

12-1939

Auditor's Opinion on the Basis of a Restricted Examination

American Institute of Accountants. Special Committee on Auditing Procedure

Follow this and additional works at: <https://egrove.olemiss.edu/jofa>



Part of the [Accounting Commons](#)

Recommended Citation

American Institute of Accountants. Special Committee on Auditing Procedure (1939) "Auditor's Opinion on the Basis of a Restricted Examination," *Journal of Accountancy*. Vol. 68: Iss. 6, Article 1.

Available at: <https://egrove.olemiss.edu/jofa/vol68/iss6/1>

This Article is brought to you for free and open access by the Archival Digital Accounting Collection at eGrove. It has been accepted for inclusion in Journal of Accountancy by an authorized editor of eGrove. For more information, please contact egrove@olemiss.edu.

The Auditor's Opinion on the Basis of a Restricted Examination

A STATEMENT BY THE AMERICAN INSTITUTE OF ACCOUNTANTS SPECIAL COMMITTEE ON AUDITING PROCEDURE

THERE has been submitted to the special committee on auditing procedure a question involving the propriety or otherwise of the independent certified public accountant's expressing an opinion regarding the financial statements on the basis of a restricted examination. The committee believes that the question is of sufficient interest that the substance of its views should be made available to the membership.

The circumstances surrounding the particular engagement, as furnished to the committee, are as follows: Approximately 50 per cent of a client's assets are represented by current assets. Inventories account for 55 per cent of the current assets, and receivables an additional 13 per cent. Over 90 per cent of the receivables are maintained at branch offices and approximately 60 per cent of the inventories are located at branches. Approximately 90 per cent of sales (and thus presumably 90 per cent of the income) originate at the branches. The cash and fixed-asset accounts, investments and other asset accounts can be satisfactorily examined at the head office. Most of the liabilities originate at the branches. The branch accounts are examined by the client's internal auditing staff.

The committee is also informed that the company is well managed, its accounts are conservatively stated and there is no reason, from the work done at head office, to question the completeness and accuracy of the reports of the traveling auditors.

It is proposed that the examination by the independent certified public accountants be limited to the head-office records and that, as to the several im-

portant branches located throughout the country, they should rely entirely on reports of the client's internal auditing staff. The independent certified public accountants are not afforded an opportunity to confirm receivables by communication with debtors or to make physical tests of inventory quantities.

The situation with regard to receivables and inventories, in the opinion of the committee, comes clearly within the scope of the recommendations contained in the report, "Extensions of Auditing Procedure," dated October 18, 1939,* in that (1) "inventories are a material factor" and (2) "the aggregate amount of notes and accounts receivable represents a significant proportion of the current assets." Also there is no opportunity for the independent certified public accountants to satisfy themselves by examination in the field that the system of internal check and control, including the internal audit procedures, is being carried out as formulated. The committee believes that, depending on conditions, the effectiveness of the procedures regarding internal check and control at the branches (including the internal audit) might be determined by reasonable tests, i.e., without necessarily attending at all the branches.

In comparison with generally accepted auditing procedure, the proposed examination appears to be deficient in the following respects:

1. Restriction of the examination to the head-office records, and to that extent failure to make an examination in conformity with the procedures and practices outlined in the bulletin, *Examination of Financial Statements*;

* Reprinted in this issue, beginning page 377.

2. Omission of confirmation of receivables;
3. Omission of generally accepted auditing procedures with regard to physical quantities of inventories.

The question is whether, on the basis of an examination thus limited, the auditors are justified in giving a qualified opinion in which they state the limitations.

The pertinent statement in the report, "Extensions of Auditing Procedure," dated October 18, 1939, reads as follows:

"As previously stated, if such exceptions are sufficiently material to negative the expression of an opinion, the auditor should refrain from giving any opinion at all, although he may render an informative report in which he states that the limitations or exceptions relating to the examination are such as to make it impossible for him to express an opinion as to the fairness of the financial statements as a whole."

In view of the materiality of the assets and transactions involved, the committee is of the opinion that in this case the exceptions with regard to the scope of the examination are sufficiently material to negative the expression of an opinion, and that, accordingly, the auditors should refrain from expressing one.

Having dealt with the immediate question before it, the committee believes that it should take advantage of this opportunity to make certain observations. To quote the report of October 18, 1939: "It is the responsibility of the accountant—and one which he cannot escape—to determine the scope of the examination which

he should make before giving his opinion on the statements under review." This is a responsibility which cannot be shared by the client. The independent certified public accountant should determine the scope of his examination and the client must rely upon the professional integrity and standing of the accountant for his assurance that no work unnecessary in the circumstances will be undertaken.

Internal auditing departments are an important part of the system of internal check and control, particularly where a concern has numerous plants or offices. The work of the internal auditor reduces the volume of testing and checking required of the independent auditor. However, the objectives, purposes, and points of emphasis of the two are by no means parallel. An internal audit stresses particularly the accuracy of the bookkeeping records, the fact that they conform with standard accounting procedures of the concern, and the discovery of irregularities and possible shortages. The independent auditor also has these matters in mind but they are not his primary objective. He concerns himself more particularly with the soundness of the judgments of the management as reflected in the financial statements and their conformity with generally accepted accounting principles and conventions. Furthermore, one of the safeguards of an independent audit is the fact that it is made by those independent of the concern under examination. For the reasons stated, an internal audit, however efficient, cannot be considered as a substitute for the work of the independent auditor.