University of North Dakota
UND Scholarly Commons

Theses and Dissertations | Theses, Dissertations, and Senior Projects

8-1972

Short Form Opinions

Larry W. Huus

How does access to this work benefit you? Let us know!

Follow this and additional works at: https://commons.und.edu/theses

Recommended Citation
Huus, Larry W., "Short Form Opinions" (1972). *Theses and Dissertations*. 5407.
https://commons.und.edu/theses/5407

This Independent Study is brought to you for free and open access by the Theses, Dissertations, and Senior Projects at UND Scholarly Commons. It has been accepted for inclusion in Theses and Dissertations by an authorized administrator of UND Scholarly Commons. For more information, please contact und.commons@library.und.edu.

University of North Dakota Libraries

3 3100 01904 8213
UND CHESTER FRITZ LIBRARY

SHORT FORM OPINIONS

by

Larry W. Huus

Bachelor of Science in Business Education

Mayville State College 1969

An Independent Study

Submitted to the Faculty

of the

University of North Dakota

in partial fulfillment of the requirements

for the degree of

Master of Science

Grand Forks, North Dakota

August
1972

ARCHIVAL COPY

ACKNOWLEDGEMENTS

The Investigator wishes to thank Mr. Lyle Steinmeier for his advice and patience which have significantly contributed to the completion of this study.

TABLE OF CONTENTS

Chapter		Page
I.	INTRODUCTION ----------------------------	1
II.	HISTORY AND DEVELOPMENT ---------------	2
III.	ANALYSES OF THE PRESENT SHORT FORM REPORT ----------	12
IV.	PROBLEMS WHICH REQUIRE DEPARTURE FROM THE STANDARD -----	33
V.	SUMMARY ----------------------------------	58

INTRODUCTION

In the first section of the report, the author has traced the history and development of the short form opinion. The short form opinion started to be used in 1917. From this date until the present time, the short form opinion will be discussed. With each change, the author has illustrated the new opinion adopted and discussed its effects.

The second section deals with the present day opinion. The author has discussed each part, such as to date and address, and certain phrases of the short form opinion. Each phrase or part has a certain meaning, which has been explored.

The last section points out that the standard short form opinion has to be adapted to fit the specific situation. In this part, the author has talked about situations that may arise which would present problems for the auditor and the suggested wording for the problem.

HISTORY AND DEVELOPMENT

For large engagements, the short form opinion is generally used for the report. A standard form is followed by most accounting firms. This form has been modified from time to time.

In April 1917, the Federal Reserve Board issued a bulletin entitled Uniform Accounting. In this bulletin, the board made the following reference to certificates:

> "The balance sheet and certificate should be connected with the accounts in such a way to insure that they shall be used only conjointly. This rule applies also to any report or memorandum containing any reservations as to the auditor's responsibility; any qualification as to the accounts, or any reference to facts materially affecting the financial position of the concern."

The certificate should be as short and concise as possible, consistent with a correct statement of the facts, and if qualifications are necessary, the auditor must state them in a clear and concise matter.

If the auditor is satisfied that his audit has been complete and conforms to the general instructions of the Federal Reserve Board, and that the balance sheet and profit and loss statement are correct, or that any minor qualifications are fully covered by the footnotes on the balance sheet, the form shown on Illustration 1 is proper.

Illustration 1

Report of 1917

I have audited the accounts of Blank and Company for the period from January 1 to December 31, 1917, and I certify that the above balance sheet and statement of profit and loss have been made in accordance with the plan suggested and advised by the Federal Reserve Board and in my opinion set forth the financial condition of the firm at December 31, 1917 and the results of its operations for the period.

Signed ABC

In 1929, the Federal Reserve Board issued a bulletin entitled Verification of Financial Statements, in which the following statement was issued:

> "If the auditor is convinced that his examination has been adequate and in conformity with these general instructions, that the balance sheet and profit and loss statement are correct, and that any minor qualifications are fully stated, the form shown in Illustration 2 may be used."

Illustration 2

Report of 1929

I have examined the accounts of ABC Company for the period from January 1 to December 31, 1929.

I certify that the accompanying balance sheet and statement of profit and loss, in my opinion, set forth the financial condition of the company at December 31, 1929, and the results of operations for the period.

In this period of time, there was no mention made of the fairness of presentation. The reports did not mention whether the statements were in conformity with generally accepted accounting principles. The reports did not mention whether the statements were consistent with that of the preceding year.

It should be noted that there is no mention made of a detailed audit or the lack of it. The assumption was that if the suggestions of the Federal Reserve Board were followed, and if the auditor was satisfied with the results obtained, additional scope comment was not necessary.

In 1932, the Special Committee on Cooperation with Stock

Exchanges of the American Institute worked with the Committee on Stock List of the New York Stock Exchange in an effort to improve the annual reports of listed corporations. They also worked to initiate a change in the form of the audit certificate so that the auditors would specifically report to the shareholders whether the accounts were properly prepared in accordance with the methods regularly employed by the company.

As of July 1, 1933, the New York Stock Exchange required all listing applications be accompanied by a certificate of a certified public accountant as to the correctness of the financial statements for the year and for each future year. On December 31, 1933, the American Institute's Special Committee on Cooperation with Stock Exchanges submitted to the New York Stock Exchange the short form report shown in Illustration 3. In January, 1936, when Examination of Financial Statements was revised, the Institute recommended the use of the same form.

Illustration 3

Report of 1933

We have made an examination of the balance sheet of the XYZ Company for the year 1933. In connection therewith we examined

or tested accounting records of the Company and other supporting evidence and obtained information and explanation from officers and employees of the company; we also made a general review of the accounting methods and of the operating and income accounts for the year; but, we did not make a detailed audit of the transactions.

In our opinion, based upon examination, the accompanying balance sheet and related statement of income and surplus fairly present, in accordance with accepted principles of accounting consistently maintained by the company during the year under review, its position at December 31, 1933, and the results of its operations for the year.

The above report includes a comprehensive scope paragraph. The words "to certify" do not appear in the opinion paragraph because they believed it was associated with the word warranty. To many people the word certificate meant the auditor was issuing a guarantee of absolute correctness of the financial statement. The auditor cannot guarantee the correctness of financial statements. In the first place, the auditor does not perform a detailed verification of all transactions. Secondly, there are so many different accounting methods which fall within the concept of "generally

accepted accounting principles" that no one method can be considered as the only correct method and each method may produce different results. Finally, financial statements always contain many estimates which may not be absolutely correct. Because of this, the auditor no longer issues a certificate which implies absolute correctness but he will issue an opinion on the statements. It should be noted that the concept of fair presentation, the idea of consistent maintenance of the accounting records during the year and the concept of accepted accounting principles were, also, introduced during 1933.

On October 18, 1939, Statements on Auditing Procedure, No. 1 was issued. This statement dealt with the examination of inventories, the examination of receivables, the appointment of independent certified public accountants, and the form of the report. The statement changed the form of the opinion as shown in Illustration 4.

Illustration 4

Report of 1939

To the Board of Directors (or stockholders) of the XYZ Company.

We have examined the balance sheet of the XYZ Company as of April 30, 1939, and the statements of income and surplus for the

year then ended, have reviewed the system of internal control and the accounting procedures of the company, and without making a detailed audit of the transactions, have examined or tested accounting records of the company and other supporting evidence, by methods and to the extent we deemed appropriate.

In our opinion, the accompanying balance sheet and related statements of income and surplus present fairly the position of the XYZ Company at April 30, 1939, and the results of its operations for the fiscal year, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

In Illustration 4, internal control is mentioned and the statement pertaining to internal control was retained to emphasize sampling. The reference to obtaining information from employees and officers as shown in Illustration 3 was omitted because it was considered unimportant. In the opinion paragraph, the phrase "based upon such examination" was dropped because it would be impossible to give an opinion unless such an examination was made. The concept of consisting with the preceding year was introduced so that the results could be compared in order to give them more meaning.

In 1939 the Securities and Exchange Commission began studying the accountant's report and on February 5, 1941, they amended some rules concerning the accountant's report. On February 14, 1941, the American Institute amended the form, as shown in Illustration 5, to meet the new requirements of the Securities and Exchange Commission.

Illustration 5

Report of 1941

We have examined the balance sheet of the XYZ Company as of February 28, 1941, and the statements of income and surplus for the fiscal year then ended, have reviewed the system of internal control and the accounting procedures of the company and, without making a detailed audit of the transactions, have examined or tested accounting records of the company and other supporting evidence, by methods and to the extent we deemed appropriate. Our examination was made in accordance with generally accepted auditing standards applicable in the circumstances and included all procedures which we considered necessary.

In our opinion, the accompanying balance sheet and related statements of income and surplus present fairly the position of the

XYZ Company at February 28, 1941, and the results of its operations for the fiscal year, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

The last sentence in the scope paragraph was added in order to comply with the regulations of the Securities and Exchange Commission. This sentence is an unqualified statement of the professional conduct of the audit, but it does not mean that all audits follow the same procedure or that all accountants would use the same techniques in the same type of engagements.

In 1944, the certificate was simplified by the elimination of reference to the review of the system of internal control, elimination of reference to the accounting procedures, and elimination of the statement "by methods and to the extent we deemed appropriate". These things had to be up to par in order to give a qualified opinion but they did not consider it important to mention it in the report.

In 1948, the certificate was again changed in order to correct the inconsistent expression relating to auditing standards applicable in the circumstances and to remove reference to internal control because one of the auditing standards requires the study of

internal control. This form, shown in Illustration 6, is the one that is currently being used.

Illustration 6

July 15, 1972

To the Board of Directors of the ABC Company:

We have examined the balance sheet of the ABC Company as of June 30, 1972, and the related statements of income and retained income for the year then ended. 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.

In our opinion, the accompanying balance sheet and statements of income and retained income present fairly the financial position of the ABC Company at June 30, 1972 and theresults of its operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Signed L and M
Certified Public Accountants

ANALYSES OF THE PRESENT SHORT FORM REPORT

The Date

The auditor must consider the effect of any significant event or transaction which occurs after the date of the financial statements but before the auditor completes his examination. Ordinarily the auditor's report carries the date of the completion of the field work and this date is the end of the period subsequent to the balance sheet date during which the auditor has continued certain limited auditing procedures. During this period there could have been events or transactions which have a material effect on the financial statements and the auditor may have to give effect to these events or transactions on the statements, footnotes, or the report.

For example, if subsequent information occurs which would have been reflected in the financial statements at the balance sheet date, an appropriate adjustment may be required. Examples of this type of event would be the collection of receivables or settlement or determination of liabilities on a substantially different basis from that previously anticipated. In addition, there may be certain subsequent events which have no material effect on the financial statements, but they may be of such importance that disclosure is

necessary. Examples of this type are the sale or issuance of significant amounts of additional capital stock or the purchase of a new business.

Reports should be Addressed to Clients

In the case of Ultramares Corporation v. Touche, which involved the responsibilities and liabilities of auditors, the court ruled that an auditor should not be held liable to third parties for negligence. For legal reasons then, auditors will address their reports to their clients so that there will be no uncertainty of who the third parties are. Ordinarily, the report is addressed to the client company. Many accountants will address the report to the stockholders, board of directors, or to a committee of stockholders depending on the wishes of the client and the group which made the appointment. Also, it is general practice to address the report to the client when it accompanies financial statements which will go to the Securities and Exchange Commission under the Securities Act of 1933 and 1934 even though the liabilities may run to others.

Identification of the Statements Examined

In the first sentence of the scope paragraph, the auditor states that he has examined specific statements of a certain company.

These financial statements belong to the company being audited. The use of the possessive should be noted "we have examined the balance sheet of . . . ." This emphasizes the fact that the financial statements are representations of the company.

Scope of Examination

The language of the first paragraph of the American Institute form has been widely accepted as an adequate statement of the type of examination that was made. The auditor may modify or elaborate on it. He should not consider it a sterotyped form because in a particular situation he may wish to mention some point. However, modification of the report should only be made when it is significant and for a good reason.

Some auditing firms will expand the short form report and comments are made regarding certain items such as cash, receivables, inventories, etc. The general form of report is adaptable to such modifications.

A criticism of the expanded short form report and the regular short form report is that the reader may feel that he must judge whether or not the scope was adequate, a responsibility which the auditor should assume. Although no brief report can reflect the entire audit, the selection of certain specific procedures as worthy

of mention may not convey to the reader the full extent of the examination or whether a qualification was intended.

The first part of the second sentence of the scope paragraph states "Our examination was made in accordance with generally accepted auditing standards". These generally accepted auditing standards have been introduced and approved by the membership of the Institute. These standards are classified into three groups: The general standards; standards of field work; and, reporting standards. Each of the three groups of standards will be discussed in the following paragraphs because they would directly affect the opinion.

General Standards

The general standards discuss the personal qualities required by the independent CPA. The examination must be made by auditors having adequate technical training and proficiency in auditing, the auditors must have independence from the client, and they must exercise due professional care.

Training and Proficiency:

The Certified Public Accountant is presumed to meet the requirements for this first general standard because he must meet the educational and experience standards set by the var-

ious boards before he may become a CPA.

Independence:

The second general standard requires the auditor to be independent. The auditor must not be biased toward his client.

"As pointed out in statement number 33, independence does not imply the attitude of a prosecutor, but rather a judicial impartiality that recognizes an obligation for fairness, not only to the management and owners (shareholders) of a business, but also to creditors and those who may otherwise rely (in part, at least) upon the auditor's report, as in the case of prospective owners or creditors."[1]

The auditor must not only be independent but he must appear to be independent by others. For example, an auditor with a financial interest in a company may, in fact, be independent but the public would not believe that he was unbiased. The AICPA has established definite guidelines to guard against the loss of independence. Rule 101 of the code reads, in part, as follows:

"Neither a member or associate, nor a firm of which he is a partner, shall express an opinion on financial statements of any enterprise unless he and his firm are in fact independent with respect to such enterprise.
Independence is not susceptable of precise definition, but is an expression of the professional integrity of the individual. A member or associate before expressing his opinion on financial statements, has the responsibility of assessing his relationships with an enterprise to determine whether, in the circumstances, he might expect his opinion to be considered independent, objective and unbiased by one who had

knowledge of all the facts.

A member or associate will be considered not independent, for example, with respect to any enterprise if he, or one of his partners, (a) during the period of his professional engagement or at the time of expressing his opinion had or was committed to acquire, any direct financial interest or material indirect financial interest in the enterprise or (b) during the period of his professional engagement, at the time of expressing his opinion or during the period covered by the financial statements, was connected with the enterprise as a promoter, underwriter, voting trustee, director, officer, or key employee . . . ."[2]

Due Professional Care:

The third general standard requires that due professional care be exercised during the audit. "The exercise of due care requires a critical review of supervision of the work done at every level and of the judgment exercised by those assisting in the examination - in other words, what the independent auditor does and how well he does it".

A paragraph appearing in Cooley on Tarts often cited by attorneys in discussing due care merits quotation here:

"Every man who offers his service to another and is employed assumes the duty to exercise in the employment such skill as he possesses with reasonable care and diligence. In all these employments where peculiar skill is a prerequisite, if one offers his service, he is understood as holding himself out to the public as possessing the degree of skill commonly possessed by others in the same employment, and, if his pretentions are unfounded, he commits a species of fraud upon every man who employs him in reliance on his public profession. But no man, whether skilled or unskilled, under-

takes that the task he assumes shall be performed successfully, and without fault or error. He undertakes for good faith and integrity, but not for infallibility, and he is liable to his employer for negligence, bad faith or dishonesty, but not for losses consequent upon pure errors of judgment."[3]

Standards of Field Work

The three standards of field work require that the work be adequately planned and assistants should be properly supervised; there should be a proper study of internal contol; and there should be sufficient evidential matter.

Planning the Audit:

The first standard of field work recognizes that early appointment of the auditor has advantages to both the auditor and the client. This permits the auditor to perform some of the audit work during the year. This preliminary work benefits the client in that it allows the work to be done in a more efficient manner and to be completed at an early date after year end.

All assistants must have proper supervision and the assistant's work must be reviewed by a superior. The final responsibility for the audit rests with the supervising partner and he must use his judgment as to the degree of supervision.

Evaluation of Internal Control:

"Internal control comprises the plan of organization and all of the coordinate methods and measures adopted within a

business to safeguard its assets, check the accuracy and reliability of its accounting data, promote operational efficiency, and encourage adherence to prescribed managerial policy."[4]

It should be pointed out that internal control is not only concerned with matters concerning accounting but it goes to all aspects of the company's operations.

Since the auditing procedures will vary from company to company, the auditing procedures must also vary from company to company.

The auditors will notify management of weaknesses in internal control but it is management's responsibility to establish and enforce good internal control. Although a weakness in internal control will cause the auditor to adapt procedures to fit the circumstances, it would not affect his opinion on the fairness on the statements and it would not be noted in the auditor's report.

Evidential Matter:

The third standard of field work requires that sufficient evidence be obtained through inspection, inquiries and confirmation to support the basis for the opinion. Most of the auditor's work in arriving at his opinion consists of obtaining and evaluating evidential matter. The auditor must use his judgment

in determining the validity of the evidence.

Reporting Standards

The reporting standards govern the preparation of the auditor's report. Of the four standards, two of them have been discussed previously and the remaining two will be discussed in greater detail later in the report. The four standards as taken from Statements on Auditing Procedure No. 33 by the Committee on Auditing Procedure of the American Institute of CPA's are as follows:

1. The report shall state whether the financial statements are presented in accordance with generally accepted principles of accounting.

2. The report shall state whether such principles have been consistently observed in the current period in relation to the preceding period.

3. Informative disclosures in the financial statements are to be regarded as reasonably adequate unless otherwise stated in the report.

4. The report shall contain either an expression of an opinion regarding the financial statements taken as a whole or an assertion to the effect that an opinion cannot be expressed. When an overall opinion cannot be expressed, the reasons therefore should be stated. In all cases where an auditor's name is associated with financial statements, the report should contain a clearcut indication of the character of the auditor's examination, if any, and the degree of responsibility he is taking.

In Our Opinion

People outside the accounting profession sometimes believe

that the auditor's reports are statements of fact rather than opinions. This could be due to the popular misconception that auditors deal with facts and figures. Actually an auditor can seldom claim something is fact. He may state as a matter of fact that he has investigated the records of the company, but he cannot even claim that he has made an adequate investigation. The auditor cannot even state that securities of a company are correct because he cannot be certain that the securities belong to the company, that the securities are not forgeries or that the records he has used to check the securities are correct. He may feel sure in these matters but they are still only opinions.

In the Ultramares case, the court stressed the point that the auditors had made a statement to be true to their knowledge when they had no knowledge of the subject. From this the accounting profession came to realize that the auditor's responsibility for statements of fact was greater than for statements of opinion. Therefore, it is important for the auditor to make it clear in his report that he is expressing an opinion.

> "The unqualified opinion is not a stamp of approval from a credit or investment viewpoint and should never be mistaken for one. A company may or may not be a good investment risk, but it is not for the independent auditor to make such a determination; his function is to express an opinion of the fairness of the financial information presented."[5]

The phrase "in our opinion" should be clearly connected to all parts of the report which are expressions of opinion. When you are referring to plant additions, depreciation, inventories, etc., it is important that they be connected to the phrase "in our opinion".

In Accordance With
Generally Accepted Accounting Principles

In recent years attempts have been made to formulate comprehensive statements of accounting principles. The American Institute's Committee on Accounting Procedure issues a series of accounting bulletins and the Institute's Accounting Principles Board issues opinions to help practicing accountants decide whether a procedure is generally accepted. The Securities and Exchange Committee also has a series of accounting releases.

There is no one comprehensive book of principles which the accountant may consult to find what is generally accepted. It is probably unlikely that such a book could ever be assembled which would be authoritative, exhaustive and permanent. Accounting must be able to adapt to the many different types of businesses and specific situations. It must be judged by the accountant rather than a mechanical application of fixed rules. Therefore, the accountant must be aware of accountant literature and pass judgment on the par-

ticular practice.

The phrase "in accordance with generally accepted accounting principles" has come into general use in the auditor's reports since 1933 when it was a part of the form of the suggested wording of the report to be used with annual statements submitted to the shareholders by corporations listed on the New York Stock Exchange. The auditor must be sure that the accounting principles are sound for the particular case and he must be sure that they are generally accepted.

The auditor may be confronted with a difficulty when the company is using practices which have not received authoritive sanction or in phrasing his report when alternative practices have not been recognized as acceptable. The Securities and Exchange Commission has issued the following statement of administrative policy:

> "In cases where financial statements filed with this commission pursuant to its rules and regulations under the Securities Act of 1933 or the Securities Exchange Act of 1934 are prepared in accordance with accounting principles for which there is no substantial authorative support, such financial statements will be presumed to be misleading or inaccurate despite disclosures contained in the certificate of the accountant or in footnotes to the statements provided the matters involved are material. In cases where there is a difference of opinion between the Commission and the Registrant as to the proper principles of accounting to be followed, disclosure will be accepted in lieu of correction of the financial statements themselves only if the points involved are such that there is substantial authorative support for the practices followed by the registrant and the position of the

> commission has not previously been expressed in rules, regulations or other official releases of the commission, including the published opinions of its chief accountant."[6]

There are so many generally accepted accounting methods that financial statement presentations can vary significantly depending upon the practices that are adopted. The AICPA has taken steps to reduce the number of alternative accounting principles and methods. This has been done in the following ways as shown in the Auditor's Report, page 13:

1. In 1959 a research group was formed under a new director of accounting research for the purpose of issuing a new director of accounting research studies to provide professional accountants and others interested in the development of accounting with an informative discussion of accounting problems under review. The studies also furnish a vehicle for the exposure of matters for consideration and experimentation prior to the issuance of pronouncement by the Accounting Principles Board (also formed at the same time).
2. It is recognized that opinions of the Accounting Principles Board could not bind the business community because other authorative support may exist for principles not accepted by the Board. The AICPA declared in 1964 that when

financial statements employ accounting principles that depart from those prescribed by an official APB opinion, Institute members issuing reports would be required to take exception to the practices followed. If substantial authoritative support exists, the auditor must see that the effects of the departure from the APB opinion is disclosed in the footnotes to the financial statements or in the auditors report.

These efforts will narrow the range of alternatives permitted in "generally accepted accounting principles" and help the financial statements to be more comparable. Mr. Marvin L. Stone, the past president of the American Institute has commented: "Soundness also provides a more meaningful guide in the move to eliminate unwarranted differences in final reporting -- the drive to making like things look alike and different things look different".[7]

Certain accounting practices are peculiar to individual industries. When there are exceptions to the principles generally accepted, the accountant must give careful consideration as to whether the financial statements could be misleading. Some accountants will vary the language of their reports when there is a practice generally followed in the industry to read "in conformity with principles of

accounting generally accepted in the industry". Under such circumstances the Securities and Exchange Commission has asked the accountant to state how the principles have differed from generally accepted principles and to express an opinion on the principles that were followed.

It should be pointed out that generally accepted accounting principles may at times conflict with practices that are permitted by state statutes or other authorities. There may be no legal prohibition of the payment of dividends from capital surplus when there exists a balance of earned surplus but the Securities and Exchange Commission has questioned such a procedure. Another example is where an investment company under authority of specific provisions in the trust indenture credits to income the proceeds from the sale of stock dividends and rights received. In cases like this, the accountant should make an explanation in his report indicating his opinion as to how it should have been handled. The former chief accountant of the Securities and Exchange Commission has expressed the opinion that permission of the law does not make a practice good accounting.

Applied on a Basis

Consistent with that of the Preceding Year

When a material change has been made in accounting principles or its application, the accountant should disclose the change and he should consider the possibility of giving the effect in dollars on the comparability of financial statements. The former Chief Accountant of the Securities and Exchange Commission said:

> "It is material whether a change in the rate of depreciation or a change in the policy of amortizing debt discount and expense should be considered a change in principle or merely a procedural change. If the changes will materially affect comparisons, they must be clearly revealed in order that the statements may not be misleading."[8]

Registration statements under the Securities Act of 1933 include statements of earnings for the last three years. Many times a company has made changes in accounting practice which would affect the comparison of the three years of statements with each other. The auditor may also uncover practices which should be changed to sound generally accepted accounting principles. When the company has already published such statements, it must face the question of dealing with the inconsistency. The financial statements should be consistent for all three years and they should be in accord with sound practice but any difference between any previously published figures may be explained in footnotes so that the auditor's exception,

which he is required to make, can be accomplished by a footnote.

It should be pointed out that certain changes affecting the comparability of financial statements between years do not require any disclosure in the auditor's report. For example, there may be a change in conditions unrelated to accounting, such as the acquisition of a new subsidiary or business or the sale of a division or plant or a product line.

Qualified Opinions, Adverse Opinions and Disclaimers of Opinion

The auditor's report that we have been considering up to this point, has been the unqualified or clear opinion. Ideally, every audit examination could be given a clean opinion but, when this cannot be done, the auditor must issue a qualified opinion, an adverse opinion or disclaim an opinion.

Qualified Opinion

There are two types of qualified opinions. They are the "subject to" opinion and the "except for" opinion.

The "subject to" opinion is used where the outcome of some material unresolved matter is dependent upon future developments or decisions outside the control of management. An example is the

pending lawsuit concerning the collection of a disputed receivable or a contested federal income tax return. "Subject to" opinions cannot be verified by auditing. When the auditor writes his opinion, he will note the unresolved matter and, if possible, disclose the aggregate amount.

An "except for" qualification may indicate that the auditor is not in agreement with one of the accounting principles that the company used in their financial statements. Another example would be when an auditor is unable to satisfy himself in a first-time audit as to inventory quantities at the beginning of the year which were not observed. In this type of qualification, the auditor would normally explain in his report the reasons for qualifications and the approximate amount involved on the financial statements.

Disclaimer of Opinion

The auditor may find that there are great uncertainties about the financial statements or that there are extensive limitations on the scope of the audit, or that the records are so inadequate that the auditor cannot form an opinion on the overall statements. The auditor would then have to indicate his reasons for disclaiming his overall opinion.

The auditor must use his judgment. If the auditor did not be-

lieve the amount were material enough, he would issue a "subject to" opinion but when the amount is quite material, the auditor would issue a "disclaimer of opinion".

Adverse Opinion

An adverse opinion is one that states that the financial statements do not present fairly the financial position of the company. An adverse opinion does not happen often because the auditor can usually persuade the client to correct the matter.

The adverse opinion is usually issued when the auditor is not in agreement with one of the accounting principles used by the company or when there are scope limitations. The adverse opinion results for the same reasons as the "subject to" opinion but the adverse opinion is given when the amount is so material that a qualified opinion cannot be given.

> "An adverse opinion is required in any report where the exceptions as to fairness of presentation are so material that in the independent auditor's judgment a qualified opinion is not justified. In such circumstances a disclaimer of opinion is not considered appropriate since the auditor has sufficient information to form an opinion that the financial statements are not presented fairly."[9]

When the auditor must issue an adverse opinion, he should include an explanatory middle paragraph.

Signature

Accounting firms will usually sign the report with the firm name without any regard to the individual partner in charge. Occasionally a government bureau or state commission will also require the partner in charge to sign his own name with the firm name.

Footnotes -- Section II

1. American Institute of Certified Public Accountants. Statement on Auditing Procedure No. 33, A statement issued by the committee on Auditing Procedure of the American Institute of Certified Public Accountants. New York: American Institute of Certified Public Accountants, Inc., 1963.

2. American Institute of Certified Public Accountants. Code of Professional Ethics. New York: American Institute of Certified Public Accountants, 1969.

3. American Institute of Certified Public Accountants. Statement on Auditing Procedure No. 33, Loc. Cit. p. 21.

4. American Institute of Certified Public Accountants. Statement on Auditing Procedure No. 33, Loc. Cit. p. 27

5. National Conference of Bankers and Certified Public Accountants. The Auditor's Report, A statement prepared by the Certified Public Accountant Members of National Conference of Bankers and Certified Public Accountants. July 1967.

6. Securities and Exchange Commission. Accounting Series Release No. 4, April 25, 1938, as cited by Montgomery, Robert H., Auditing Theory and Practice. 6th ediction. New York: The Ronald Press Company, 1940.

7. Letter from Herrick, Anson. Journal of Accountancy, v. 127, (June 1969) p. 30.

8. Blough, Carmon G., "Accountant's Certificates", Journal of Accountancy, v. 115, (February 1938).

9. American Institute of Certified Public Accountants. Statement on Auditing Procedure No. 33, Loc. Cit. p. 59.

PROBLEMS WHICH REQUIRE

A DEPARTURE FROM THE STANDARD

In the remainder of this paper, the author is going to discuss the short form opinions and suggested wording of the report under specific circumstances. It would be impossible to try to include suggested wordings for every conceivable circumstance that could arise. This paper will merely try to discuss the more common circumstances.

Consistency

The second standard of reporting reads: "The Report shall state whether such principles have been consistently observed in the current period in relation to the preceding period."[1]

A change in accounting principles used would affect the comparability of the financial statements. Examples are a change from straight line depreciation to the declining balance method or a change from the cash basis to the accrual basis.

When a change in accounting principles employed has changed and the change has a material affect on the statements, the auditor should refer to a note in the financial statements or he should describe the change and its effect in his report. If the change affects net income, the auditor should include the amount that the change

has caused in net income.

Change from one Accepted Principle to another Accepted Principle

If the client makes a change from the use of one generally accepted principle to another generally accepted accounting principle, the change should be footnoted to the financial statements and the auditor should refer to the footnote in his opinion. Although it is assumed that the auditor approves the change, he may wish to express his approval of the change. The suggested wording follows:

> "... in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year, except for the change, which we approve, in pricing of inventories, as described in Note 1 to the financial statements."

Change from Principle which lacks Acceptance to one that Does

The company may decide to change from a principle which lacks acceptance to a generally accepted accounting principle. In situations like this the auditor may wish to express approval and the above illustrated wordings would be appropriate.

Change to a Principle which lacks Acceptance

When a company changes from a generally accepted principle to one which lacks acceptance, the auditor should state this in his report when the amount is material. The auditor would have to give a qualified opinion, which is illustrated below:

"In our opinion, except for (brief description of the change and its effect) as explained in Note 1, a practice which we believe is at variance with generally accepted principles, the accompanying statements present fairly the financial position of X Company at October 31, 1972, and the results of its operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year."

When the change is sufficiently material, the auditor must give and adverse opinion. The auditor cannot disclaim an opinion because he has completed his examination and he has an adverse opinion, such as the following:

"The company has heretofore followed the practice of (brief description of prior practice) and has now adopted the practice of (brief description of new practice). As a result of this change, reported net income for the year ended October 31, 1972, and retained earnings of that date, are each $_____ greater than they otherwise would have been.

In view of materiality of the effect of above noted change to a practice which we believe is at variance with generally accepted accounting principles, we are of the opinion that the financial statements do not present fairly the financial position of X Company at October 31, 1972, or the results of operations for the year then ended in conformity with generally accepted accounting principles."

Change in Accounting but not in Accounting Principles

Conditions may arise which will necessitate an accounting change but in which accounting principles would not change. An example is a change in the estimated life of plant property. It should be disclosed in a note to the financial statements. Ordinarily

you would not have to comment on it in the report but the SEC may disagree.

"With respect to financial statements filed with the Securities and Exchange Commission, regulation S-X requires the independent auditor to disclose in his report, and express his opinion of any material changes in accounting principles or practices or methods of applying them which affect comparability, or any material retroactive adjustments of the accounts, as described in the applicable rules."[2]

Changed Condition Unrelated to Accounting

Comparability of financial statements may be affected with a changed condition unrelated to accounting. An example is the acquisition of plant or the adoption of a pension plan. This may require a note to the financial statements but it is rarely commented upon in the auditor's report.

Reclassifications

A reclassification may cause problems with the comparability of financial statements. If the reclassification is material, an explanatory note should be attached to the statements but the auditor does not have to refer to the note in his report.

Accounting Changes in Previous and Future Years

When the auditor's report covers the statements of more than two years, you should not disclose an inconsistently with periods prior to the years being presented. If the statements are presented

for more than two years, "applied on a consistent basis 'or' consistently applied during the period" should be substituted for "on a basis consistent with that of the preceding year".

If a change is made in the accounting principles that has no material effect on the statements for the current year but, which will affect future years, it should properly be disclosed in a note in the current year. An example of such a note follows:

"It has been the consistent practice of the company to provide for the depreciation of properties on a straight line basis over their estimated useful lives. Commencing with the current year, the company is providing for depreciation on new additions to property on the declining balance method. This change has no effect on the current financial statements."

When such a note is disclosed, the auditor need not mention it in his report.

When the auditor reports on the first period of a new company, he does not have to make any reference to consistency. If it is his first report on an established company, he should extend his procedures to assure that consistency has been followed. The client may impose limitations on the client or the records may be inadequate and the auditor may not be able to give a clean opinion because of the inconsistency application and the balances at the beginning of the year, which would affect the statement of income. If this is the case, the auditor must give a qualified report as follows:

"... and such other auditing procedures as we considered necessary in the circumstances, except as indicated in the following paragraph.

Because of major inadequacies in the company's accounting records for the previous year, it was not practical to extend our auditing procedures sufficiently to enable us to express an opinion on the statements of income and retained earnings for the year ended or on the consistency of application of accounting principles with the preceding year.

In our opinion, the accompanying balance sheet presents fairly the financial position of the X Company as of December 31, 1972, in conformity with generally accepted accounting principles."

If the accounting records of prior years were kept on a basis which did not result in a fair presentation for prior years, but the current year is fairly presented, the auditor would not refer to consistency and he could give a report like the following:

"The company has kept its records and has prepared its financial statements for previous years on the cash basis with no recognition having been accorded, accounts receivable, accounts payable, or accrued expenses. At the beginning of the current year the company, with our approval, adopted the accrual basis of accounting, and, appropriate adjustments, where material, have been made to retained earnings as of the beginning of the year.

In our opinion, the accompanying balance sheet and statements of income and retained earnings present fairly the financial position of the X Company as of October 31, 1972, and the results of its operations for the year then ended, in accordance with generally accepted accounting principles."

Scope of Examination

There may be circumstances which would make it impossible or impracticable for the auditor to follow normal auditing procedures. When this occurs, the auditor does not have to qualify his opinion if he can satisfy himself by other auditing procedures. If the auditor cannot satisfy himself by other auditing procedures, he may have to give a qualified opinion or disclaim an opinion. An example of a qualified opinion follows:

"We have examined the balance sheet of XYZ Company as of September 30, 1972, and the related statements of income and retained earnings for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such other auditing procedures as we considered necessary in the circumstances, except as stated in the following paragraph:

Because we were not engaged as auditors until after September 30, 1972, we were not present to observe the physical inventory taken at that date and we have not been able to satisfy ourselves concerning inventory quantities by other procedures. The beginning inventory has a significant effect on the results of operations for the year. Therefore, we do not express an opinion on the accompanying statements of income and retained earnings for the year ended September 30, 1963.

In our opinion, the accompanying balance sheet presents fairly the financial position of the company at September 30, 1963, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year."

A qualified opinion may be given when the client imposes a restriction on the auditor. An example follows:

"... and such other auditing procedures as we considered necessary in the circumstances, except as noted in the following paragraph.

In accordance with your instructions, we did not request any owners to confirm their balances of accumulated storage charges. Accordingly, we do not express an opinion as to accumulated storage charges, stated as $5,000, which amount enters into the determination of financial position and results of operations.

In our opinion, with the exception stated in the preceding paragraph, the accompanying . . . ."

The amount stated may be of such importance that the auditor will have to disclaim an opinion on the financial statements as a whole. For example, the report may read:

"... and such other auditing procedures as we considered necessary in the circumstances, except as noted in the following paragraph.

In accordance with your instructions we were not in attendance at the taking of the physical inventory as of November 30, 1972. Accordingly, we do not express an opinion concerning such inventory stated at $10,000.

Because the inventory at November 30, 1972, enters materially into the determination of the financial position and results of operations, we do not express an opinion on the accompanying financial statements taken as a whole."

Lack of Conformity with Generally Accepted Accounting Principles

When financial statements deviate materially from generally accepted accounting principles, the auditor must use his judgment

to determine if it is material. If he considers it to be material, he must give a qualified report such as the following:

> "Although the proceeds of sales are collectable on the installment basis over a five year period, revenue from such sales is recorded in full by the company at time of sale. However, for income tax purposes, income is reported only as collections are received and no provision has been made for income taxes on installments to be collected in the future as required by generally accepted accounting principles. If such provisions had been made, net income for 1972 and retained earnings as of December 31, 1972, would have been reduced by approximately $_____ and $_____, respectively, and the balance sheet would have included a liability for deferred income taxes of approximately $_____.
>
> In our opinion, except that provision has not been made for additional income taxes as described in the foregoing paragraph, the accompanying financial statements present fairly . . . ."

If the auditor feels that the amounts are sufficiently material, he would give an adverse opinion. He would have to include the first paragraph illustrated above and the following opinion paragraph:

> "Because of the materiality of the amounts omitted, income taxes as described in the preceding paragraph, we are of the opinion that the financial statements do not present fairly the financial position of X Company at December 31, 1972, or the results of its operations for the year then ended in conformity with generally accepted accounting principles."

Inadequate Disclosure

All information that is necessary for a fair presentation should be included in the financial statements. When the client does not disclose all the necessary information in his statements, the auditor

ing financial statements present fairly . . . .

NOTE A: The Company is presently contesting deficiency in consolidated federal income taxes proposed by the Internal Revenue Service for the years 1969 to 1970, inclusive in the aggregate amount of $_____, exclusive of interest. The point in question is one on which there are conflicting federal court decisions and one which further litigation may be required; consequently, it is impossible to determine the extent of the Company's liability, if any, at this time. No provision has been made for this contingent liability."

At times, there may be a question as to valuation or relizability of assets dependent upon management's judgment, which may require a qualification. Again, the "subject to" qualification would be appropriate.

"In our opinion, subject to the successful conclusion of X project and ultimate recovery thereby of the related deferred research and development costs in the amount of $_____ described in Note ___ the accompanying financial statements . . . ."

In some instances where the outcome of a matter is uncertain, the amount may be so material that a qualification is not appropriate.

An example would be when the client company is being sued for an amount that is very large in relation to its assets. In these cases, it can be explained in a middle paragraph and the necessary disclaimer of opinion could read as follows:

"Because of the possible material affect on the financial statements of the above mentioned lawsuit, the outcome of which is uncertain, we do not express any opinion on the company's financial statements taken as a whole."

Opinions on Prior Years' Statements

When financial statements for prior years are presented for comparative purposes and the auditor has not made an examination of the prior statements, the auditor should make an appropriate disclosure in his report. If he has examined the prior statements and he has reservations, he should point this out in his report. In cases where he has examined the prior statements and found them to be correct, he would mention this in the report.

Subsequent Events

The auditor is responsible for the period subsequent to the balance sheet date. The Institute's Committee on Auditing Procedure emphasized that there is no predetermined period after the balance sheet date with which the auditor must be concerned in completing various phases of his examination, including his review of subsequent events. It stated that the duration will depend upon the practical requirements of each examination. However, the Committee indicated that generally the period extends from the balance sheet date to approximately the date of completion of all important procedures. It also recommended that this date normally should be used as the date of the auditor's report.

In addition, the Securities Act of 1933 extends the period of time with which the auditor has a responsibility for subsequent events to the effective date of the registration statement. Section 11 of the Securities Act of 1933 provides in effect that among other persons no independent auditor shall be liable, as provided therein, if such auditor shall sustain the burden of proof that as to the part of the registraion statement purporting to be made on his authority as an expert.

> "... he had, after reasonable investigation, reasonable ground to believe and did believe, at the time of such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading ... ."[3]

One kind of subsequent event is a type that would directly affect the financial statements. When subsequent information become available on conditions which existed at the balance sheet date which management would have used had it been available, management should make proper adjustments of the financial statements. For example, collection of receivables, settlement or determination of liabilities on a substantially different basis from that anticipated, or a loss on an uncollectable account receivable as a result of bankruptcy would all indicate conditions which existed at the balance sheet date and would require adjustment of the financial

statements. On the other hand, a loss which was caused by a customer's flood or fire subsequent to the balance sheet date would not require an adjustment because it was not a condition which existed at the balance sheet date.

There may be subsequent events which provide conditions that did not exist at the balance sheet date but that took place subsequent to the date of the balance sheet. Since these conditions developed after the balance sheet date, they may be of such importance that disclosure would be in order. Examples of this type of subsequent event are the sale of bonds or capital stock, the purchase of a business, settlement of litigation which took place after the balance sheet date, the loss of plant or inventories by a casualty, and the loss of receivables from conditions arising after the balance sheet date. The auditor will have used his better judgement in deciding whether a footnote or pro forma statements would be proper in the particular situation. When pro forma statements are to be issued, the auditor will usually issue the pro forma balance sheet only in columnar form on the face of the historical statements.

The last type of subsequent event would not require adjustment of the financial statements or a footnote. Disclosure of this type may create false doubts about the statements which could be more

misleading than disclosure of the event. Examples of this type of subsequent event are war, legislation, management changes, product changes, strikes, unionization, and loss of customers.

There may be cases where the subsequent event requiring disclosure or adjustment occurs after the completion of field work but before the issuance of the report. If an adjustment is made without disclosure, the date of completion of field work can be used. If disclosure of the event is made, the auditor can use the date the disclosure is made, which extends the auditor's liability for subsequent events to this date. Dual dating, "February 15, 1972, except for Note 1 as to which the date is March 1, 1972", extends the auditor's liability to March 1 to the specific event in Note 1.

The auditor may be asked to reissue his report or to furnish additional copies of his report. The auditor can use the original report date, which should make it clear that the transactions are unaudited after this date, to relieve him of the responsibility of making a further investigation. If an important subsequent event has occurred, the auditor should disclose it and he could date it as shown in the previous paragraph. Also, he could use the original date of the report and attach a note to the financial statements with a heading such as the following: "Even (unaudited) Subsequent to the Date of the Report of Independent Auditor."

Subsequent Discovery of Facts Existing

at the Date of the Auditor's Report

When the auditor discovers subsequent information that existed at the date of his report which has been issued, he should immediately notify the client and they should revise financial statements with a new report. The reasons for the revisions should be noted in the statements and referred to in the auditor's report. Generally, only the current year's statements have to be revised even if the event occurred in prior years.

The effect on the financial statements of the subsequent information may not be known until a complete investigation has been made. In this case the client should notify people who are relying on or people who may rely on the financial statements that they are incorrect and that new statements will be issued after an investigation. The client should also discuss the matter with the Securities and Exchange Commission and other regulatory bodies who have the statements.

If the client will not cooperate with a thorough investigation, the auditor should disclose the information but he should not give any specific detailed information. He should merely indicate that information has come to his attention which the client will not

cooperate in investigating, and the auditor believes his report should no longer rely on or associate with the statements.

The client company may refuse to make adequate disclosure of the information. Then, the auditor should notify his client that his report must no longer be associated with the statements and he should notify the appropriate regulatory agencies. He should also notify all persons known to be relying upon the statements, but, if this is not practical, he should notify the securities and exchange commission and probably a lawyer.

Unaudited Statements

A certified public accountant becomes associated with unaudited financial statements, whenever he permits his name to be used in a report, document, or written communication containing the statements he prepares or assists in preparing. This association exists even if he does not attach his name or uses plain paper rather than his own stationery. However, he is not associated with the statements if he types on plain paper or reproduces the statements as long as he gives them to the client only and he does not assist in preparing them.

When the auditor becomes associated with the unaudited financial statements, he must point out this:

"The committee believes that a disclaimer of opinion should accompany unaudited financial statements with which the certified public accountant is associated. The disclaimer of opinion is the means by which the certified public accountant clearly indicates the fact that he has not audited the financial statements and accordingly does not express an opinion on them."[4]

An example of a disclaimer follows:

"The accompanying balance sheet of X Company as of December 31, 1972, and the related statements of income and retained earnings for the year then ended were not audited by us and accordingly we do not express an opinion on them."

"Signature"

This disclaimer can be placed directly on the financial statements. In addition to the disclaimer, each page of the statements should be clearly and conspiciously marked as unaudited.

The certified public accountant may find that the unaudited statements are not in conformity with generally accepted accounting principles. The auditor should insist that they be corrected or he should note this in his report even though they are unaudited. However, if the client has prepared the statements for internal use only, he would not have to mention this in his report because all footnotes and disclosures would not be necessary but the auditor should then note in his disclaimer that they are for internal use only.

Any auditing procedure which the auditor has performed should not be reported in the disclaimer because it may lead someone to

believe that an audit was performed. However, in letters to underwriters or other special letters, it may be appropriate to point out auditing procedures that the auditor has completed.

Companies will usually include financial statements of prior years for comparative purposes with the current year. Paragraph 48 of Chapter 10 of Statements on Auditing Procedure No. 33 states that where the independent auditor "has not made an examination of the prior years' statements, there should be appropriate disclosure in the statement or in the auditor's report". The statements should be clearly and conspiciously marked as unaudited, or a disclaimer such as the following should be included:

> "We did not examine the financial statements for the year 1972 and accordingly do not express an opinion on them."

This disclaimer would not be necessary if the statements are marked as unaudited because the opinion is limited to the current year. Paragraph 48 of Chapter 10 of Statements on Auditing Procedure No. 33 also states that the auditor should make appropriate disclosure in his report when he has significant exceptions or reservations as to the prior years statements.

When the client will not agree to revisions or the auditor's disclaimer, the certified public accountant should refuse and, if necessary, withdraw from the engagement. The auditor should refuse

to type, reproduce or do anything with financial statements that he believes are false.

Reporting when not Independent

The second general standard requires that the independent public accountant be independent and unbiased toward the client. If he is not independent, the audit is not in accordance with generally accepted auditing procedures and he cannot express an opinion on them.

The accountant would have to disclaim an opinion on the financial statements. The auditor should state that he is not independent in his report but he should not state why he is not independent and he should not describe any auditing procedures because it would confuse the reader. The recommended disclaimer is as follows:

> "We are not independent with respect to XYZ Company, and the accompanying balance sheet as of December 31, 1972, and the related statements of income and retained earnings for the year then ended were not audited by us; accordingly, we do not express an opinion on them."

This disclaimer can be used regardless of the extent of services performed. Also, each page of the financial statements should be clearly and conspicuously marked "Unaudited -- see accompanying disclaimer of opinion".

Again, if the statements are not in conformity with generally

accepted accounting principles or do not include adequate disclosure, the auditor should insist upon revision. When the client will not accept the revision, the auditor must point it out in his report. If the client does not accept the report, the auditor should refuse to be associated with the statement and, if necessary, withdraw from the engagement.

Using the Work and Reports of Other Auditors

The auditor must first decide whether his participation would be adequate enough to allow him to serve as the principal auditor and to report on the financial statements as a whole. In arriving at a conclusion, the auditor must consider the materiality of the portion of the financial statements he has examined in comparison with that examined by other auditors, the extent of his knowledge of the overall financial statements and the importance of the part he examined in relation to the business as a whole.

If the auditor decides that it is appropriate for him to serve as the principal auditor, he must then decide whether he will make reference in his report to the work done by another auditor. If the auditor decides to assume responsibility for the work of the other auditor, he should not make a reference in his report. On the other hand, when the auditor decides not to assume responsibility, he

should make a reference in his report which would clearly indicate the division of responsibility. In either case, the other auditor is responsible for his own work and report.

The principal auditor may decide not to make a reference to the other auditor's work. As pointed out in Statement on Auditing Procedure No. 45, p. 93, the principal may adopt this position only when:

1. Part of the examination is made by another independent auditor which is an associated or correspondent firm and whose work is acceptable to the principal auditor based on his knowledge of the professional standards and competence of that firm; or
2. The other auditor was retained by the principal auditor and the work was performed under the principal auditor's guidance and control; or
3. The principal auditor, whether or not he selected the other auditor, nevertheless takes steps he considers necessary to satisfy himself as to the other auditor's examination and accordingly is satisfied as to the reasonableness of the accounts for the purpose of inclusion in the financial statements on which he is expressing his opinion; or
4. The portion of the financial statements examined by the other

auditor is not material to the financial statements covered by the principal's opinion.

It may be impracticable for the principal auditor to review the work of the other auditor. The report then, should clearly indicate in both the scope and opinion paragraph the division of responsibility. (The auditor will want to dollar amount the other auditor's work.) The other auditor can be named but only with his express permission and his report is presented together with the principal auditor's report. The Securities and Exchange Commission has stated the following in respect to this problem:

"If, with respect to the certification of the financial statements of any person, the principal accountant relies on an examination made by another independent public accountant of certain of the accounts of such person or its subsidiaries, the certificate of such other accountant shall be filed ... ; however, the certificate of such other accountant need not be filed: (a) if no reference is made directly or indirectly to such other accountant's examination in the principals accountant's certificate; or, (b) if having referred to such other accountant's examination, the principal accountant states in his certificate that he assumes responsibility for such other accountant's examination in the same manner as if it had been made by him."[5]

The suggested wording for the report when the principal auditor makes reference in his report follows:

"We have examined the consolidated balance sheet of X Company and subsidiaries as of December 31, 1972, and the related consolidated statements of income and retained earnings and of changes in financial position for the year then ended. 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. We did not examine the financial statements of B Company, a consolidated subsidiary, which statements reflected total assets and revenues constituting 20 percent and 22 percent respectively, of the related consolidated totals. These statements were examined by other auditors whose report thereon has been furnished to us and our opinion expressed herein, insofar as it relates to the amounts included for B Company, is based solely upon the report of other auditors.

In our opinion, based upon our examination and the report of other auditors, the accompanying consolidated balance sheet and consolidated statements of income and retained earnings and of changes in financial position present fairly .... ."

When there are two or more auditors in addition to the principal auditor, the percentages may be stated in the total amount. This reference should not be taken as a qualification of the opinion but as an indication of the divided responsibility.

When the opinion of the other auditor is qualified, the principal auditor must decide whether the qualification is material in relation to the financial statements as a whole. If it is not material and the other auditors report is not presented, the principal auditor does not have to mention anything in his report. If the other auditors report is presented, the principal auditor should make a reference to it in his report.

Footnotes -- Section III

1. American Institute of Certified Public Accountants. Statement on Auditing Procedure No. 33. A Statement issued by the Committee on Auditing Procedure of the American Institute of Certified Public Accountants. New York: American Institute of Certified Public Accountants, Inc., 1963, p. 42.

2. Ibid. p. 44.

3. Ibid. p. 78.

4. Ibid. p. 54.

5. Securities and Exchange Commission. Rule 2-05 of Regulation S-X as cited by the American Institute of Certified Public Accountants. Statement on Auditing Procedure No. 45. A Statement issued by the Committee on Auditing Procedure of the American Institute of Certified Public Accountants. New York: American Institute of Certified Public Accountants, Inc., July, 1971.

SUMMARY

Before 1917, there was no uniformity in short form reports issued by the public accountant. During 1917, a uniform short form opinion was approved and became widely accepted. As the years went by, the short form opinion was frequently changed to fit the current needs. In 1948, the opinion was changed to the one that is presently being used.

The short form of report consists of a concise statement of the scope of an auditor's examination and an expression of an opinion regarding the financial statements. The short form opinion is usually the only statement of the auditor which is published. Because of the reliance of the investing and lending public on the short form report, the working and content of the report are extremely important. In the second chapter of this paper, the investigator has analyzed the precise meanings of phrases and sections of the present short form opinion.

There may be times when the short form opinion may not be proper in the circumstances. In these cases, the auditor will have to modify the opinion to fit his needs. The last section of this paper discusses some of the situations which would require a change in the report and the suggested wording for a specific situation. The

report must be adapted to fit each particular situation. This section of the paper has not attempted to discuss every circumstance that could arise; it merely points out some of the cases that could occur and the suggested wording.

BIBLIOGRAPHY

Holmes, Arthur W. Auditing Principles and Procedure. 3rd Edition. Chicago: Richard D. Irwin, Inc., 1951.

Kohler, Eric L., and Pettengill, Paul W. Principles of Auditing. 3rd edition revised. New York: McGraw-Hill Book Co., 1932.

Jencko, W. B. Auditing Principles. New York, Toronto and London: McGraw-Hill Book Company, Inc., 1960.

Kohler, E. L. Auditing: An Introduction to the Work of the Public Accountant. 2nd edition. New York: Prentice-Hall, Inc., 1954.

Holmes, Arthur W. Basic Auditing Principles, revised edition. Homewood· Richard D. Irwin, Inc., 1962.

Lenhart, Norman J., and Defliese, Philip L. Montgomery's Auditing. 8th edition. New York: The Ronald Press Company, 1959.

Holmes, Arthur W. Auditing Principles and Procedure. 4th edition. Homewood: Richard D. Irwin, Inc., 1956.

Hansen, Arthur Warren. Auditing: Theory and Its Application. 1st edition. New York and London: McGraw-Hill Book Company, Inc., 1942.

Culley, Roy T., and Bauer, Royal D. M. Auditing. Cincinnati: South-Western Publishing Company, 1953.

Bell, William H., and Johns, Ralph S. Auditing. Revised edition. New York: Prentice-Hall, Inc., 1942.

Holmes, Arthur W. Auditing Principles and Procedures. 5th edition. Homewood: Richard D. Irwin, Inc., 1959.

Bell, William H., and Powelson, John A. Auditing. New York: Prentice-Hall, Inc., 1939.

Bell, William H., and Johns, Ralph S. Auditing. 3rd edition. New York: Prentice-Hall, Inc., 1952.

Byrnes, Thomas W. Baker, K.L., and Smith, C. A. Auditing. New York: The Ronald Press Company, 1948.

Oehler, Christian. Audits and Examinations. New York: Fordham University Press, 1940.

Johnson, Arnold W. Case Problems in Auditing. New York: Rinehart Company, Inc., 1950.

Sherwood, J. F., and Culey, Roy T. Auditing Theory and Procedure. Cincinnati: South-Western Publishing Company, 1940.

Nielsen, Oswald. Cases in Auditing. Homewood: Richard D. Irwin, Inc., 1965.

Meigs, Walter B. Principles of Auditing. Homewood: Richard D. Irwin, Inc., 1953.

Cashin, James A., and Owens, Garland C. Auditing. 2nd edition. New York: The Ronald Press Company, 1940.

Montgomery, Robert H. Auditing Theory and Practice. 6th edition. New York: The Ronald Press Company, 1940.

Stettler, Howard F. Auditing Principles. Englewood Cliffs: Prentice-Hall, Inc., 1956.

Meigs, Walter B. Principles of Auditing. Revised edition. Homewood: Richard D. Irwin, Inc., 1959.

American Institute of Certified Public Accountants. Writing Audit Reports: Short Form. A report prepared by the Professional Development Division. New York: American Institute of Certified Public Accountants, Inc., 1970.

Ecton, William W. Some Notes on Writing Audit Reports. Journal of Accountancy, V. 127, Jan. 1969, pp. 69-71.

American Institute of Certified Public Accountants. Accounting Trends and Techniques. New York: American Institute of Certified Public Accountants, 1969.

Herrick, Anson. Re the Term "In Accordance with Sound Principles". Journal of Accountancy, V. 127, June 1969, p. 30.

Silvoso, Joseph, A., and Bauer, Royal D. M. Auditing. Cincinnati: South-Western Publishing Company, 1965.

American Institute of Certified Public Accountants. The Auditor's Report. A Statement prepared by the Certified Public Accountant members of the National Conference of Bankers and Certified Public Accountants, July 1967.

American Institute of Certified Public Accountants. Statement on Auditing Procedure No. 33. A Statement issued by the Committee on Auditing Procedure of the American Institute of Certified Public Accountants. New York: American Institute of Certified Public Accountants, Inc., 1963.

American Institute of Certified Public Accountants. Statement on Auditing Procedure No. 34. A Statement issued by the Committee on Auditing Procedure of the American Institute of Certified Public Accountants. New York: American Institute of Certified Public Accountants, Inc., 1965.

American Institute of Certified Public Accountants. Statement on Auditing Procedure No. 38. A Statement issued by the Committee on Auditing Procedure of the American Institute of Certified Public Accountants, New York: American Institute of Certified Public Accountants, Inc., 1967.

American Institute of Certified Public Accountants. Statement on Auditing Procedure No. 41. A Statement issued by the Committee on Auditing Procedure of the American Institute of Certified Public Accountants. New York: American Institute of Certified Public Accountants, Inc., 1969.

American Institute of Certified Public Accountants. Statement on Auditing Procedure No. 42. A Statement issued by the

Committee on Auditing Procedure of the American Institute of Certified Public Accountants. New York: American Institute of Certified Public Accountants, Inc., 1970.

American Institute of Certified Public Accountants. Statement on Auditing Procedure No. 43. A Statement issued by the Committee on Auditing Procedure of the American Institute of Certified Public Accountants. New York: American Institute of Certified Public Accountants, Inc., 1970.

American Institute of Certified Public Accountants. Statement on Auditing Procedure No. 45. A Statement issued by the Committee on Auditing Procedure of the American Institute of Certified Public Accountants. New York: American Institute of Certified Public Accountants, Inc., 1971.

American Institute of Certified Public Accountants. Statement on Auditing Procedure No. 47. A Statement issued by the Committee on Auditing Procedure of the American Institute of Certified Public Accountants. New York: American Institute of Certified Public Accountants, Inc., 1971.

American Institute of Certified Public Accountants. Code of Professional Ethics. New York: American Institute of Certified Public Accountants, 1969.