

8-1919

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Recommended Citation

Bell, William H. (1919) "Audit Working Papers," *Journal of Accountancy*. Vol. 28: Iss. 2, Article 3.
Available at: <https://egrove.olemiss.edu/jofa/vol28/iss2/3>

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Audit Working Papers*

BY WILLIAM H. BELL

My remarks will be predicated to a large degree upon the idea that the principal is not to do the auditing work himself, or at least upon the necessity for some one to utilize the papers other than the accountant directly engaged upon the audit. With this assumption, it may be stated that the importance of the substance and form of working papers is threefold: first, to the accountant himself, not only in the audit procedure and the preparation of his report, but in answering questions that may later arise from any source; second, to the person or persons who review and check the report; and, third, to the accountant making a subsequent audit. I shall endeavor to avoid a discussion of methods of auditing, but the subjects are so closely related that it may be impossible to do so entirely.

There are two general tendencies regarding the data contained in working papers, viz., deficiency and superfluity. It is probable that the latter is more prevalent than the former, but the tendency to prepare superfluous working papers diminishes in direct ratio to an accountant's advance in proficiency as an auditor, that is, as he becomes more practical. Granting that an accountant charged with the preparation of working papers has the requisite knowledge of the principles of auditing, it should be almost unnecessary to tell him what to do, except as a means of facilitating his work, other than by telling him what not to do.

The most glaring examples of superfluous work or misdirected energy are mere transcripts of accounts or so-called analyses of accounts designed to classify the entries, which utterly fail to accomplish what might be written on one line. The principles actuating accountants in preparing such papers appear to be to obtain information, no matter how untrustworthy or unnecessary, and to check the mathematical accuracy of the accounts in that manner. Practically, they are often meaningless figures. Cases in point are analyses of reserves for depreciation without determination of the rates and the asset values constituting the

* A paper presented at the tri-state meeting of accountants of Delaware, Maryland and Virginia at Baltimore, June 25, 1919.

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bases for the credits and without information regarding the charges; elaborate tabulations of sales, cash receipts and disbursements, accounts receivable and payable controlling accounts, etc., the only practical benefit from which may usually be derived in a great deal less time by checking the footings and a few postings on the books; schedules of accounts receivable, unpaid vouchers, etc., prepared by the accountant, when the client's trial balances may usually be utilized to equal advantage.

On the other hand, it is well to recognize the aid to the memory in recording what is brought to the attention; also the fact that the act of writing may serve to impress upon the mind what might otherwise be overlooked. As an example of the application of the latter principle may be cited summaries of inventories. It is well known that the verification of computations of inventories becomes somewhat monotonous, and that therefore important factors may be overlooked if the accountant's attention is not abruptly arrested by means of writing a summary. I have in mind a case where an accountant overlooked erroneous additions and deductions in the summary of an inventory which were of considerable importance. I am confident that the facts would have been forced upon his attention by writing the items; if not, they would certainly have been disclosed to the accountant in charge of the work.

It may seem rudimentary, but is nevertheless important, that every letter and figure in working papers should be legible to others as well as to the accountant himself. In my search through papers for information elucidating some assertion in a report, I have even found memoranda in shorthand, which might as well be in Sanskrit for my use. This precaution regarding legibility applies particularly to names. If these are to be used in a report they should be typewritten if practicable; if not, they should be printed or written with great care. Abbreviations should not be used when there is any possibility of their being misunderstood.

I do not favor the use of ink in preparing working papers, believing that there are too many occasions for erasures and that there is no practical advantage to offset the additional time required.

Especially in large organizations, or where several accountants are engaged upon an audit, it is important that each paper

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bear the initials or, if necessary, the full name of the person responsible therefor.

It is desirable that papers be of standard size, so that the larger sheets of analysis paper, when folded, will be uniform in size with the journal or memorandum paper. The principal advantage of this is that it is conducive to a more orderly condition of the files, but it also tends to obviate loss or misplacement. It would be ideal if all memoranda were made on sheets of standard size, but that ideal will hardly be attained. In fact, I prefer to sacrifice uniformity in size, if necessary, for the sake of preservation of all papers that can even remotely be regarded as having a future value. I have heard of a lawsuit being won through the preservation of a piece of scratch paper showing a multiplication. However, odd pieces of paper may be pasted or securely attached to standard size sheets, thus affording greater assurance of their being preserved.

It is important that only one side of the paper be used. Writing on the back of a sheet may easily be overlooked. Paper is cheap, even at present prices, as compared with the impairment of efficiency resulting from too great economy.

Each sheet should be headed with a terse description of what it purports to be, including the name of the engagement and, usually, the date or the period covered by the audit, to avoid possible confusion with other papers. When sheets are folded the same information should appear on the outside.

It is a matter of individual preference as to whether all papers shall be fastened together. I fail to see any advantage in it, excepting as to irregular size sheets, and believe that a judicious use of folders is better, especially considering the additional work of cutting or folding the larger sheets for the purpose of attaching them, and the greater facility of reference if they are loose.

It may not be amiss to refer to the color of paper to be used. In my opinion all paper used by accountants in their work should be buff—to relieve eye-strain as much as possible.

During the early stages of the work the accountant should acquaint himself with the accounting system in use and the office personnel. Unless the client's organization is comparatively small, it is usually desirable to include in the working papers a list of the books and records that will be used in the audit, the names of the

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persons keeping such records and of officers, etc., with whom the accountant or his assistants will come in contact, and such information as the names of persons authorized to approve vouchers, sign cheques, etc. This memorandum can also be utilized in conducting future audits.

When the accountant has progressed far enough in the work to formulate a comprehensive plan, he should prepare a work sheet or audit programme, or if it be the policy of his organization to use what may be called a stock form of programme, he should adapt it to the requirements of the particular engagement. One such programme may be made to cover several periodical audits if good judgment be exercised in giving effect to changing conditions. For this purpose a columnar sheet may be used, with the various details of work to be done listed down the left side and the columns headed, in pairs, with the dates of the respective periods to be covered. One of each pair may then be used for the initials of the person doing the work and the other for the date on which it was performed. When certain parts of the audit are limited to tests, such as the verification of vouchers, footings, sales invoices, postings, etc., the work sheet should show what periods or approximately what percentages of accounts, etc., were selected and examined. The word test is subject to much abuse unless properly safeguarded. It is often advantageous, also, to make a note on the work sheet of the time devoted to certain phases of the work. I do not advocate using the same work sheet for two periods as far apart as a year. However, I believe it is desirable for an accountant to familiarize himself with the work of the previous year, as a basis for his judgment regarding the work to be done, by reviewing all the working papers used at that time.

The basic working paper, the backbone of the working papers, is the general ledger trial balance. Virtually all other papers relate to the items shown on the trial balance. It is usually desirable for the accountant to draw off a trial balance himself. It should always be included in the working papers in any event—that is, the client's trial balance book should not be checked and the statements prepared therefrom—and it has been my experience that time is seldom saved by utilizing the client's printed or typewritten form.

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My comments on the general ledger trial balance are intended to include the trial balance of a private ledger, if any. If there be more than one ledger containing general or financial accounts the trial balances should be combined, either by eliminating the controlling accounts for the purpose or otherwise. Of course, there may be exceptional cases where the private ledger accounts are of such a confidential character that the trial balance of that ledger should not be exposed by being used in conjunction with that of the general ledger. In such cases the former should be treated as an analysis or schedule of the latter.

In my opinion, it is usually desirable to treat the profit and loss accounts, whether before or after closing, as a part of the general trial balance. This will necessarily be done if the closing entries have not been made, and I believe that the procedure is advantageously simplified, in the great majority of audits, by having only one series of supporting analyses and schedules. If subsidiary operating ledgers be kept it is usually advisable to treat the trial balances thereof as analyses supporting the general ledger trial balance.

In my opinion there are few trial balances so small that it is not desirable to separate the debits from the credits, putting the latter on a separate sheet or on the bottom of the same sheet. Where there are few accounts, and especially if the books have not been closed, it is usually satisfactory to make no distinction at first between classes of accounts and to arrange the trial balance in columns as follows, with separate sheets or sections for the debits and credits:

Ledger folio.

Name of account.

Balance at beginning of period.

Balance at end of period, per books.

Adjustments, in one or two columns—increases in black and decreases in red, both in one column, or debits in one column and credits in the other.

Balance as adjusted, in two columns—one for assets or liabilities, and the other for profit and loss charges or credits.

Remarks.

Reference to supporting papers.

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In perhaps the majority of cases, however, I believe that it is desirable to show separately the asset and liability and the profit and loss debit and credit accounts, that is, on four sheets or parts of sheets. Then only one column is required for the final figures. If the books have been closed it is usually desirable to place the liability accounts immediately after the asset accounts and effect a balance. Then should follow the debit and credit profit and loss accounts, which should also be made to balance by including in the credits the balance at the beginning of the period and in the debits the balance at the end—assuming, of course, that they are both credit balances. If the books have not been closed it is usually not worth while thus to balance both the balance-sheet and the profit and loss accounts, but the preparation of the statements is facilitated by doing so eventually.

In the case of monthly or, perhaps quarterly audits, one trial balance may be used for a number of periods, as it is usually unnecessary to provide columns for adjustments, etc. It will be found advantageous in such trial balances to work from right to left, that is, to have the latest figures nearest the name of the account.

When the classification of items in the balance-sheet and the profit and loss statement and the number of accounts on the trial balance can be foreseen with reasonable accuracy, as will be the case if the accounts have been audited before, it is often an advantage, especially on a voluminous trial balance, to group the items as they will be recapitulated in the statements, without regard to their sequence in the ledger. This will usually obviate the preparation of special grouping sheets.

To summarize, the arrangement of the trial balance should be varied if necessary to meet the particular conditions, as, more than any other factor, it will facilitate or impede the work of all who for any purpose have occasion to use the working papers.

All adjustments made by the accountant during the progress of the audit should be prepared in his papers in journal entry form, with the same care as to explanations that he would exercise if he were making the entries on the books. All entries should be numbered, and a separation made between those made on the books, if any, and those necessary to reconcile the balances of the accounts as shown by the books and as adjusted by him. If the trial balance has been originally taken off before closing and there

are many adjusting entries in closing, it may be desirable to take off another trial balance on the same sheet, after closing, rather than to make all these entries in his papers. At any rate, the final trial balance taken off the books should be the basis for all figures subsequently used, and any adjustments thereof should be shown in the papers. The adjusting entries, with their numbers, should be posted to the trial balance in the column or columns provided for the purpose. If, however, there are many entries affecting one account they may be recapitulated and posted as one item. The adjustment column or columns of the trial balance should be footed to see that they balance. All adjustments should be applied to supporting analyses or schedules as well as to the trial balance.

In the space provided on the trial balance for remarks should be noted any information regarding the nature of, changes in or verification of the accounts when it has not been considered necessary to prepare supporting papers. There are very few items on a trial balance, other than those requiring analysis or supporting schedule, that do not call for some comment, if only "no change," which may be ample in the case of property accounts if there has actually been no change. This should not be inferred from the fact that the balance at the end of the period is the same as at the beginning.

In the last column of the trial balance should be shown the reference number of papers relating to the account. All analyses or schedules of accounts or other data relating thereto, which cannot be indicated on the trial balance itself, should be numbered conspicuously, preferably in colored pencil, and the number should be shown on the trial balance. If appropriate, the same sheet may be used for more than one account, but unless there would be unnecessary repetition or waste of paper, it is better to use separate sheets. Supporting papers are usually numbered in the order of the appearance of the items on the trial balance, but this is by no means essential—in fact, it is usually desirable to put the bulkier papers at the back of the folder. All supporting papers relative to one account should be fastened together and similarly numbered. This applies to confirmations, unless their bulk precludes attaching them to the other papers, in which case their location should be definitely shown by some method of indexing. If a confirmation cover more than one subject—for example, a

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bank's certification of cash balance, notes payable and securities held as collateral—and it be attached to the cash papers, reference should be made thereto opposite the related items on the analyses of notes payable and securities pledged. It is often desirable to distinguish between sub-analyses by a series of letters, which should be indicated plainly on the main analysis.

Any papers which do not relate directly to a trial balance item should be placed in a special folder and, if there be many, should be indexed on the cover. Among such papers will be the work sheet or audit programme, memoranda regarding salient features of the accounting system, etc., excerpts from by-laws and minutes, various agreements, data regarding contingent assets and liabilities not on the books, copies of the client's statements and memoranda prepared during the progress of the audit relating to points to be covered in the report.

The accountant should be so methodical in the preparation of the statements for his report that each item can be readily traced back to the trial balance. Unless the accounts in the trial balance are so few that they are carried as such to the statements, or unless the trial balance has been specially arranged to show the constituent items of the statements, as explained in the foregoing, it will be necessary to prepare grouping or assembly sheets for the purpose. These usually contain simply the captions used in the statements and the component trial balance items. If the classification be elaborate and the accounts numerous, it is usually well to designate the captions by letter or number, referring thereto on the trial balance. In rare cases it will be found convenient to apply adjustments to the grouping sheet instead of to the trial balance.

Perhaps it is not especially germane to this subject, but I am constrained at this point to call attention to the necessity of being certain that the figures used in the preparation of statements, through the grouping sheet or trial balance, "tie up" to the supporting analyses and schedules; also that the profit and loss balance used in the balance-sheet is the same as that shown in the profit and loss statement. It is well to use a distinctive check mark to indicate final approval of the trial balance items. Care should be exercised in making last-minute changes to see that a clear record is left in all the working papers affected.

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With regard to the various analyses, etc., almost all that can be said in such a general discussion as this is that, both as to content and form, they should be adapted by the accountant to meet the exigencies of the situation which he faces. Attention has already been directed to the folly of making mere transcripts of accounts when it is the intention to check their accuracy or bring out certain of their salient features. Further, analyses may often be combined to good advantage. For example, additional columns on the analyses of notes receivable, notes payable and investment securities will take the place of separate analyses of interest accrued or paid in advance, profits and losses on sales of securities and interest income. The same principle may sometimes be applied to summaries of property accounts and depreciation. On the other hand, I have seen some fanciful arrangements of analyses, ostensibly designed as labor-saving devices, that must have taken more time to prepare than would have been consumed in expressing the facts in a simpler manner.

A judicious use of distinctive ticks and colored pencils will often be found helpful, as indications concerning procedure in the verification of accounts, but care should be exercised to furnish a key to their significance.

As a rule, analyses should not be abstracted from previous papers and used again. However, this is sometimes desirable to avoid rewriting lengthy explanations, and it may be done provided a memorandum is placed in the previous papers, properly indexed, to show where the paper can be found.

I cannot emphasize too much the necessity for an accountant's including in his working papers everything that comes to his attention bearing upon the audit. He should make notes of any conclusions he may reach regarding the accounts, and make them complete, so that, to take an extreme case, but one with which I have had to deal recently, if he were to die before the report had been prepared some one else could prepare it from his papers. In brief, the accountant should bear constantly in mind that his working papers are the only record of what he has done, and that for this reason they should be a complete record, including any conclusions or deductions he may have made—both for his own use during the work and after its completion and for the use of others.