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# Review of audit working papers

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# The Review of Audit Working Papers

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ONE of the more important duties of the public accountant is the review of the working papers prepared in the performance of professional engagements. In this connection the term "working papers" is used in the broad sense and would include not only all of the working paper analyses prepared to support the verification of the various accounting and other records under examination, but would include also the rough drafts of audit reports, special reports such as suggestion letters and reports to the Securities and Exchange Commission, and Federal and State income tax returns. Since the review of working papers results in the expenditure of much time and effort on the part of public accountants, the purpose of my remarks tonight is to consider the reasons why such review is necessary, and to discuss briefly the duties and responsibilities that the various members of the staff of a public accounting firm assume in the review procedure and the methods to be followed in performing such review.

## EDUCATION, TRAINING, AND EXPERIENCE DIFFERENCES NECESSITATE REVIEW

On all engagements except the very smallest, where all the work can be done by one accountant, there will be two or more men assigned. In such cases one accountant will be the "senior" or "in-charge" accountant on the engagement, responsible for the adequate performance thereof, and the remaining accountant or accountants will work as his assistants, performing such duties as the in-charge accountant instructs them to perform or delegates to them. The in-charge accountant, of course, will be a man of requisite intelligence and educational background and with sufficient training and experience in field work to enable him to perform, with such advice and consultation as he from time to time may require from his supervisor on the engagement, an adequate examination. However, the other accountants on the engagement, the assistants to the in-charge accountant, will not have the same degree of education, training, and experience as the in-charge accountant.

For a number of years now it has been the general practice in the public accounting profession for firms to hire for the permanent staff only college graduates who have majored in accounting, with the result that there is generally very little, if any, difference between the in-charge accountant and the assistants as to educational background. However, during the busy season in public accounting, which is the period from about the middle of November until approximately the end of the following March, many firms find it necessary to hire a number of accountants on a temporary basis, and the majority of these men do not have the same degree of educational background as do the permanent staff accountants.

It is in the realm of experience and training in field work that we find the greatest divergence between the in-charge accountants and the assistants, and among the various assistants themselves. On any large or medium-sized engagement, for example, it is not unusual to find one or more assistant accountants who are participating in their first examination, while others may have anywhere from a few weeks' to several years' experience on a variety of engagements; some may have worked on previous engagements for the particular client; others, although never having worked on an engagement for this client, may have worked for other clients in the same or related business fields; and others undoubtedly have had no previous experience or contact with any similar business.

The differences in educational qualifications of accountants, and in their training and experience in field work vary to such an extent that each must be assigned to such duties as he is capable of performing and be instructed therein by the in-charge accountant according to the particular education, training, and experience of the individual. Therefore, because of the variation in the education, training, and experience of accountants, after each has performed the work to which he has been assigned it is imperative that the working papers prepared in the performance of the assignment be subjected to a thorough review by his superiors to determine that the work assigned has been adequately performed.

#### USE OF TEST AND SAMPLING PROCEDURE REQUIRES REVIEW

Back in the early days of public accounting, when business organizations were relatively small and simple, it was an easy task in performing an audit to make what today would be called a detailed

audit—an examination of each transaction that occurred during the period under review. Today, however, with the gigantic and complicated structure of many business enterprises, it is no longer practicable, from a time and fee viewpoint, to perform generally anything that resembles a detailed audit. Instead, almost every examination today is what is commonly termed a general audit—an examination based on a selected test and sampling procedure, the type and extent of the tests and samples being governed to a very large extent by the system of internal control in effect in the particular business enterprise.

In the performance of a general audit the type and extent of the tests selected and the period they are to cover are left to the judgment of the in-charge accountant, subject to such advice from his supervisor as he may feel called upon to request or—and this is particularly true in the first examination of a client by the public accounting firm—such advice as the supervisor may feel it desirable to volunteer. Therefore, because of the degree of discretion allowed to the in-charge accountant, it is necessary that the working papers prepared on the engagement, which indicate the type, extent, and periods covered by the tests, be subjected to a critical review by the supervisor on the engagement—who is a man of broader experience and background in the practice of public accounting—to give assurance the audit program employed is adequate.

#### IMPORTANCE OF CONTENTS OF WORKING PAPERS MAKE REVIEW ESSENTIAL

The working papers prepared in connection with an audit engagement are the primary evidence of the work performed. Since it may be necessary at a subsequent date to substantiate the adequacy of an examination upon which an opinion was rendered, and since this can best be accomplished by reference to the working papers prepared in connection with the examination, it is essential that the working papers contain sufficient information to support the opinion. To be certain that they do, it is necessary that they be reviewed by accountants other than those who prepare them and who are sufficiently well qualified by education, training, and, particularly, experience to determine that the working papers do contain pertinent information adequately supporting the opinion rendered.

Now let us consider briefly the duties and responsibilities the various accountants in a public accounting firm assume in the review

procedure and the methods they follow in such procedure.

A matter of primary importance in connection with the review of working papers, if such review is to be effective, is that each accountant be familiar with the review procedure of the firm. He should know not only what his duties are as far as review work is concerned, but he also should be familiar with the review procedures required of his subordinates and the review procedures that will be performed by his superiors if he is to perform effectively his own review work.

#### WORKING PAPERS FIRST REVIEWED BY PREPARING ACCOUNTANT

The first review of any working paper analysis should be made by the accountant preparing it, regardless of whether he is an assistant or the in-charge accountant on the engagement. When the accountant who prepares an analysis feels he has completed it, but before he "signs-off" to indicate the analysis has been prepared by him and that his is the primary responsibility in connection therewith, he should give it a careful final scrutiny and review, and ask himself the following three questions:

Is the analysis complete in that it fully and accurately presents the information it is intended to present?

Are the verification procedures performed in connection therewith adequate, and are they clearly indicated?

Are all comments, explanations, or exceptions of any kind clearly and concisely set forth?

If the accountant preparing an analysis will take the time necessary to review his own work, before taking up another task, by asking himself and being able to answer in the affirmative the above questions, the resultant saving in time both for himself and for his superiors, not to mention the savings in charges to the client, would be substantial. In addition, nothing contributes more to the advancement of staff accountants within a public accounting firm than the ability to prepare working papers that *are complete* when turned in *as complete*. This does not mean, of course, that subsequent review by in-charge or supervising accountants will not result in additional work being required in connection with the analysis, or in an indication that the work performed was excessive, or in other changes being made therein. The additional training and experience of these accountants may well indicate that such changes are necessary, but all

that can be asked or expected of such review by the person preparing the analysis is an affirmative answer to the above questions based on his own education, training, and experience.

#### REVIEW BY THE IN-CHARGE ACCOUNTANT

All working papers prepared on an engagement are reviewed by the in-charge accountant. This review should be performed, of course, at the client's office as the engagement progresses so that any changes necessary or any additional procedures that need be applied can be made or performed while the assistants are still available and while the client's records are readily accessible.

The in-charge accountant, as has been mentioned previously, is responsible for the performance of an adequate examination in the field. Depending upon the purpose of the examination and the system of internal control in effect in the client's organization, he first determines the audit procedures to be applied, the periods they are to cover, whether he or one of his assistants is to perform a particular verification procedure, the type of analysis to be prepared and the information to be contained therein, and the approximate amount of time that should be required on any particular verification or analysis.

The in-charge accountant is the only one of the field accountants whose perspective must encompass the engagement as a whole. He must determine not only the work that must be performed in connection with each individual verification procedure or analysis, but he must also recognize the interrelationship of the various accounts and procedures and how each of these fits into the complete verification procedure taken as a whole. In other words, each individual verification procedure or analysis is similar to any one piece of a jig-saw puzzle, and it is only when they are all put together, in proper place and relation one to the other, that a completed picture or an adequate verification results.

Thus it is imperative, to perform his function properly, that the in-charge accountant review every working paper prepared on an engagement, satisfying himself as to the same general points mentioned previously in the discussion of review by the accountant preparing an analysis, and in addition satisfying himself, because of his broader perspective toward the engagement, that the interrelationship between individual analyses and verifications results in an adequate over-all examination. At the time of his review, he must determine that any questions or exceptions raised by the assistant

accountants are properly taken care of, either through additional investigation, explanation, or mention in the draft of the report. If in his review of an analysis the information presented, when considered in the light of information gained through his own verification or in review of other analyses, indicates that additional verification procedures are required, he makes certain that they are performed. Conversely, if upon review he feels that the verifications performed are in excess of those required for an adequate examination, he will so note in the applicable working paper so that consideration can be given to the matter in a similar examination for a succeeding period. When the in-charge accountant has completed his review of a particular analysis, he "signs-off" on the analysis to indicate such review and his approval.

#### THE SUPERVISOR'S REVIEW OF WORKING PAPERS

The final review of the working papers is performed by a supervisor on the engagement, who may be either a partner or a principal. Let me digress for just a moment here to point out that each engagement is always under the direct supervision of a partner. However, in many public accounting firms there is a class of accountants between the in-charge accountants and the partners (in Haskins & Sells designated "principals") who also act in a supervisory capacity, and a principal as well as a partner will be assigned to the larger engagements. One of the usual supervisory duties of the principal in such cases is the review of the working papers; however, this does not mean that there is not an over-riding close supervision on, and final responsibility for, the engagement by a partner. Now, getting back, the final review of the working papers is performed by a supervisor, either a partner or a principal, who will have had considerable experience in public accounting, will usually have come up through the various classes of accountants in his public accounting firm, and will be familiar generally with the class of business endeavor in which the client is engaged and specifically with the particular client's organization and operations.

Up to this phase of the review each participant therein also has been fundamentally concerned with the performance of the engagement, either in determining the actual verification procedures to be performed, or in performing them, or both, and it has been somewhat difficult for the reviewer to get an impartial, over-all viewpoint in connection with his review. The supervisor, however, is not so con-

cerned with individual verification procedures, as such, but more with the complete verification picture. His main concern is the determination that the verification procedures performed, taken as a whole, are adequate to support the opinion rendered on the examination and that the contents of the working papers are clearly sufficient to support such adequacy. This might be termed the *report responsibility* review, as compared with the *specific analysis* review of the accountant preparing the analysis, and the *job performance* review of the in-charge accountant.

The supervisor reviews all working papers prepared in connection with the engagement, reviews the draft of all reports to be issued (previously prepared by the in-charge accountant or, if in whole or in part by an assistant accountant, reviewed by the in-charge accountant), and indicates his approval of the various analyses and of the adequacy of the verification performed in connection therewith by signing or initialing the working papers and the draft of the reports.

The review by the supervisor, if at all practicable, should be performed in the client's office and usually at the time when the engagement is nearing completion. If it is a large engagement covering a considerable period of time it is desirable for the supervisor to be present several times during the course of the engagement to confer with the in-charge accountant and with the client as to the various phases of, and problems arising in connection with the engagement, and a portion of his review can very profitably be performed at these times. By so doing any suggestions the supervisor may have for improvements or changes in the verification procedures or in the preparation of analyses can be made prior to the completion of the examination, with a resulting saving in time and betterment of examination.

The advantages of an *on the job* review by the supervisor, as compared with an office review, i.e., review of working papers and reports in the public accountant's office after the field work by the in-charge accountant and his assistants has been completed and they have gone on to new assignments, are so numerous that every effort should be made by the supervisor to perform his review in the field. Just to list a few of the advantages of an *on the job* review, consider the following points: availability of the field men at the time of review for questioning, explanations, and additional verification work when required, rather than the necessity for contacting them by telephone



or having them come into the office from other engagements when the examination being reviewed may no longer be fresh in their minds and when any additional work required would mean another trip to the client's office after the work there was supposedly completed; contact of the supervisor with the client's officers and employees and the psychological effect of having the client's officials know the engagement receives a thorough review by a supervisor; advantages from the point of view of training and subsequent improvement in the work of the in-charge and assistant accountants whereby any improvements, expansions, or changes in their working papers or verification procedures can be called to their attention immediately and the reasons therefor discussed with them so that they are thoroughly understood; and just the personal contact of the supervisor with the field accountants so that each gets to know the other as a personality and not just a name.

Before beginning his review of the working papers the supervisor should become thoroughly familiar with the report requirements on the engagement. By so doing he can ascertain in the course of his review that the working papers contain all of the information that will be required in connection with the various reports that are to be rendered. For example, if in connection with an engagement to make a general audit the public accountants also are to prepare the Federal income tax return of the client, the supervisor must ascertain in his review of the working papers that they contain all the information that will be required in the preparation of the return and also that the various items of income and expense have been grouped in the manner that will best facilitate such preparation. Similarly, if the engagement contemplates the preparation of reports to the Securities and Exchange Commission, or reports to other regulatory authorities, the supervisor should be so aware before beginning his review of the working papers so that, if necessary, he can refresh his memory as to the requirements of such reports and then, during the course of his review, can determine whether or not the required information is included in the working papers.

#### REVIEW OF REPORTS BY THE SUPERVISOR

The review of the draft of reports that are to be rendered on an engagement is one of the more important review duties of the supervisor. Such reports are written by the in-charge accountant and the supervisor's is the first review that is made. The supervisor would

"check out" the financial statements and schedules for the current period included in the report, both as to the captions of items and amounts therefor, in their entirety. If, as is customary, amounts for the immediately preceding period are presented for comparative purposes, he would determine that the captions therefor were correct. As to the amounts for prior periods, since they come from previous reports of the public accountants and the checking consists merely of tracing them back to such previous reports, this normally is not done by the supervisor but is delegated to the public accounting firm's report department. However, should there be any reclassification of the figures for the prior period from those previously reported, to make them comparable with figures for the current period, it would be required of the supervisor that he determine the propriety and accuracy of such reclassifications. By "checking out" the captions and amounts is meant that the supervisor would determine that each caption used was a correct statement of fact, that the amounts were in agreement with or computable from amounts taken from the working papers, and that the presentation was made in accordance with generally accepted auditing standards of reporting.

Footnotes to financial statements are, of course, considered a part of the financial statements and the supervisor's review of the statements would include a review of the footnotes. In this connection, his review would include a determination that all matters requiring mention by footnote are so mentioned and that each footnote is a true and correct statement of fact which, together with any amounts contained therein, is supported by the working papers.

In reviewing financial statements, the supervisor must keep in mind that such statements are the representations of the client, not of the public accountants, and that as to captions, amounts, and wording included therein, the public accountants only suggest. The accountants' opinion, or certificate, however, is the representation of the public accountants and, if suggestions as to financial statements are not accepted by the client and the matter is of sufficient importance, the public accountants' recourse is to bring the matter to attention through mention in the certificate.

The supervisor now, after having reviewed the working papers and the financial statements included in the report, is in a position to determine that the financial statements present fairly the financial position of the client as of a date and for the period under examination, in conformity with generally accepted accounting principles

applied on a consistent basis, and that a statement to that effect is included in the opinion paragraph of the certificate, as required, or, if such is not done, to see that the opinion paragraph contains an exception. The supervisor may now complete his review of the certificate since, having completed his review of the working papers and financial statements, he can determine what exceptions or explanations, if any, are required in the certificate.

#### REVIEW OF REPORT WITH REPRESENTATIVES OF THE CLIENT

One or two other phases of the review of reports should be mentioned. The first is the review of the draft of the report with representatives of the client. After the report has been reviewed by the supervisor, and usually before it is typed, it is customary for the supervisor and the in-charge accountant to review the draft thereof with representatives of the client. This review serves several purposes: it gives the client's representatives the occasion to make any comments, inquiries, criticisms, or suggestions they consider appropriate as to the contents of the report prior to the time it is typed; it gives the public accountants an opportunity to discuss the report generally with the client and to mention specifically any matters of an unusual nature which may or may not require particular mention or special handling in the report, and to so inform and explain such matters to the client's representatives before the report is typed; it is an excellent opportunity for the public accountants to make any oral comments, criticisms, or suggestions as to changes or improvements in the client's record-keeping or related procedures, or to discuss such other matters noted in connection with the examination as the public accountants deem appropriate, which comments and suggestions are frequently the subject of a later separate suggestion letter or report to the client; and it is an additional opportunity for both to become better acquainted, for the client to make any comments or suggestions as to the service rendered by the public accountants, and for the public accountants to indicate any additional areas of service whereby their firm can be of benefit to the client.

#### FINAL READING OF REPORTS

Another phase of report review that should be mentioned is what is termed *final reading*. After the report is typed, but before binding,

copies are given to the head of the firm's report department and to the supervisor for reading. This reading is performed quite rapidly, more in the manner that a similar report which had not been seen previously would be read, and primarily for the general sense and content thereof. At the completion of this review the report is bound and ready for delivery to the client.

#### MAKING CHANGES IN WORKING PAPERS AND REPORTS

It might be well to mention here the manner of making changes in working papers and drafts of reports. Because of the matter of responsibility, any changes made, other than those made by the accountant who originally wrote the portion being changed, should generally be made so that the changed portion remains clearly legible. This can be accomplished by drawing a line through the part to be changed and then inserting the change. The reason for this is that if an accountant is held responsible for the preparation of analyses, the performance of indicated verification procedures, or the writing of reports, changes subsequently considered necessary by his superiors after he has completed and signed for the work done should not be made without leaving evidence of the work he performed. Thus an eraser should be used only by the one who originally wrote the material being changed; all other changes should be accomplished so that the material changed remains legible.

It sometimes happens that information is inserted in the working papers, particularly by new and inexperienced junior accountants, which further or more complete investigation shows should not have been included. Deletion by crossing out such information so that it is still legible is not always sufficient deletion. In such cases the proper procedure is for his superior to explain the matter to the junior accountant, have the junior thoroughly satisfy himself that the information is unwarranted, and then have the junior completely delete it from the working papers.

#### CONCLUSION—EXTENT OF THE REVIEW

Comments are sometimes heard in connection with the subject of review of working papers and reports that too much time and effort are expended in the review procedures and that some of the review time would be better spent in performing additional or more extensive

verification procedures and in the preparation of additional analyses, or, if not spent in this manner, such time should be eliminated and the charges for the examination correspondingly reduced. When we consider, however, the responsibility of certified public accounting firms in connection with examinations performed by them, as shown by the wording of the standard form of certificate currently in use which they sign (particularly the terminology of "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" and "In our opinion, the accompanying financial statements present fairly the financial position of \* \* \* as of a date and the results of its operations for the period then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding period"), it readily becomes apparent that it is a matter of self-preservation to the public accounting firm that its best accounting minds review the working papers and reports so as to be as certain as it is possible to be that such responsibility has been met fully and completely.

Another matter that should be mentioned in this connection, and one that all too frequently is not given sufficient consideration, is that the reports rendered to the clients are normally the only tangible evidence of the work of the public accountants which the client receives. The representatives of the public accounting firm may be at the client's office for weeks or even, in the case of some of the larger clients, months making an examination and when the engagement is completed all that the client receives for the considerable disruption of its accounting department, disturbance of its accounting and other personnel, and liability for an oftentimes substantial fee, may be a three-page report. Therefore, regardless of the number or types of reports rendered on an examination, it is essential that each be as accurately, lucidly, and informatively written as possible and contain not only all necessary information but also all such other material of an informative nature that will be of interest to the client and appropriately included in the particular report. To accomplish this, each such report and the related working papers must be reviewed carefully and completely by the most competent accountants in the public accounting firm.

Thus, to meet the responsibility of the public accounting firms to their clients, and to others who rely upon the financial statements of

clients that are covered by the certificate, and to render to the clients reports on examinations that are complete, accurate, and informative, it is essential that the working papers and reports be thoroughly and intelligently reviewed. And the procedures outlined for accomplishing this purpose are no more than the reasonable and necessary requirements for such a thorough and intelligent review.