinion, the accompanying balance sheet and statement of income and surplus set forth the financial condition of that company at (date), and the results of its operations for the (period) ended on that date.
(Place) (Date)

Form of Qualified Certificate

We have examined the accounts of Blank Company for the (period) ended (date), and, subject to (qualifications), in our opinion, the accompanying balance sheet and statement of income and surplus set forth the financial condition of that company at (date), and the results of its operations for the (period) ended on that date.
(Place) (Date)

II. TEST AUDIT:

Form of Unqualified Certificate

We have examined the accounts of Blank Company for the (period) ended (date), and, in our opinion, the accompanying balance sheet and statement of income and surplus set forth the financial condition of that company at (date), and the results of its operations for the (period) ended on that date.
(Place) (Date)