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Piecemeal opinions : (supersedes paragraphs 22-25 of chapter 10 of Statement on auditing procedure no. 33 and pertinent portions of paragraph 9 of Statement on auditing procedure no. 34) ; Statement on auditing procedure, No. 46

American Institute of Accountants. Committee on Auditing Procedure

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STATEMENT ON AUDITING PROCEDURE

46

Piecemeal Opinions

(Supersedes paragraphs 22-25 of Chapter 10 of *Statement on Auditing Procedure No. 33* and pertinent portions of paragraph 9 of *Statement on Auditing Procedure No. 34*)

1. The purposes of this Statement are to identify the circumstances in which the auditor's expression of a piecemeal opinion may be appropriate, to clarify the scope of an examination necessary to support a piecemeal opinion, and to set forth the precautions which should be taken when a piecemeal opinion is expressed.

Introduction

2. Piecemeal opinions differ from qualified opinions. In a qualified opinion, the auditor expresses his opinion on the statements taken as a whole, while at the same time clearly stating the qualification which he believes does not negate his opinion on the financial statements taken as a whole. In the case of a piecemeal opinion, the auditor has concluded that he either must disclaim an opinion or must express an adverse opinion on the statements taken as a whole; however, he believes the circumstances, including the scope of his examination, justify his ex-

*Issued by the Committee on Auditing Procedure
American Institute of Certified Public Accountants*

pression of an opinion limited to certain items with which he is satisfied in the financial statements.

3. The independent auditor may issue a piecemeal opinion only when, in his judgment, the scope of his examination and his findings justify it (see paragraphs 4, 5, 6 and 7) and it is accompanied by a disclaimer of opinion or adverse opinion with respect to the financial statements taken as a whole.¹ However, a piecemeal opinion should not be issued if the items with which he is satisfied in the financial statements are, in the aggregate, insignificant. Moreover, the piecemeal opinion should not overshadow or appear to contradict the disclaimer of opinion or adverse opinion; otherwise, it may result in a misleading inference regarding the auditor's position as to the financial statements taken as a whole. Even if the conditions in this paragraph are satisfied, there is no requirement that a piecemeal opinion be issued. The auditor in deciding whether to issue a piecemeal opinion should consider all the circumstances, including whether, in his judgment, a piecemeal opinion will serve a useful purpose.

Scope of Examination

4. The auditor should recognize that the expression of a piecemeal opinion with respect to specific items included in financial statements usually requires a more extensive examination of such items than would ordinarily be required if he were expressing an opinion on the financial statements taken as a whole. Three basic factors influence the sufficiency and competence of evidence necessary to support a piecemeal opinion as to specific items in financial statements:

- a. Client-imposed restrictions on scope limit the auditor's freedom to select procedures and examine evidence.
- b. Many items within financial statements are interrelated.
- c. The materiality threshold for financial statement items considered individually is ordinarily lower than for such items considered as components of financial statements taken as a whole.

¹ Whenever the independent auditor issues a disclaimer of opinion or an adverse opinion, he should disclose *all* the substantive reasons for doing so (see paragraphs 13 and 16 of Chapter 10 of *Statement on Auditing Procedure No. 33*).

5. A piecemeal opinion should not be expressed, if, as a result of restrictions imposed by the client (such as not being permitted to examine a sufficient number of subsidiaries of a holding company, not being permitted to observe physical inventories, etc.), the auditor is unable to examine evidence supporting financial statement items or is prevented from applying auditing procedures he believes would be necessary to support an unqualified or qualified opinion on the financial statements taken as a whole. Exceptions to this general prohibition can be made only in the following special circumstances:

- a. The report on the client's financial statements is intended solely for the internal information of the client's management; the auditor specifies in his report that its distribution is to be so restricted;² and the nature and source of the limitations on his work are clearly described.
- b. The report is issued pursuant to an agreement between a prospective buyer and seller of a business; the parties involved agree to the limitations imposed on the auditor's work; the auditor describes in the report the nature and source of such limitations; and the auditor specifies in his report that its distribution is to be restricted to the parties involved.

In these special circumstances, the readers normally would be fully aware of the nature and significance of the scope limitation and would be unlikely to misinterpret the disclaimer of opinion and the piecemeal opinion.

6. Many financial statement items are interrelated, for example, sales and receivables, inventory and payables, and fixed assets and depreciation. A piecemeal opinion on specific items can be expressed only after the auditor is satisfied that the reservations, limitations or insufficiency of evidence which prevent the expression of an opinion with respect to items to be excluded from the piecemeal opinion do not materially affect, directly or indirectly, the items on which the opinion is issued.

² An example of such restrictive language is as follows: "This report is solely for the internal information of the Company's management; it is not to be referred to or presented to anyone outside the Company for any purpose because of the restricted nature of our examination."

7. For purposes of reporting on individual financial statement items, the threshold of materiality is ordinarily lower since, rather than being measured in relation to the statements as a whole, the individual items stand alone, thus affording a smaller base. Therefore the auditor ordinarily should extend his auditing procedures because of such materiality considerations.

Expression of Piecemeal Opinion

8. A piecemeal opinion should be carefully worded so as not to contradict or overshadow the disclaimer of opinion or adverse opinion with regard to the financial statements taken as a whole. A piecemeal opinion should clearly indicate that no opinion on financial position or results of operations is intended. The report should identify the specific accounts covered by the piecemeal opinion, such as "cash, accounts receivable and securities." In some cases, when there are only a few accounts not covered by the piecemeal opinion, clear identification may be accomplished by reference to the excluded accounts, such as "assets other than accounts receivable." Use of broad phrases in identifying the items on which an opinion is being given, such as "in all other respects," could lead users of the report to believe that the opinion applies to items other than those intended, and, consequently, use of such phrases should be avoided.

9. When the auditor expresses a piecemeal opinion, the inter-relationship of the accounts affected should be carefully considered. For example, when an opinion on financial statements is disclaimed because the auditor has been unable to satisfy himself as to the valuation of inventories, it would ordinarily be improper for the auditor to express his piecemeal opinion upon "accounts other than inventories."³ To do so would extend his opinion to related items as to which audit satisfaction has not been obtained, such as cost of sales, gross profit, earnings before income taxes, income taxes, net earnings, accrued income taxes and retained earnings.

³ If the auditor is unable to satisfy himself as to the valuation of inventories because of a restriction imposed by the client, a piecemeal opinion should not be expressed except in the limited circumstances described in paragraph 5.

10. The piecemeal opinion should also avoid any implication that the accounts upon which an opinion is expressed present financial position or results of operations. Reference should not be made to “financial position” and “results of operations” within the piecemeal opinion portion of the report.

11. If a piecemeal opinion is considered appropriate, it should follow immediately after the disclaimer of opinion or adverse opinion covering the financial statements. The piecemeal opinion should be expressed either in the paragraph in which the disclaimer of opinion or adverse opinion appears or in an additional paragraph. The following report is an example of wording that might be used in a piecemeal opinion. This example is not intended to imply that in cases where there are uncertainties of the kinds indicated that a disclaimer of opinion is necessarily required; rather it is assumed that in this case the auditor has concluded that a qualified opinion is not justified in the circumstances.

(Scope paragraph—standard wording)

(Middle paragraph)

Deferred development costs of \$_____ relate to the development of computer programs and educational films and books. The recovery of such costs is dependent on successful development of these projects and the company's ability to sell the related products profitably in the future. (See note X to the financial statements.) Also, as indicated in note Y, the company is defendant in a legal action wherein the plaintiffs are claiming damages of \$_____ and the company is counterclaiming \$_____ against the plaintiffs. The ultimate outcome of this litigation is uncertain.

(Opinion paragraph)

Because of the possible material effect of the uncertainties described in the preceding paragraph on financial position and results of operations, we do not express an opinion on the financial statements taken as a whole. In our opinion, however, the following items in the accompanying finan-

cial statements are presented fairly at December 31, 197— and for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year: cash; trade accounts receivable; inventories; property and equipment; notes payable to banks; accounts payable; long-term debt; capital stock; sales; selling, general and administrative expenses; and interest expense.

Effective Date

12. Statements on Auditing Procedure generally are effective at the time of their issuance. However, because the restriction on expression of piecemeal opinions discussed in paragraph 5 changes practice which has heretofore been considered acceptable, such restriction shall not be effective with respect to reports on financial statements for periods ending on or before November 30, 1971.

The Statement entitled "Piecemeal Opinions" was adopted by the assenting votes of twenty-one members of the Committee, of whom Messrs. Burriss, Gomprecht, Heft, Hepp and Krebs assented with qualification.

Mr. Gomprecht qualifies his assent with respect to paragraph 5. He believes the use of piecemeal opinions should be discontinued. However, recognizing this Statement's improvement over previous literature on the subject and in recognition of the Committee's present deliberations and intent to issue a statement on the subject of auditors' reports other than unqualified opinions, he assents to its publication. Mr. Gomprecht also believes the exceptions in paragraphs 5(a) and (b) are not required, as reporting in these situations is adequately provided for in *Statement on Auditing Procedure No. 33*, Chapter 13 on Special Reports.

Messrs. Burriss, Heft, Hepp and Krebs also qualify their assent with respect to the exceptions permitted in paragraphs 5(a) and (b). They are in accord with the prohibition expressed in paragraph 5 wherein an auditor, because of restrictions imposed by the client, is now prohibited from issuing a piecemeal opinion. However, they do not believe that the exceptions permitted

under paragraph 5(a) and (b) are appropriate. They join Mr. Gomprecht in the belief that opinions on limited engagements should be rendered only through the vehicle of a special report as described in *Statement on Auditing Procedure No. 33*, Chapter 13 on Special Reports.

NOTE

Statements on Auditing Procedure present the considered opinion of the Committee on Auditing Procedure, which is the senior technical committee of the Institute designated to issue pronouncements on auditing matters. Departures from the Committee's recommendations must be justified by those who do not follow them.

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