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A STUDY OF THE POSSIBLE EXTENSION OF THE  
CERTIFIED PUBLIC ACCOUNTANT'S ATTEST FUNCTION  
IN CORPORATE ANNUAL REPORTS

BY

ROBERT WAYNE CLARKE  
B.S., Syracuse University, 1961  
M.B.A., Syracuse University, 1962

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I HEREBY RECOMMEND THAT THE THESIS PREPARED UNDER MY  
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THE DEGREE OF DOCTOR OF PHILOSOPHY

C. A. Moyer

In Charge of Thesis

P. Joe DeMarsi

Head of Department

Recommendation concurred in†

C. A. Moyer

Robert A. Mober

P. Joe DeMarsi

W. K. Zinsent

Paul M. Van Dordt

Committee

on

Final Examination†

† Required for doctor's degree but not for master's

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## CHAPTER I

## NATURE OF THE STUDY

The attest function, up to now most prominently identified with the CPA's opinion based on audit of conventional financial statements, can naturally and properly be extended to other areas.<sup>1</sup>

The primary purpose of this study is to examine the possibility of extending the certified public accountant's attest function with respect to information in corporate annual reports. The specific concern of the study is whether the attest function can be extended to include certain additional information in annual reports which is generally not covered by the independent auditor's opinion. The remainder of this chapter is devoted to a brief discussion of the nature of the CPA's attest function, the purpose and scope of the study, and the content of subsequent chapters.

#### The Attest Function

Extensive reference to the CPA's independent audit function as the "attest function" is a relatively recent development in the literature of the profession. Herman W. Bevis indicates that "the attest function results in the expression of an opinion by an independent expert that a

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<sup>1</sup>John L. Carey, The CPA Plans for The Future (New York: American Institute of Certified Public Accountants, 1965), p. 119.



communication of economic data by one party to another is fairly presented."<sup>2</sup> Bevis states further that "discharge of the function in the U. S. is confined largely to the CPA, because of his professional knowledge, skills, stature and other qualifications--including the characteristics of independence, dependability and objectivity."<sup>3</sup>

The CPA's attest function has involved primarily the rendering of opinions on the fairness of financial statement presentations in reports to creditors and investors. This application is typified best by the examination of, and expression of an opinion on the conventional financial statements included in corporate annual reports to stockholders.

The auditor's opinion in today's corporate annual reports is usually confined to the balance sheet, income statement, and statement of retained earnings. During the first thirty years of this century the majority of companies published only a balance sheet, and the auditor's examination was generally restricted to a "balance-sheet audit."<sup>4</sup> Littleton and Zimmerman state that "the changing nature of corporate equity structures from short-term to long-term

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<sup>2</sup>Herman W. Bevis, "The CPA's Attest Function in Modern Society," The Journal of Accountancy, CXIII (February, 1962), 28.

<sup>3</sup>Ibid., 35.

<sup>4</sup>George Cochrane, "The Auditor's Report," The New York Certified Public Accountant, XXI (May, 1951), 319.

sources brought about the now heralded primacy of the income statement."<sup>5</sup> The profession's apparent recognition of the significance of periodic earnings was indicated in the American Institute of Certified Public Accountants bulletin, "Verification of Financial Statements" published in 1929.<sup>6</sup> The scope of the Institute's earlier "auditing bulletins" (1917 and 1918) had been essentially restricted to balance sheets and balance-sheet audits.<sup>7</sup> The requirements for certified financial statements effected by the New York Stock Exchange in 1933, and similar requirements for reporting to the Securities and Exchange Commission under the Securities Acts of 1933-34 probably provided the major impetus for the presentation and certification of the three basic financial statements in most annual reports of the past three decades.<sup>8</sup>

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<sup>5</sup>A. C. Littleton and V. K. Zimmerman, Accounting Theory: Continuity and Change (Englewood Cliffs, N. J.: Prentice-Hall, Inc., 1962), p. 124.

<sup>6</sup>"With the gradually greater emphasis on periodic earnings, the earlier restrictive consideration of the balance-sheet was superseded . . . by according the income account at least equal status." Committee on Auditing Procedure, Statements on Auditing Procedure No. 33 (New York: American Institute of Certified Public Accountants, 1963), p. 94.

<sup>7</sup>Ibid., pp. 92-93.

<sup>8</sup>Most companies whose stock is listed on the New York Stock Exchange are required to include a certified balance sheet, income statement, and statement of retained earnings in their published annual reports. Similar requirements for certified statements exist for certain reports filed with the Securities and Exchange Commission.

In recent years opinion coverage has been extended in some reports to include certain supporting schedules in addition to the basic financial statements and footnotes. But an examination of the results of a recent study indicates that most of the information included in these schedules is included in footnotes or in the body of one of the basic statements, and covered by the auditor's opinion, in other annual reports.<sup>9</sup> The examination of eighty-nine corporate annual reports, the results of which are presented in Chapter II of this study, confirms the latter. The only significant extension of the CPA's attest function in corporate annual reports in recent years has been the increased coverage of the "funds" statement. This development is described in Chapter II.

Several areas for possible extension of the CPA's attest function have been proposed in recent years, ranging from certification of Federal income tax returns to complete management and information system audits. In 1959, the AICPA's Committee on Long-Range Objectives suggested that "it might be useful if certified public accountants attested tax returns, as they do financial statements for stockholders and bank credit purposes."<sup>10</sup> One comparatively re-

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<sup>9</sup>Accounting Trends and Techniques (20th ed.; New York: American Institute of Certified Public Accountants, 1966), p. 25.

<sup>10</sup>"Long-Range Objectives of the Accounting Profession" (official releases), The Journal of Accountancy, CVII (May, 1959), 73.

cent extension of the CPA's attest function is the "compliance examination." This examination results in the expression of an opinion as to a client's compliance with certain Federal laws and regulations.<sup>11</sup>

John L. Carey, Executive Director of the American Institute of Certified Public Accountants, indicates some of the possibilities for extension of the attest function in the following statement:

In the United States, what we now call the CPA's attest function seems likely to expand beyond the expression of opinion on financial statements. Government agencies are already asking CPAs to attest to compliance with regulations as well as to financial data. Under Medicare, CPAs will be asked to attest to the validity of cost-reimbursement claims. In spite of many opinions to the contrary, it seems to me inevitable that at some distant date, perhaps by 1985, some form of attestation of income tax returns will be developed. If supplemental financial statements based on price-level changes become commonplace, CPAs will probably be called upon to attest to them. Pressure is now building up for information from conglomerate companies which will indicate profits by broad industrial classifications--or even profits by product lines. CPAs might well be called upon to attest to all these kinds of information.<sup>12</sup>

#### Purpose and Scope of the Study

The principal application of the CPA's attest function has been the expression of opinions on the fairness of

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<sup>11</sup>"Compliance Examinations" (editorial), The Journal of Accountancy, CXVI (October, 1963), 33.

<sup>12</sup>John L. Carey, "Accounting Legislation of the Future," The Journal of Accountancy, CXXIII (January, 1967), 48.

financial statement presentations in corporate annual reports. Therefore, the corporate annual report would appear to be a logical starting place for considering the possible extension of the attest function. The possibility of extension in the annual report is suggested in the following statement:

It is not at all inconceivable that in the future enlightened managers of publicly held corporations might welcome the formal expression of an independent opinion on more of the elements in their stewardship than are now reported in financial statements. Many companies cover some of these elements in the president's letter or elsewhere in the text of their annual reports. To the extent that such information can be checked by the auditors, stockholders, potential investors, and management itself would benefit.<sup>13</sup>

As indicated previously, the primary purpose of this study is to examine the possibility of extending the CPA's attest function to include certain additional information in corporate annual reports. The study is confined to the reports of industrial corporations in order to preclude any special problems relating to the reporting requirements imposed on regulated companies.

Elizabeth R. Floyd states:

A company's annual report is one of its most important vehicles for telling the public about itself. It is read and used by stockholders, brokers, banks, buyers, prospective and present employees, and many others on whose interest and good will the firm must depend for the continued health of its operations. In recent years, as

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<sup>13</sup>"Measuring Management Efficiency" (editorial), The Journal of Accountancy, CXI (March, 1961), 38.

ownership has broadened and public interest in business has increased, many companies are including more and more kinds of information in their annual reports, . . .<sup>14</sup>

This expansion of information has occurred, for the most part, outside of the conventional financial statements. Thomas R. Prince "feels that most of the non-financial presentations in the annual report are responses to requests of the decision maker (that is, society demands relevant information over and above the financial statements)."<sup>15</sup>

Virgil S. Tilly states:

The wide variety of additional information which corporations find it desirable to present in the president's letter, supplementary statements and otherwise, stems from the apparent limitations of the three primary statements. While accounting statements give the appearance of completeness and exactness, they do not actually cover all matters which are of importance in evaluating the current status and future prospects of a business concern.<sup>16</sup>

Thomas D. Flynn indicates:

In deciding how to increase the informative content of reports to investors, the limitations of financial statements must be kept in mind. Many investors believe that financial statements should present all the significant economic facts about

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<sup>14</sup>Elizabeth R. Floyd, Preparing the Annual Report, AMA Research Study 46 (New York: American Management Association, 1960), p. 5.

<sup>15</sup>Thomas R. Prince, "Who Should Determine the Contents of Published Annual Reports?," The Illinois Certified Public Accountant, XXVI (Winter, 1963), 6.

<sup>16</sup>Virgil S. Tilly, "Financial Statement Presentation," CPA Handbook, ed. Robert L. Kane, Jr. (New York: American Institute of Certified Public Accountants, 1956), II, chap. xviii, 3-4.

an enterprise. This notion is ill-founded. The income statement purports to present results of operations; the balance sheet, financial position. But, clearly, not all important economic facts about a company can be compressed into these exhibits.

Vital economic facts usually are covered in the "letter" text and other segments of corporate annual reports.<sup>17</sup>

In a recently published book, Herman Bevis states:

No matter how clear and complete are the balance sheet and statement of income and retained earnings, nor how comparable among companies the practices used in preparing them, the information in these conventional financial statements invariably needs to be supplemented. The corporation is too complex to be compressed completely into such confines.<sup>18</sup>

No attempt is made in this study to establish the importance of any particular item of additional information being reported in annual reports, although the above comments would appear to indicate there is at least some support for the proposition that the additional information in general is important. Also, several recent studies indicate that much of the additional information being reported by some companies in their annual reports is needed for decision-making purposes.<sup>19</sup>

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<sup>17</sup>Accounting Papers of the Sixteenth Annual Conference of Accountants (Tulsa, Oklahoma: The University of Tulsa, 1962), pp. 85-86.

<sup>18</sup>Herman W. Bevis, Corporate Financial Reporting in a Competitive Economy (New York: The Macmillan Co., 1965), p. 201.

<sup>19</sup>See, e.g., Corliss D. Anderson, Corporate Reporting for the Professional Investor (Auburndale, Mass.:

It seems logical to assume that management has some rational reason for reporting all the information included in its annual report; that is, there must be some significance or relevance attached to the information to prompt management's decision to include it in the report. Some of the information may even be as relevant if not more relevant for decision-making purposes than the basic financial statement presentations. Management is responsible for the reliability of any kind of information which is included in the corporation's annual report. In fact, it has both a moral and legal obligation to insure that the information being reported is reliable.

This study is concerned with the fact that certain information is being reported by one party (management) to another (stockholders and others), and there is no independent attestation to the reliability of these representations. The purpose of the study is to examine the possibility of extending the CPA's examination and opinion to include this information.

The scope of this study includes consideration of

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Financial Analysts Federation, 1962); Richard D. Bradish, A Critical Evaluation of the Financial Information Contained in Published Corporate Annual Reports (University of Washington: Unpublished Ph.D. Dissertation, 1963); Alan R. Cerf, Corporate Reporting and Investment Decisions (Berkeley, Calif.: University of California, 1961); and Donald E. Stone, Investor-Oriented Supplementary Disclosures for Annual Reports (University of Wisconsin: Unpublished Ph.D. Dissertation, 1965).



the auditor's ability to verify the additional information, the nature of the CPA's opinion if the attest function is extended, the legal and ethical implications of extension, the economic feasibility of extension, and the applicability of the profession's auditing standards if the attest function is extended to include certain additional information in corporate annual reports.

Another constraint on this thesis, in addition to precluding a study of the relevance or significance of the additional information, is that no attempt is made to establish the social value of the CPA's attest function. Bevis indicates that discharge of the attest function adds credibility to the representations made by one party to another and increases reliance upon them.<sup>20</sup> The very existence of the public accounting profession relies heavily upon this basic premise. The only justifiable reason for the existence of the attest function is to add credibility to representations made by one party to another. Carey and Doherty state:

Obviously the extent to which the opinion of a CPA on financial statements will add to their credibility in the eyes of investors or credit grantors will depend on their confidence in his independence of professional judgment, his technical competence and his assumption of an ethical responsibility to the public, as well

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<sup>20</sup>Bevis, The Journal of Accountancy, CXIII (February, 1962), 28.

as to his client.<sup>21</sup>

It is beyond the scope of this study to attempt to prove or disprove the proposition that the CPA's attest function adds credibility to representations. There appears to be enough evidence of its value to society to at least justify considering the extension of its scope.

For over thirty years, the Federal government (through the Securities Acts of 1933-34 and the Securities and Exchange Commission) and the New York Stock Exchange have clearly indicated their apparent recognition of the value of the CPA's attest function by requiring certified financial statements. The "compliance examination" mentioned earlier is another example of apparent recognition by the Federal government of the significance of the CPA's attest function. Andrew Barr, Chief Accountant for the Securities and Exchange Commission, indicates that "for the Federal Government as a whole there has been a definite trend toward the reliance on the accountant's attest function through the increased use of independent audits in recent years."<sup>22</sup>

The independent public accountant's attest function developed out of the need for an independent review of

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<sup>21</sup>John L. Carey and William O. Doherty, Ethical Standards of the Accounting Profession (New York: American Institute of Certified Public Accountants, 1966), p. 62.

<sup>22</sup>Andrew Barr, "Trends in Financial Reporting," The Journal of Accountancy, CXX (July, 1965), 56.

financial reports by corporate managements to owners and creditors. Littleton states that:

The need to protect the investing public against financial misrepresentations by corporation managers gradually produced external auditing and a class of independent professional accountants.<sup>23</sup>

John Carey indicates that "the CPA profession has probably contributed more, in the audit function, to economic morality in our times, than any other single group."<sup>24</sup>

Robert K. Mautz states:

Traditionally, auditing has added credibility to financial statement representations to aid investment decisions. The historical role of the independent CPA in the attest function has had to do with facilitating the flow of credit in the economy.<sup>25</sup>

Kenneth MacNeal, in referring to the CPA's certificate or opinion, indicates that "a business must obtain this certificate in order to retain the confidence of the financial world."<sup>26</sup> Carman G. Blough states that "many businesses have no use for an audit except to assure third parties that the financial statements given to them by the

<sup>23</sup>A. C. Littleton, Structure of Accounting Theory (Urbana, Ill.: American Accounting Association, 1953), p. 4.

<sup>24</sup>Carey, The CPA Plans for The Future, p. 377.

<sup>25</sup>"The Meaning of the Term 'Attest Function'" (statements in quotes), The Journal of Accountancy, CXXII (October, 1966), 61.

<sup>26</sup>Kenneth MacNeal, "What's Wrong with Accounting?," Studies in Accounting Theory, ed. W. T. Baxter and Sidney Davidson (Homewood, Ill.: Richard D. Irwin, Inc., 1962), p. 58.

management of the business can be relied upon."<sup>27</sup> James

Don Edwards indicates:

Since its beginning, the profession of public accountancy has made a significant contribution to financial confidence in American business. Reliance on independent audits of financial statements has by now become an integral factor in public trust in business enterprise.<sup>28</sup>

Howard F. Stettler states:

Using financial statements prepared by management and submitted to third parties without the statements having been first subjected to an independent audit examination would be comparable to having a judge hear a case in which he was a litigant, or to having a member of an opposing athletic team act as official referee and scorekeeper.<sup>29</sup>

Littleton and Zimmerman indicate:

One party could report to an interested second party, but he would hardly be expected to verify the data reflecting his own activities. Since the second party would also normally have a personal interest or bias, a third party, one not individually involved, is needed if effective verification or audit is desired.<sup>30</sup>

Stettler stresses the importance of the attest function in the following statement:

The importance of the basic reason for inde-

<sup>27</sup>Carman G. Blough, "Responsibility to Third Parties," The Journal of Accountancy, CIX (May, 1960), 58.

<sup>28</sup>James Don Edwards, History of Public Accounting in the United States (E. Lansing, Mich.: Michigan State University Business Studies, 1960), p. 1.

<sup>29</sup>Howard F. Stettler, Auditing Principles (2d ed.; Englewood Cliffs, N. J.: Prentice-Hall, Inc., 1961), p. 2.

<sup>30</sup>Littleton and Zimmerman, p. 105.

pendent audits--the expression of an opinion on the fairness of financial statements to be used by third parties--cannot be overstressed. I contend that independent audits have been a significant factor in achieving in the United States the world's highest standard of living. We have had a vigorous and generous capital market, capable of supplying the capital for productive facilities which have made possible the phenomenally high productivity of labor in this country and a correspondingly high standard of living. A significant factor in sustaining the flow of capital into productive uses has been the availability of extensive and reliable financial and operating information about concerns seeking capital funds. Independent audits have been the primary source of this reliability.<sup>31</sup>

The preceding comments are but a few of the many similar statements found during the research for this study. Of course, this apparent recognition of the social value of the profession's attest function does not prove that it adds credibility to management's representations. Neither does it prove that the CPA's attest function is a significant factor in facilitating the flow of capital or credit in the economy. Nevertheless there does seem to be enough support for the importance of the CPA's attest function in our society to at least justify consideration of whether this function can be extended to other areas where the possibility exists for affording added credibility. Bevis states that "the social importance of the attest function and the changing economic environment strongly suggest the

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<sup>31</sup>Howard F. Stettler, "The Significance of Auditing Standards Underlying Opinions by Independent Accountants," The Cooperative Accountant, XVII (Summer, 1964), 3-4.

expansion of its use."<sup>32</sup>

### Sample of Annual Reports

Eighty-nine 1965 annual reports were examined in order to determine some of the kinds of information being presented which are generally not covered by the CPA's opinion. The companies were purposively selected on the basis of criteria which appeared likely to include reports containing the greatest variety and quality of additional disclosure. Cerf, in his study of 527 corporate annual reports, concluded:

New York Stock Exchange companies were significantly superior in disclosure to the other companies in our sample. Thus it seems that these factors which cause firms to list on the New York Stock Exchange go hand in hand with those factors which cause good disclosure.<sup>33</sup>

Anderson and Schmidt indicate:

The general trend during the last ten or fifteen years toward more complete and informative reports to stockholders has been especially noticeable in the case of companies having securities listed on one or more national exchanges.<sup>34</sup>

All of the companies included in this study have stock listed on the New York Stock Exchange.

Large public companies are usually the leaders in

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<sup>32</sup>Bevis, The Journal of Accountancy, CXIII (February, 1962), 35.

<sup>33</sup>Cerf, p. 4.

<sup>34</sup>David R. Anderson and Leo A. Schmidt, Practical Controllershship (1st ed. rev.; Homewood, Ill.: Richard D. Irwin, Inc., 1961), p. 46.

quality and quantity of annual report disclosure.<sup>35</sup> All of the companies in this study are in The Fortune Directory of the 500 largest U. S. industrial corporations.<sup>36</sup> Companies in all major industries were selected (so many dollar sales leaders in each major industry depending upon the number of companies in the industry), and an effort was made to obtain a fairly even distribution of CPA firms (that audit the companies). These latter criteria were employed to preclude as much repetition as possible in the nature of the additional disclosures included in the reports examined.

No statistical inferences can be made on the basis of this sample. This was not the purpose of selecting the sample. The selection was not random. It was intentionally biased to include the reports of those companies that would seem to be leaders in good annual report disclosure. The results of the examination of these reports are presented in Chapter II.

To summarize, this study is confined to an examination of the possibility of extending the CPA's attest function to certain additional information in corporate annual reports which is generally not covered by his opinion. The scope of the study precludes establishment of the

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<sup>35</sup>Thomas H. Sanders, Company Annual Reports (Boston: Harvard University, 1949), p. 4.

<sup>36</sup>"The Fortune Directory," Fortune, July 15, 1966, pp. 230-251.

importance of any particular item of additional information, and the social value of the CPA's attest function. There appears to be enough support for the propositions that (1) this information should be reliable, and (2) the CPA's opinion adds credibility to representations made by one party to another to justify studying the possibility of extending the attest function.

Professors Mautz and Sharaf provide much of the stimulus for this study in the following challenge to the profession:

As the public requires more and more verified information, much of it well beyond that currently found in financial statements, will auditing see and seize the opportunity to extend its range of service? If it does, there are literally no bounds to its future. If on the other hand, it either deliberately or unconsciously limits itself to but a small fraction of the total of verifiable information, its position of eminence may be lost to those who do seize the larger opportunity.<sup>37</sup>

A 1961 editorial states:

Most CPAs are aware of the fact that their profession, like all others, must either grow continually, or stagnate. If they are to grow, they must continually explore all opportunities for added service to the economy, and accept or reject them with the same objectivity which is traditional in auditing.<sup>38</sup>

An attempt is made in this study to determine if the

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<sup>37</sup>R. K. Mautz and Hussein A. Sharaf, The Philosophy of Auditing (Madison, Wisc.: American Accounting Association, 1961), p. 200.

<sup>38</sup>Editorial, The Journal of Accountancy, CXI (March, 1961), 39.



profession can extend its attest function to include certain information beyond the traditional financial statement presentations. Of course, one of the primary considerations is whether the information can be verified. The reporting, legal, economic, and ethical implications of such an extension must also be considered. The applicability of the profession's auditing standards if the attest function is extended is another important consideration. These latter considerations are an integral part of determining whether the CPA's attest function can be extended. The ability to verify alone is not adequate support for concluding that the profession can extend its attest function.

### Chapter Development

Chapter II includes a description of what is generally covered and what is generally not covered by the CPA's opinion in corporate annual reports.

The CPA's ability to verify the additional information which is generally not covered by his opinion is the specific concern of Chapter III.

The reporting aspects of extending the CPA's attest function to the additional information are discussed in Chapter IV. The problems discussed relate to (1) coverage of additional information presented for two years or more, (2) identification of additional information covered by the auditor's opinion, and (3) the nature of the auditor's

opinion on the additional information.

Chapter V is devoted to a discussion of the ethical and legal implications of extension, the economic feasibility of extension, and the applicability of the profession's general and field work standards if the attest function is extended.

Chapter VI includes a summary of the major conclusions in the study, and some general observations concerning the value of having the additional information attested to by the CPA.

Appendix A lists the companies whose annual reports were examined for this study. Appendix B includes a list of the assertions that would have to be verified in order to substantiate the additional information included in this study.

## CHAPTER II

AUDIT OPINION COVERAGE IN PUBLISHED  
ANNUAL REPORTS

Chapter I included a brief discussion of the CPA's attest function, the purpose and scope of the study, and the content of the remaining chapters in the thesis. This chapter is primarily devoted to presenting the results of the examination of 89 corporate annual reports.<sup>1</sup> In addition, some statistics are presented from the American Institute of Certified Public Accountants' last two editions of Accounting Trends and Techniques.<sup>2</sup> This survey by the Institute is an excellent effort and was most helpful in providing certain statistics for this study. But since the survey is essentially confined to financial and accounting data it does not afford the coverage of information generally not covered by the auditor's opinion which is required for this study. In addition, the Institute's survey does not provide sufficient detail in some financial and accounting areas to satisfy the needs of this study. The detailed examination of the 89 annual reports was undertaken primari-

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<sup>1</sup>See Appendix A for a list of the companies whose annual reports were examined.

<sup>2</sup>Accounting Trends and Techniques (19th ed.; New York: American Institute of Certified Public Accountants, 1965), and Accounting Trends and Techniques (20th ed.; New York: American Institute of Certified Public Accountants, 1966).

ly to determine various kinds of information in the entire annual report which are generally not covered by the CPA's opinion.

In describing what is generally covered and what is generally not covered by the independent auditor's opinion it is important to differentiate between kinds of information and types of statements. The information covered by the CPA's opinion is usually confined to that included in the conventional financial statements and footnotes. This study is concerned with the possibility of extending the CPA's opinion to cover additional information. Therefore, subsequent discussion of what is generally covered by the auditor's opinion does not include a detailed description of the kinds of information covered. The information generally covered by the auditor's opinion is essentially the traditional financial and accounting information with which most readers are quite familiar. It was stated in Chapter I that the CPA's certificate also covers certain supplementary schedules in some annual reports. But as indicated there most of the information included in these schedules is included in the conventional financial statements or accompanying footnotes in other annual reports.

Certain information (for example, sales and earnings) included in the basic financial statements, and covered by the CPA's opinion, is frequently repeated elsewhere in the annual report (for example, in the president's letter, finan-

cial review, "highlights," or long-term "summary"). These additional presentations of basic financial and accounting information are generally not covered by the CPA's opinion. But since the repeated data is already covered in the basic financial statements, the problem would appear to be essentially one of how to indicate that it was covered by the CPA's opinion rather than whether he can or cannot cover the information in his opinion. This and related problems are discussed in Chapter IV.

Of course, there are some items which are basically financial statement type information which are generally not specifically covered by the CPA's opinion because they are usually not disclosed in the conventional financial statements (for example, advertising expenditures and employment costs). These items are, however, often presented elsewhere in the annual report. They are included in this study as information generally not covered by the CPA's opinion.

Most companies now present the conventional financial statements (at least the balance sheet and income statement) for a period of two years. Some CPA firms have specifically indicated in their reports that the statements for both years are covered by their opinion. But most firms have made no reference except to the statements for the particular year under examination. A similar problem exists when some companies present certain basic financial and accounting information relating to a period of two years or

more in the president's letter or the financial review (for example, sales and earnings increases, and record highs for sales and earnings). These presentations are generally not covered by the auditor's opinion, and the problem is one of covering a period of more than one year rather than covering the kind of information involved. Extension of the CPA's opinion beyond the traditional one year coverage is discussed in Chapter IV.

#### Present Audit Opinion Coverage of Financial Statements

The American Institute of Certified Public Accountants' survey of six hundred 1965 published annual reports indicates that all 600 companies presented a balance sheet covered by the auditor's opinion.<sup>3</sup> All but one of the 600 companies also presented a certified income statement, either separately (312) or in the form of a combined statement of income and retained earnings (287). The other company presented a combined statement of income and stockholders' equity covered by the auditor's opinion.<sup>4</sup> In addition, 568 of the 600 companies presented some type of retained earnings statement covered by the auditor's opinion. The latter included 279 separate statements of retained earnings. Another 24 companies presented certified

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<sup>3</sup>Ibid., 1966, p. 2.

<sup>4</sup>Ibid., 1966, p. 4

stockholders' equity statements which included a retained earnings "section" similar to the retained earnings statement itself.<sup>5</sup>

The survey also indicates that 151 companies presented certified "capital surplus" ("surplus" other than retained earnings) statements and 30 presented certified stockholders' equity statements.<sup>6</sup> The "funds" statement (discussed later in this chapter) is not considered a customary statement in the Institute's survey.<sup>7</sup> The "capital surplus" and stockholders' equity statements are essentially little more than a supplementary approach to disclosing information which most companies usually include in the stockholders' equity section of the balance sheet or the footnotes accompanying the balance sheet.

The examination of 89 annual reports undertaken specifically for this study indicated that all 89 companies presented a balance sheet covered by the CPA's opinion. All 89 companies also presented a certified income statement, either separately or in combined statement form. In addition 84 of the 89 companies presented some type of retained earnings statement covered by the CPA's opinion. Four of the 5 remaining companies presented certified stockholders'

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<sup>5</sup>Ibid., 1966, p. 5.

<sup>6</sup>Ibid., 1966, pp. 4, 19.

<sup>7</sup>Ibid., 1966, p. 2.

equity statements and the other company included a rather detailed retained earnings section in its certified balance sheet. These results are not surprising, however, since 87 of the 89 companies included in this study were also included in the Institute's survey of 600 companies.

### The "Funds" Statement

In recent years more and more companies are presenting a "funds" statement in their published annual reports. Another trend appears to be increased coverage of funds statement presentations by the CPA's opinion. Colin Park indicates:

The funds statement is being upgraded from its lowly status as a supplemental schedule to rank as a basic financial statement equal (and perhaps eventually superior) to the other financial statements.<sup>8</sup>

Some CPAs feel that a certified funds statement should be a required presentation in the annual report. Others recommend presentation and audit opinion coverage, but would not go so far as to require that the funds statement be presented and covered.

Probably much of the recent increase in the presentation and audit opinion coverage of funds statements can be attributed to the influence of the following two publications. In Accounting Research Study No. 2, the late Perry

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<sup>8</sup>Colin Park, "Funds Flow," Modern Accounting Theory, ed. Morton Backer (Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1966), chap. xiv, 301.



Mason recommended that:

The funds statement should be treated as a major financial statement. It should be presented in all annual reports of corporations and be covered by the auditor's short-form report.<sup>9</sup>

Mason also indicated:

Little or no additional auditing will be required since the funds statement is based upon data already subjected to tests and other auditing procedures in connection with other financial statements.<sup>10</sup>

In Accounting Principles Board Opinion No. 3, the Board states:

A statement of source and application of funds should be presented as supplementary information in financial reports. The inclusion of such information is not mandatory, and it is optional as to whether it should be covered in the report of the independent accountant.<sup>11</sup>

The desirability of (1) presenting a funds statement, and (2) having it covered by the CPA's opinion are certainly important issues. But this study is not directly concerned with whether the statement should be presented or covered by the CPA's opinion. Neither is it concerned with the reasons for the apparent increased recognition in recent years of the funds statement as an important financial statement pre-

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<sup>9</sup>Perry Mason, "Cash Flow" Analysis and the Funds Statement, Accounting Research Study No. 2 (New York: American Institute of Certified Public Accountants, 1961), p. 90.

<sup>10</sup>Ibid., p. 89.

<sup>11</sup>Accounting Principles Board, The Statement of Source and Application of Funds, Opinion No. 3 (New York: American Institute of Certified Public Accountants, 1963), p. 16.

sentation. Increased audit opinion coverage of the statement does, however, appear to be a significant "extension" of the CPA's attest function in the annual report. One item included in most funds statements which is generally not covered by the auditor's opinion elsewhere in the annual report is the figure for capital expenditures. If the funds statement is not covered by the auditor's opinion the figure for capital expenditures is generally not covered either.<sup>12</sup>

Regardless of whether or not the funds statement is now or eventually will be considered a basic financial statement, the following statistics from Accounting Trends and Techniques for the past three years would appear to support the contention that many companies and CPAs are recognizing that the statement is an important financial presentation-- basic or supplementary:

1963 annual reports -- 271 of 600 companies (45%) presented a funds statement, and 65 of the 271 statements (24%) presented were covered by the auditor's opinion.

1964 annual reports -- 387 of 600 companies (65%) presented a funds statement, and 191 of the 387 statements (49%) presented were covered by the audi-

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<sup>12</sup>Based upon the examination of 89 annual reports.

tor's opinion.<sup>13</sup>

1955 annual reports -- 458 of 600 companies (76%) presented a funds statement, and 273 of the 458 statements (60%) presented were covered by the auditor's opinion.<sup>14</sup>

The reader might like to compare these figures with the following: Only 13 certified funds statements were presented by the 600 survey companies in 1950, 21 in 1955, and 31 in 1960!<sup>15</sup>

The examination of 89 annual reports undertaken for this study covered only one year so no trends could be observed. But it is interesting to note that 91% (81 companies) of the 89 companies presented a funds statement in their 1965 annual reports. This may be some indication of the type of companies included in the sample and their apparently good disclosure practices.

The nature of the CPA's report on the funds statement and other items is discussed in Chapter IV. The remainder of this chapter is devoted to a description of some of the kinds of information presented in corporate annual reports which are generally not covered by the CPA's opinion.

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<sup>13</sup>Accounting Trends and Techniques, 1965, p. 230.

<sup>14</sup>Accounting Trends and Techniques, 1966, p. 239.

<sup>15</sup>Accounting Trends and Techniques, 1965, p. 20.

Additional Information Generally  
Not Covered by the Auditor's  
Opinion

Many companies include one or both of two additional "statements" in their annual reports. These are the "highlights" and "summary" type of presentations. They are generally not covered by the CPA's opinion. The Institute's survey of 600 companies indicates that 464 companies presented a long-term "summary" and 508 companies included a "highlights" type of statement in their 1965 annual reports.<sup>16</sup> All 89 of the companies in the survey conducted specifically for this study included one or both of these additional presentations in their 1965 annual reports.

The most common period covered by the "highlights" type of statement is two years. The greatest number of long-term "summary" statements cover a ten year period. Both "statements" usually include information which is generally covered by the auditor's opinion elsewhere in the annual report as well as information which is generally not covered by the auditor's opinion. These "statements" appear to be significant enough to require special consideration. A section of Chapter IV is devoted to that purpose.

The remainder of this chapter is devoted to a description of certain kinds of information in the annual report which are generally not covered by the CPA's opinion.

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<sup>16</sup>Accounting Trends and Techniques, 1966, p. 26.

For the purpose of this study, "generally not covered" means that when the particular item was presented in the reports examined either it was never covered by the CPA's opinion or it was covered in only a very few reports. But the vast majority, virtually all, of the information included in this study as "information generally not covered" by the auditor's opinion was not covered in any of the annual reports examined.

The information included in this study is not all the information in annual reports which is generally not covered by the CPA's opinion. An attempt was made, however, to include enough variety to enable the reader to apply most of the analyses and conclusions in this study to any other kind of information which is being presented in corporate annual reports and is generally not covered by the auditor's opinion. The information included would appear to be representative enough of the various kinds of information being reported to facilitate this application.

The following breakdown of information under one of four main headings probably involves some overlapping. This would probably be characteristic of any attempt to categorize annual report presentations within a narrow range of classes. However, the fact that these categories may not be mutually exclusive would not appear to have any significant bearing upon the analyses and conclusions of this study.

The presentation of the following information in

corporate annual reports is generally not accompanied by the CPA's opinion as to its fairness. Examples from the 1965 annual reports of companies included in this study are presented under each of the categories. The four main categories are:

1. Other Financial and Accounting Information
2. Shareholder and Personnel Information
3. Facilities and Products Information
4. Governmental and Social Contribution Information

1. Other Financial and Accounting Information

The information described in this section is financial and accounting information which is presented in addition to that financial and accounting information generally considered to be necessary for the fair presentation of a company's financial position and results of operations. Apparently the presentation of this "additional" information is not required for the CPA to be able to render an unqualified opinion as to whether or not the basic financial statements present fairly the company's financial position and results of operations--the "additional" information is generally not covered by his opinion.

a) Sales

By major product groups or divisions.--Eastman Kodak Company indicates the dollar sales and per cent of total sales for each of its five major product groups--Commercial

and professional photographic products; Amateur photographic products; Fibers, plastics, and industrial chemicals; Special products; and Professional motion-picture products.

Charles Pfizer and Company presents sales broken down by per cent of total dollar sales for each of its six product groups--Human antibiotics; Other ethicals; Chemicals; Minerals, pigments and metals; Agricultural; and Consumer.

By customers, industries, or markets served.--Sperry Rand Corporation indicates dollar sales to each of three classes of customers--U. S. government, domestic commercial, and international.

E. I. du Pont Nemeurs and Company presents sales broken down by per cent of total sales to principal industries--textile mill products; sales outside the United States; chemicals and allied products; rubber and miscellaneous plastic products; transportation; petroleum refining and related industries; food and related products; machinery-electrical and other; paper, printing and publishing; agriculture; primary metals and fabricated metal products; mining; sporting and military powders (including export); and other industries (construction, tobacco, etc.).

Ingersoll-Rand Company reports dollar sales and per cent of total sales to each of six principal markets-- construction and mining; general manufacturing; oil, gas and process industries; service industries, repair and maintenance; utilities; and other.

Government sales.--Sperry Rand includes dollar sales to the U. S. government in its presentation of sales by customer classification.

Lockheed Aircraft Corporation indicates dollar sales and per cent of total sales to the U. S. government.

Quarterly sales.--Minnesota Mining and Manufacturing Company, Monsanto Company, National Lead Company, and Reynolds Metals Company are some of the companies that reported total dollar sales by quarters.

Unit sales.--Several companies include unit sales figures in their 1965 annual reports. Ford Motor Company presents a detailed breakdown of unit sales for both cars and trucks.

Index of selling prices.--Du Pont indicates its "index of selling prices averaged 2 per cent lower than in 1964 and 17 per cent below the peak in 1953."

Sales forecast.--FMC Corporation:

We are confident, therefore, that in 1966 our sales volume will exceed one billion dollars. (Italics mine.)

Carrier Corporation:

After taking all factors into account, further gains in net sales and earnings are expected in fiscal 1966. (Italics mine.)

Crown Zellerbach Corporation:

On balance we expect 1966 to establish new records in both sales and profits. (Italics mine.)

Industry sales.--Ford Motor reports industry unit



sales figures for both cars and trucks, and the company's per cent of those totals.

Motorola states that the dollar sales increase rate in its semiconductor products division "was substantially more than that of the industry."

b) Unfilled orders (total and Government backlog)

North American Aviation:

The company's backlog of unfilled orders was \$996,000,000 at September 30, 1965, as compared to \$942,000,000 the year before. The 1965 figure excludes an estimated \$2,083,000,000 for orders not yet funded but which are either negotiated or currently under negotiation. Including this amount, the total backlog of unfilled orders on September 30, 1965, was \$3,079,000,000.

The Boeing Company indicates its dollar backlog of unfilled commercial and government orders, and states:

Backlog of unfilled commercial orders at the end of 1965 more than doubled from the previous year end, while the government order backlog decreased slightly. As stated in previous reports, unfilled orders from the U. S. Government are limited to amounts obligated to contracts by the procuring agencies. If recognition were given to unfunded amounts believed to be firmly established in Department of Defense and NASA procurement plans, unfilled orders would be substantially increased.

c) Advertising expenditures

Current.--The Glidden Company:

Advertising expenditures for the company amounted to \$7,595,897 in fiscal 1965; company advertising expenditures the previous year were \$6,831,482.

By media.--Colgate-Palmolive Company states that the major share of its advertising funds was expended for tele-

vision.

Budgeted.--Burlington Industries indicates "advertising and promotional expenditures are expected to increase 20% in 1966."

d) Suppliers and subcontractors

Total dollar amount of contracts or orders.--North American Aviation:

During 1965 the company committed \$735,000,000 to subcontractors and suppliers for their part in developing and building its products.

Number of suppliers and subcontractors.--Boeing states that "during 1965 such contracts were let to over 15,000 firms in an amount of more than \$1.2 billion."

Number of small businesses among suppliers and subcontractors.--North American states that "about 14,700 suppliers (85.5 per cent) were small businesses."

Boeing indicates:

Of the firms with which the Company deals, 74% are classified as small business--generally defined as those with less than 500 employees.

e) Earnings

By major product groups or divisions.--Midland-Ross Corporation states that each of its 16 divisions contributed to corporate earnings in 1965.

Glidden presents the percentage of profits for each of its three operating groups--Coatings and resins, Foods, and Chemicals.

Westinghouse Electric Corporation indicates that five of its six product groups advanced in earnings.

Motorola states all six of its product divisions contributed to the earnings increase for the year.

Quarterly earnings.--Minnesota Mining and Manufacturing, Monsanto, and Reynolds Metals presented earnings by quarters in their 1965 annual reports.

Earnings forecast.--FMC Corporation:

In the absence of a change in economic conditions, both sales and profits once again will attain new highs for an uninterrupted record of seventeen consecutive years.

Carrier:

After taking all factors into account, further gains in net sales and earnings are expected in fiscal 1966. (*Italics mine.*)

Crown Zellerbach:

On balance we expect 1966 to establish new records in both sales and profits. (*Italics mine.*)

f) Dividend record

Pullman Incorporated:

During the year 1965, Pullman Incorporated continued the payment of quarterly cash dividends, maintaining an unbroken record of such payments since 1867.

The Gillette Company:

For the 60th consecutive year the Company paid dividends on its common stock.

Ex-Cell-O Corporation:

Of added significance is the fact that 1965 represented the thirtieth consecutive year in which

we have paid a dividend to our shareholders in an amount equal to or greater than the prior year.

National Biscuit Company:

This was the seventh consecutive year in which NABISCO has raised its dividends to shareholders.

g) Price range of company's stock

The Anaconda Company indicates the price range (New York Stock Exchange) of its stock during the year.

2. Shareholder and Personnel Information

a) Shareholder information

Type of shareholder, number of each, and number of shares held by each type.--The Borden Company presents a breakdown of the "ownership of the company." This breakdown indicates the number of shares held by each type of stockholder and the number of each type of stockholder.

The types of stockholders included are:

- Women
- Men
- Joint accounts
- Trusts and estates
- Brokers, banks and nominees
- Non-U.S. shareholders
- Charities, churches, schools, etc.
- Insurance and pension funds
- Foundations
- All others

Gillette states that its officers and directors as a group own 199,441 shares.

Swift and Company indicates that about 10,000 of its employees own the company's stock.

Frequency distribution of holdings.--United States Rubber Company presents a frequency distribution of the ownership of its common stock. This presentation indicates the number of stockholders with holdings in each of the following classes:

1-100 shares  
 101-200 shares  
 201-500 shares  
 501 shares or more

Voting at the annual meeting.--Du Pont includes the following statement in its 1965 annual report:

At the annual meeting of stockholders in April 1965, nearly 90 per cent of the shares eligible to be voted were voted by 153,052 holders of common stock, about 65 per cent of those entitled to vote.

b) Personnel information

Director data.--Directors' business or professional affiliations

Ages of directors

Years service as directors of the company

Years service with the company

Attendance at regular Board meetings

General Electric Company provides all of the above information except "years service with the company." The average age of the members of the Board is given instead of the age of each member.

R. J. Reynolds Tobacco Company indicates the number of years of company service for each of its directors.

Officer data.--Positions held by officers

Ages of officers

Years service with the company

Education

Texaco presents the following statement in its 1965 annual report:

These are the executive officers of Texaco Inc., together with their areas of responsibility. They average 55 years in age and 29 years in length of service with the Company.

American Can Company indicates the college or colleges from which its officers received degrees.

Officer and director changes.--Most companies include a description of changes in their officer and director ranks which took place during the year (for example, new assignments, resignations, retirements, and deaths).

Employee data.--Number of employees

Years service with the company

Employee turnover rate

Most companies state how many employees they have.

Caterpillar Tractor Company includes the following comment in its annual report:

A key factor in Caterpillar's growth is the skill and experience of its long-service employees. More than 3,600 have 25 years or more of employment service; another 18,700 have from 10 to 25 years of service.

Minnesota Mining and Manufacturing states that its rate of employee turnover is among the lowest in industry.

Eastman Kodak reports that the rate of personnel turnover in its plants and offices is one-fourth the national industrial average.

Employment costs.--Total employment cost

Salaries and wages

Officer and director salaries

Employee benefits

United States Steel Corporation presents a breakdown of its total employment costs. This breakdown includes a figure for wages and salaries, and for each of several types of employee benefits (Social security taxes, insurance costs, supplemental unemployment benefit costs, etc.).

Armco Steel Corporation presents a breakdown of its "cost of employee benefits." This breakdown includes a figure for each of several employee benefit costs (Federal and state unemployment taxes, group insurance, savings and vacation plans, thrift plan, etc.).

Education data.--College recruiting

College degrees held by employees

Educational assistance to employees

Ford Motor:

During 1965, Company recruiters conducted 12,000 interviews on 150 college campuses and hired more than 1,500 graduates with top academic records for the College Graduate Program.

Lockheed Aircraft indicates that nearly one-fourth

of its people are college trained, some 400 of them with doctorates.

**The Bendix Corporation:**

The Corporation provided \$126,381 in Educational Assistance awards to 1,119 participating employees for successfully completing 2,290 job-related courses at the University level.

Training and development programs.--Glidden indicates that it has "instituted extensive training and development programs which cost in excess of \$500,000 annually."

Johns-Manville Corporation presents the following statements:

In 1965, some 500 employees participated in supervisory and middle management training, 190 of them completing courses in administrative leadership or product management.

More than 5,000 J-M people were involved in plant training programs . . .

Boeing states that "during 1965, both on-shift and off-shift training for hourly employees totaled more than 1,100,000 man-hours, and management courses exceeded 160,000 man-hours."

Labor relations data.--Labor contracts: Reynolds Metals reports the following:

Our company negotiated new three-year labor agreements with various unions representing some 18,000 hourly employees. The new contracts, which run to June 1, 1968, generally call for direct wage increases in the first and third years. Increases in insurance, hospitalization, retirement and other benefits occur at various times over the three-year period. The most significant improvement will be the changes that become effective in 1966, as pension benefits for



hourly employees will be almost doubled. Some supplemental pension benefits were granted for disability and certain types of early retirement, and retirement is provided for hourly employees with 30 years service, regardless of age.

Continental Can Company indicates:

A total of 67 separate labor agreements were signed, covering 27,500 employees in 112 plants.

Unionization elections:

J. P. Stevens and Company reports:

In eight plants involving more than five thousand employees, where the union has called for Government-conducted secret ballot elections, your Company's employees have voted decisively against the union.

Strikes:

Du Pont states that "all plants operated without interruption due to labor disputes during the year; . . ."

Caterpillar Tractor:

The Decatur, Illinois Plant was struck by the United Automobile Workers Union (UAW) for two months ending January 19, 1966 over alleged work standard and classification disputes, idling more than 3,000 employees.

Johns-Manville:

Union attempts at multi-plant bargaining and internal union problems resulted in costly strikes at Waukegan, Natchez, Long Beach, Toronto, Defiance and Hayward.

These unfortunate work stoppages had a substantial effect on both the employees involved and the company. Cost to employees--about \$4,100,00 in lost wages. Cost to the company--1,400,000 lost man hours of work.

Hours worked per week--Chrysler Corporation reports

"hourly employees worked an average of 42.9 hours per week . . ." in 1965.

Safety data.--Company frequency and severity rates  
Industry or all industry rates

Du Pont:

From a frequency rate of .27 in 1964, we retrogressed to .48 major injuries per million man-hours in 1965. While this still compares favorably with a frequency rate of 3.13 for the chemical industry and 6.45 for all industry, the inclusion of 23 fatalities is particularly distressing.

United States Steel:

The severity rate in the steel producing operations was reduced to a new all-time low and was also substantially lower than that for the remainder of the steel industry.

Suggestion plans.--Number of suggestions submitted  
Suggestion awards

Swift reports that "during fiscal 1965, a total of 2,618 suggestion awards were made, totaling nearly \$65,000."

Awards and honors.--Aluminum Company of America:

Honors were given during 1965 to the following:

JOHN D. HARPER, president and chief executive officer, received the honorary Doctor of Engineering degree from Lehigh University.

LEON E. HICKMAN, executive vice president, received the honorary Doctor of Business Administration degree from Tennessee Wesleyan College.

R. S. OVERBECK, president, Suriname Aluminum Company, was decorated with a knighthood in the Order of Orange-Nassau (the Netherlands).

DR. KENT R. VAN HORN, vice president, received the Sainte-Claire Deville Medal of the Societe Francaise

de Metallurgie.

I. W. WILSON, director, was elected a Life Member by the Aluminum Association.

Lockheed:

President Haughton received the National Defense Transportation Association's achievement award. Vice President Clarence L. Johnson won his second Sylvanus Albert Reed award from the American Institute of Aeronautics and Astronautics. He was elected to the National Academy of Sciences and received the National Medal of Science.

3. Facilities and Products Information

a) Facilities

Floor area.--Boeing presents a breakdown of its total floor area by millions of square feet owned, leased, and government owned.

United Aircraft Corporation includes the following statement in its 1965 annual report:

The Corporation was occupying 14,827,000 square feet of floor space at December 31, 1965, of which 12,904,000 square feet were owned by the Corporation and 1,923,000 square feet were leased. None of the Corporation's plant space is furnished by the Government.

Company facilities.--Type and location

New facilities

Facilities in process of construction at the end of the year

Facilities planned at the end of the year

American Can reports the location of each of its manufacturing, sales, and research facilities.

The following statements are representative of the presentations relating to new, in process, and planned facilities:

Honeywell:

Our industrial instrumentation activities located in the Philadelphia area were consolidated in a new facility of 857,000 square feet in Fort Washington, Pa. This facility, representing an investment of more than \$10 million--the largest Honeywell has ever made in one location at one time--brings together the three divisions which produce the bulk of our industrial controls.

Weyerhaeuser Company:

At Springfield, Ore., a pulp and paperboard expansion was completed in 1965 which raised daily capacity from 400 to 1,150 tons.

The Goodyear Tire and Rubber Company:

The division completed a \$4-million expansion at the Beaumont, Tex., plant which boosted the production capacity for Natsyn polyisoprene rubber, the synthetic duplicate of natural rubber. The plant now has an annual capacity of nearly 100,000 long tons of Natsyn and Budene, a polybutadiene rubber with some properties even better than those of natural rubber.

Carrier:

A 165,000 square-foot addition to this division's facilities in Syracuse was started in 1965 and is scheduled for occupancy in the spring of 1966.

Crown Zellerbach:

The company is completing construction of a \$40,000,000 pulp and paper mill at St. Francisville, La., on the Mississippi River 25 miles north of Baton Rouge. The mill has a capacity of 90,000 tons of kraft specialty grades annually, and includes a woodmill, pulp mill, and all related facilities.

**Crane Company:**

The Company is planning a \$1.4 million expansion program at the Rogers, Arkansas plant for the manufacturing of Crane's new 5/8 inch water meters and a new line of Deming hydronic heating circulator pumps. This program will involve the construction of a new 100,000 square foot addition to the present plant. The new plant should be in operation by the middle of 1966.

**Owens-Illinois Glass Company:**

Plans to construct a 900-tons-per-day container-board mill at Orange, Texas, on the Gulf Coast, were announced last month. The mill, which will be among the most modern and efficient in the industry, is scheduled for completion during the fourth quarter of 1967.

Natural resources.--Drilling activities

Size of natural resource reserves

Texaco reports that it drilled 1,556 wells, of which 1,140 were completed as oil producers and 116 as gas wells. The remaining 300 were dry.

Continental Can reports phosphate holdings of over 80 million tons, and 1,271,462 acres of timberland holdings.

Owens-Illinois Glass states that its phosphate reserves amount to approximately 100 million tons.

Capital expenditures budget.--Cities Service Company indicates that it has "budgeted capital expenditures of \$173 million for 1966."

Continental Can states that its capital expenditures budget for 1966 is \$90,000,000.

National Dairy Products Corporation reports that "a capital budget of nearly \$52,000,000 has been approved by

the Board of Directors" for 1966.

b) Products

Number and nature of products.--Many companies provide either a partial or complete list of their products. Some also indicate the company's total number of products.

Championships won and records set using the company's products.--Chrysler:

A Plymouth Belvedere won the United States Auto Club (USAC) Drivers, Owners and Manufacturers Championship as well as the Index of Performance Award for a clean sweep among cars entered in USAC races. Plymouth and Dodge cars also dominated International Motor Contest Association (IMCA) competition, winning 38 out of 39 races. Barracudas again won the Manufacturers Championship for the Sports Car Club of America (SCCA) national rallies, and a Barracuda won its class in the Shell 4000 Rally, North America's longest and most rugged event.

At the Bonneville Salt Flats, the world land speed record for wheel driven vehicles--409.277 miles per hour--was returned to the United States by a racer powered by four Chrysler-built hemi-head engines.

Chrysler Corporation cars won four of the nine classes in the 1965 Mobil Economy Run.

Major sales or orders of company's products.--American Machine and Foundry Company states that its "\$5.7 million turnkey nuclear research reactor for the Pakistan Atomic Energy Commission became operational in December."

Radio Corporation of America:

Siemens & Halske A.G., of Germany, one of the 10 largest industrial firms of Western Europe, placed an order for 26 RCA Spectra 70 systems valued at more than \$9 million.

Production.--Weyerhaeuser presents unit production figures for each of several items--for example, million board feet of lumber, million square feet of hardwood veneer, thousands of hardwood doors, and thousand tons of paper.

Research and development.--

Current expenditures

Current expenditures financed by others

Research and development expenditures budget

Number of employees in research and development

Number of employees with college degrees in science, engineering, etc.

Number of research people with advanced degrees

Awards for research achievement

Patents received

Sales from products introduced within the past so many years

New products

The Singer Company:

Research and development expenditures . . . amounted to \$18 million, an increase of 14 per cent. These figures do not include \$7 million for research funded by others, largely the government, . . .

General Telephone and Electronics:

In addition to these company-sponsored activities, more than \$107 million in research and development work was performed for the government, bringing the total of our technical programs to more than \$144 million.

FMC Corporation:

The Company incurred research and development costs of \$21.3 million in 1965, compared with \$18.0 million spent for this purpose in the prior year. In addition, the Company was reimbursed \$15.6 million for research performed for government and industrial sponsors.

Pfizer indicates that \$24,000,000 has been budgeted for research and development in 1966.

Bendix:

One of the most vital of Bendix' activities, research and development, is conducted by our staff of 12,500 people, located in the engineering departments of our divisions and at the Research Laboratories Division. Approximately forty-three hundred of these people hold degrees in science and engineering pertinent to our fields of activity.

Ingersoll-Rand states that a large number of its research people hold advanced degrees.

Westinghouse presents the following information relating to awards received for research achievement:

Westinghouse research scientists won two prized national awards. The American Welding Society bestowed its James F. Lincoln Gold Medal for the second time on Julius Heuschkel for his original contributions to the advancement of welding. Dr. Clarence Zener received the Albert Sauveur Achievement Award from the American Society for Metals in recognition of his pioneering achievements in metallurgy.

The role of the Central Research Laboratories as a source of new products was highlighted in 1965 by a nationwide competition "to identify and honor the nation's 100 most outstanding scientific and technical innovations." Westinghouse led all American industry with eight awards, six of them products of the Research Laboratories.

Monsanto reports that it received 368 U. S. patents and 1,486 foreign patents in 1965.



The following statements relate to sales from products introduced by the particular company within the past so many years:

**Eastman Kodak:**

Better than 55 per cent of the sales made in 1965 by Eastman Chemical Products, Inc., came from products that were not on the market 15 years ago.

**General Foods Corporation:**

Products developed or acquired during the last 10 years accounted for \$378 million, or 26 per cent of total net sales.

Most companies include a partial or complete report on new products introduced during the year.

Some of the accompanying descriptions of the features of these new products follow:

**Johns-Manville:**

This new material has the texture and appearance of natural wood shake shingles.

**Litton Industries:**

. . . and a pin contact encoder with a lifetime and reliability factor up to 14 times greater than is found in conventional brush encoder units.

**Singer:**

. . . provides greatly increased programming flexibility to meet requirements of source data automation.

**Sperry Rand:**

Its key feature is an in-line piston motor containing 76 parts, which compares with units in competitive hydraulic equipment containing over 200 parts.

#### 4. Governmental and Social Contribution Information

##### a) Governmental

Government contracts.--Continental Motors Corporation presents the following statements in its 1965 annual report:

Largest of these was a \$36.3 million contract for approximately 16,000 LDS-465 six-cylinder, turbocharged compression-ignition multifuel engines for the U. S. Army's 5-ton truck series. Initial deliveries under this three-year multi-year procurement contract will begin early in 1966.

Another major award during the year was a three-year contract totaling \$11.9 million for production of 28,000 engines for the Army's M-151 quarter-ton military utility tactical trucks.

##### Chrysler reports:

In late 1965, Chrysler's Defense Operations Division received Army contracts totaling \$35.2 million to produce 314 additional M-60A1 Combat Tanks and 46 Combat Engineer Vehicles. The contract awards extend production operations into May 1967.

Antitrust.--Some companies present a good deal of detail in their annual reports concerning antitrust actions that have been brought against the company. General Motors is one company that discusses the antitrust area quite thoroughly in its 1965 annual report.

Of course, the contingent financial effect of such actions should be considered by the company in preparing its conventional financial statements and accompanying footnotes. The independent auditor should decide whether adequate disclosure of all such financial effects has been provided by

the company. Materiality, of course, determines the nature of the disclosure to be made.

But regardless of the potential financial effect of pending actions, the auditor's opinion does not generally cover the additional information presented concerning anti-trust actions. The latter includes, for example, court decisions and appeals during the year.

b) Social contribution

Balance-of-payments position.--Caterpillar states that its "net contribution to the flow of international payments into the United States was \$461 million" in 1965.

Eastman Kodak reports a net contribution or favorable balance of \$165,000,000 for 1965.

Pollution abatement expenditures.--Armco Steel reports the expenditure of nearly \$13 million during the past 10 years for pollution abatement facilities.

Du Pont states:

Du Pont has long had a deep concern for the problems of environmental pollution. No new project is approved until adequate provision is made for air, land, and water pollution control. The total investment in existing and authorized pollution abatement facilities is in the neighborhood of \$100 million.

Educational and charitable contributions.--

Total contributions

Educational contributions

Matching gift plans

United States Steel indicates it "made contributions for educational and charitable purposes during 1965 of \$6.9 million."

Ford Motor reports its "contributions for educational and charitable purposes totaled \$11 million in 1965."

General Motors states that its "aid to education totaled \$11.2 million in 1965."

Several companies report on matching gift plans whereby employee contributions to colleges or universities are matched by the company. This presentation usually indicates the number of employees who made contributions, the total dollar amount contributed, and the number of schools that received contributions through the plan during the year.

As with some of the information traditionally covered by the CPA's opinion, some of the information generally not covered by the CPA's opinion is often presented for a period of two years or more. A particular item may be specifically indicated for a period of two years or more or the information for a prior year or years may be implied in presentations referring to increases, decreases, or other comparative relationships. As mentioned previously, the problems associated with extending the auditor's opinion to cover a period of two years or more are discussed in Chapter IV. The CPA's ability to verify kinds of information which are generally not covered by his opinion is the primary concern of Chapter

### III.

Appendix B includes a list of the assertions that would have to be verified in order to substantiate the information presented in this chapter which is generally not covered by the CPA's opinion. Some of these assertions are explicit in the annual report presentations, but others are implied. The auditor's ability to verify these assertions is examined in Chapter III.

CHAPTER III  
VERIFICATION OF ADDITIONAL  
INFORMATION

The preceding chapter contained a description of certain kinds of information which are being presented in corporate annual reports and are generally not covered by the auditor's opinion. As mentioned previously, there are several important considerations pertaining to whether or not the CPA's attest function can be extended to include this additional information. These considerations are interrelated to some extent, but are treated separately in this study to facilitate their discussion.

The legal and ethical implications and economic feasibility of extension are discussed in Chapter V. The specific concern of the present chapter is the auditor's ability to verify the additional information described in Chapter II. The ability to verify this information would appear to be the primary determinant of whether or not the attest function can be extended to include it. Essentially, verification involves obtaining sufficient evidence to provide a rational basis for judging the reliability of assertions made by others.

The membership of the American Institute of Certified Public Accountants has adopted 10 "generally accepted

auditing standards."<sup>1</sup> These standards indicate the general level of quality required in the performance of the CPA's independent audit function. The CPA indicates in his audit report whether his examination has been made in accordance with these standards. The third standard of field work is particularly relevant to the discussion in this chapter:

Sufficient competent evidential matter is to be obtained through inspection, observation, inquiries and confirmations to afford a reasonable basis for an opinion regarding the financial statements under examination.<sup>2</sup>

The applicability of the remaining "generally accepted auditing standards," if the CPA's attest function is extended to include the additional information, is discussed in Chapters IV (reporting standards) and V (general and other field work standards).<sup>3</sup>

Professors R. K. Mautz and Hussein A. Sharaf point out the significance of audit evidence in the following statement:

Evidence gives us a rational basis for forming judgments.

Auditing is like other disciplines in this respect. The auditor requires evidence in order that

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<sup>1</sup>Committee on Auditing Procedure, Statements on Auditing Procedure No. 33, pp. 15-16.

<sup>2</sup>Ibid., p. 16.

<sup>3</sup>The examination of the traditional financial statements includes "verifying" conformity with "generally accepted accounting principles." These "principles" are obviously not applicable to some of the additional information included in this study. The implications of the latter are discussed in Chapter IV in connection with reporting standards.

he may rationally judge the financial statement propositions submitted to him. To the extent that he makes judgments and forms his "opinion" on the basis of adequate evidence, he acts rationally by following a systematic or methodical procedure; to the extent that he fails to gather "sufficient competent evidential matter" and fails to evaluate it effectively, he acts irrationally and his judgments can have little standing.<sup>4</sup>

The primary concern in this chapter is the general availability of sufficient evidence to afford a reasonable basis for judging the reliability of the additional information. The ability to obtain "sufficient competent evidential matter" will vary, of course, depending upon the circumstances in a particular examination and the professional competence and judgment of the auditor performing the examination. Perhaps considerations other than verification render extension impracticable, but, to repeat, the primary concern in this chapter is with verification per se; that is, the general availability of evidence for judging the reliability of the additional information described in Chapter II. Other considerations relating to whether or not the attest function can be extended to include this information are discussed in subsequent chapters.

#### Verification Procedure

W. A. Paton and A. C. Littleton state:

"To verify" means to establish the truth, to

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<sup>4</sup>Mautz and Sharaf, p. 68.



test the accuracy of a fact, to substantiate an assertion. "Evidence" is a means of ascertaining the truth or of furnishing proof.<sup>5</sup>

However, verification in auditing seldom means proving conclusively that a given assertion is true. The nature of audit evidence and the economic limitations of an audit examination prevent the auditor from obtaining conclusive proof for most assertions. Mautz and Sharaf point this out in the following statements:

Compelling evidence is available to support only a limited number of financial statement propositions and . . . a great many other propositions, probably the great majority, are such that the mind of the auditor is not compelled but rather only persuaded of the reliability of the assertion at issue.<sup>6</sup>

In view of the limitations of audit evidence in the establishment of incontrovertible truth and the influence of time and other conditions under which an auditor works, truth in auditing may be defined as conformity with reality as the auditor can determine reality at the time of his examination and with the evidence available.<sup>7</sup>

Traditionally, the verification of information in auditing has involved the collection and evaluation of evidential matter as a basis for determining the validity of management assertions in financial statements. The auditor must judge the reliability of many individual financial

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<sup>5</sup>W. A. Paton and A. C. Littleton, An Introduction to Corporate Accounting Standards (Iowa City, Iowa: American Accounting Association, 1940), p. 18.

<sup>6</sup>Mautz and Sharaf, p. 84.

<sup>7</sup>Ibid., p. 110.

statement assertions before he can render an opinion as to the over-all reliability of the statements. The additional information described in Chapter II also consists of assertions made by the management of the reporting company. Some of this additional information is not financial data, but the types of assertions made are basically the same as those in the financial statements.

Mautz and Sharaf describe the general verification procedure employed in auditing.<sup>8</sup> The reader should refer to the Mautz and Sharaf monograph for an analysis of this procedure, but essentially it involves the collection and evaluation of evidence as a logical basis for formulating judgments concerning the reliability of financial statement assertions. They indicate the types of assertions made in financial statements, the types of evidence generally available for determining the validity of these assertions and the available techniques for obtaining that evidence. In effect, given the type of assertion, the type or types of evidence generally available for judging its reliability are derived from the nature of that assertion. Similarly, the technique or techniques for obtaining audit evidence are derived from the nature of the evidence. These relationships are illustrated in subsequent sections of this chapter.

The Mautz and Sharaf classifications of assertions,

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<sup>8</sup>Ibid., pp. 79-110.

evidence, and techniques relate to financial statement information, but there appears to be no logical reason why application of the general verification procedure should be confined to financial statement assertions. If the types of assertions made outside the financial statements are basically the same as those within the statements, it seems reasonable to presume that the same general verification procedure would apply to both. The analysis in the remainder of this chapter should indicate the general applicability of the traditional verification procedure to the additional information. Furthermore, it should serve to point out the general availability of evidence for judging the reliability of this information.

### Assertions

Financial statements contain a large number of assertions--both expressed and implied. Professors Mautz and Sharaf classify financial statement assertions as follows:

- I. Assertions of existence or nonexistence
  - A. Of physical things
    1. Present
    2. Not present
  - B. Of nonphysical things
- II. Assertions of past events
- III. Assertions of quantitative conditions
  - A. Simple quantities
  - B. Amounts involving value judgments
- IV. Assertions of qualitative conditions
  - A. Expressed
  - B. Implied
- V. Mathematical assertions

- A. Resulting from single calculations
- B. Resulting from multiple calculations<sup>9</sup>

Examples of these types of assertions are presented in Table 1. The reader should refer to the Mautz and Sharaf study for a more detailed discussion of financial statement assertions.<sup>10</sup>

The additional information generally not covered by the auditor's opinion is stated in terms of expressed and implied assertions in Appendix B of this study. These assertions were analysed to determine their nature. This analysis revealed that all of the assertions could be classified in accordance with the Mautz and Sharaf classification. However, a new class, "future events," was added. This type of assertion is similar to certain classes in the Mautz and Sharaf classification (namely "value-judgment quantities" and "qualitative conditions"), but is afforded special treatment for other reasons.

Assertions of "future events" include sales and earnings forecasts, budgeted expenditures, and other projections of the future. Although budgeted and forecasted amounts are based in part upon historical data, the assertions themselves are of future events.

In his examination of the traditional financial statements the auditor must pass judgment on estimates of

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<sup>9</sup>Ibid., p. 80.

<sup>10</sup>Ibid., pp. 80-84.

TABLE 1  
 EXAMPLES OF FINANCIAL STATEMENT  
 ASSERTIONS

<u>Type of Assertion</u>	<u>Examples</u>
Existence of physical things present	Cash on hand Equipment, buildings, and land
Existence of physical things not present	Cash in bank Inventories in public warehouses
Existence of nonphysical things	Accounts receivable Goodwill Retained earnings Retained earnings appropriations
Nonexistence of physical and nonphysical things	No amounts for land or accounts payable on the balance sheet
Past events	All revenues and expenses
Simple quantitative conditions	X dollars of cash on hand X dollars of accounts payable
Value-judgment quantities	X dollars of accounts receivable X dollars of net income
Qualitative conditions	Availability of cash Marketability of securities Collectibility of receivables Ownership of assets
Mathematical	<u>Total</u> current assets <u>Total</u> current liabilities <u>Net</u> income

the future with respect to the amounts of several items. These items include, for example, depreciation, bad debts, and contingent liabilities. Professors Mautz and Sharaf classify financial statement amounts involving estimates of the future as assertions of "amounts involving value judgments."<sup>11</sup> One reason for adding a separate class for assertions of "future events" is that some of the latter do not involve amounts. For example, there is no amount involved in a company's assertion that it plans to construct a certain type of plant at a certain location. This would seem to be solely an assertion of a "future event."

Another reason, and perhaps the most significant one, is that there seems to be a significant difference between employing estimates of the future in arriving at amounts for items in this year's financial statements (for example, depreciation and contingent liabilities) and projections of the future such as a sales forecast or budgeted capital expenditures for next year. Depreciation for this year is an assertion of a past event and a contingent liability involves assertions of the existence of a nonphysical thing (liability) and a qualitative condition (contingent) as of the end of this year. The projections of the future relate only to future events.

Although some assertions of "qualitative conditions"

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<sup>11</sup>Ibid., p. 82

and "value-judgment quantities" in the traditional financial statements involve estimates or judgments concerning the future, they relate to items in this year's statements. That is, these assertions are only part of an over-all presentation relating to this year. Assertions of "future events," whether they involve amounts or not, relate entirely to events in a subsequent year. For the purposes of this study it seems necessary to distinguish the latter from assertions contained in retrospective financial statements.

However, this distinction would not seem to affect the kinds of evidence generally available for judging the reliability of assertions of "future events." Presumably the kinds of evidence would be essentially the same as those which are generally available for judging the reliability of assertions of "value-judgment quantities" and "qualitative conditions" involving estimates of "future events." The distinction is made primarily because of ethical and other considerations relating to the expression of an opinion pertaining specifically to the reliability of an assertion of "future events"--an assertion relating solely to a future period. Extension of the CPA's attest function to include assertions of "future events" is discussed further in a subsequent section of this chapter.

The class "nonexistence of physical and nonphysical things" does not apply to the additional information in the same manner that it applies to financial statement presenta-

tions. This class is applicable to the additional information only if a company expressly states that a particular physical or nonphysical thing does not exist; for example, that the company has no unfilled orders or no facilities in the process of construction. The only example of this type found in the 89 annual reports examined for this study was a statement to the effect that the particular company was utilizing no government facilities for its operations.

The omission of certain items in the financial statements is an assertion that those items do not exist. For example, if a company's balance sheet does not contain any amounts for accounts payable or buildings, then the assertion is that it has no accounts payable or buildings. The failure to report items outside the financial statements does not necessarily imply that the items do not exist. This is true because there are essentially no "generally accepted" standards relating to what should be reported in the annual report outside the financial statements. Information reported outside the financial statements varies substantially in kind and amount. If and when appropriate standards are developed for reporting the additional information the applicability of this class would undoubtedly change.

As mentioned previously, the additional information described in Chapter II is stated in terms of assertions in Appendix B. The type of assertion is also indicated in this



appendix. More than one type is indicated for most of the assertions listed because they could be further subdivided into subsidiary assertions.

### Audit Evidence

R. K. Mautz describes "evidential matter" concisely in the following statement:

Audit evidence includes any factual matter available to an auditor from which he may know or infer the relative truth or falsity of the assertions in financial statements.<sup>12</sup>

Thus audit evidence includes not only company records but any kind of corroborating information as well:

Corroborating evidential matter includes documentary material such as checks, invoices, contracts, and minutes of meetings; confirmations and other written representations by knowledgeable people; information obtained by the auditor from inquiry, observation, inspection, and physical examination; and other information developed by, or available to, the auditor which permits him to reach conclusions through valid reasoning.<sup>13</sup>

Professors Mautz and Sharaf classify audit evidence as follows:

1. Physical examination by the auditor
2. Written and oral statements by independent third parties
3. Authoritative documents
4. Formal and informal statements by officers and employees of the company

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<sup>12</sup>R. K. Mautz, "The Nature and Reliability of Audit Evidence," Independent Auditing Standards, ed. J. C. Ray (New York: Holt, Rinehart and Winston, Inc., 1964), p. 200.

<sup>13</sup>Committee on Auditing Procedure, Statements on Auditing Procedure No. 33, p. 35.

- under examination
5. Calculations performed by the auditor
  6. Satisfactory internal control procedures
  7. Subsequent actions by the company under examination and others
  8. Subsidiary or detail records with no significant indications of irregularity
  9. Interrelationships with other data<sup>14</sup>

These nine basic types of audit evidence seem to encompass all of the different types of evidence generally available for determining the validity of financial statement assertions. Mautz and Sharaf point this out in the following statement:

These types of evidence are different in nature and cover all the basic ways of knowing. Having exhausted the possibilities with respect to obtaining knowledge about a proposition and having found the available knowledge unanimously to support it, we would be acting irrationally if we refused to accept the proposition as valid.<sup>15</sup>

The auditor must obtain "sufficient competent" evidence as a basis for formulating judgments concerning the assertions under examination. "Competent" means simply that the evidence must be relevant to the assertion under examination and that this evidence must be reliable. Reliability varies substantially among the different classes of audit evidence and also within each class.<sup>16</sup> Floyd W. Windal

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<sup>14</sup>Mautz and Sharaf, p. 86.

<sup>15</sup>Ibid., p. 98.

<sup>16</sup>For example, "statements by independent third parties" are generally considered to be one of the more reliable types of audit evidence. But the reliability of this type of evidence will vary depending upon the competence of the third party.

arrived at the following general conclusions regarding the reliability of audit evidence, but the reader is reminded that there may be significant exceptions to these generalizations depending upon the circumstances in a particular examination:

1. Evidence which is obtained from a source independent of the enterprise being audited is more reliable than evidence obtained from a source within that enterprise.<sup>17</sup>

2. Evidence which is objective in nature is more reliable than evidence which reflects personal judgment or bias.<sup>18</sup>

3. Evidence obtained by the auditor himself or by his representative is more reliable than evidence supplied by another, except where the auditor is not qualified to obtain that evidence.<sup>19</sup>

For a more detailed discussion of the nature and reliability of the various types of audit evidence the reader may refer to Windal's thesis or any of several standard auditing textbooks.

"Sufficient" evidence means the quantity and types of evidence required to determine the validity of a given assertion. The auditor must decide what constitutes "sufficient" evidence for a given assertion in a particular examination. He must consider several factors in formulating

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<sup>17</sup>Floyd W. Windal, An Analysis of the Relative Reliability of the Various Types of Audit Evidence (University of Illinois: Unpublished M.S. Thesis, 1955), p. 26.

<sup>18</sup>Ibid., p. 27.

<sup>19</sup>Ibid., p. 28.

such judgments. These include the nature of the assertion, its materiality, the relative risk that the assertion may be unreliable, and the types and competence of evidence available.<sup>20</sup>

An overriding consideration in any audit is that it must be completed within a reasonable time at reasonable cost. Therefore, the auditor must strive for a rational balancing of audit cost and time with the quantity and types of evidence obtained.<sup>21</sup> Cost and time considerations relating to the possible extension of the CPA's attest function are discussed in Chapter V.

Since the materiality of a given assertion must be considered by the auditor in deciding the quantity and types of evidence required to judge its reliability, he must be able to determine the relative size and importance of that assertion. Determining the materiality of assertions outside the financial statements may be, in general, a more difficult problem than determining the materiality of financial statement assertions. Stephen Chan indicates:

- Materiality has two criteria, namely:
1. The relative largeness of the amount.
  2. The importance of the information to interested third parties, regardless of the amount; in other words, the nature of the item and its effect on the conclusions which may be

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<sup>20</sup>Committee on Auditing Procedure, Statements on Auditing Procedure No. 33, p. 36.

<sup>21</sup>Ibid., p. 37.

drawn from the financial statement.<sup>22</sup>

Determining the materiality of financial statement information is no easy job and auditors have had many years experience in this endeavor. However, there are many fairly obvious relationships between financial statement amounts which help the auditor in determining materiality. In addition, his familiarity with the nature of financial statement items facilitates the determination of their importance.

Amounts presented outside the financial statements are usually not related to other amounts in the annual report in such a way that comparisons are facilitated. Also, the nature of most of the additional information is such that it would undoubtedly be quite difficult for the auditor to determine which assertions are more important than others to readers of the annual report. It may be that in determining what constitutes "sufficient" evidence to support most assertions outside the financial statements the auditor would have to rely primarily upon his consideration of factors other than materiality.

The basic type or types of audit evidence generally available for judging the reliability of each type of financial statement assertion are as follows:<sup>23</sup>

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<sup>22</sup>Stephen Chan, "Materiality," Independent Auditing Standards, ed. J. C. Ray (New York: Holt, Rinehart and Winston, Inc., 1964), p. 459.

<sup>23</sup>This does not mean that every type of evidence indicated for each type of assertion will be available in

<u>Type of assertion</u>	<u>Evidence</u>
1. Existence of physical things present	Examination by auditor
2. Simple quantitative conditions	Examination by auditor
3. Mathematical	Calculation by auditor
4. Existence of physical things not present	Statements by independent third parties, authoritative documents, statements by company personnel, and subsidiary or detail records
5. Past events	Same as (4)
6. Existence of nonphysical things	Same as (4); and satisfactory internal control procedures, subsequent actions by the company and others, and interrelationships with other data
7. Nonexistence of physical and nonphysical things	Same as (6)
8. Qualitative conditions	Same as (6)
9. Value-judgment quantities	Same as (6) <sup>24</sup>

Assertions of "future events" are discussed separately below.

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every examination for every assertion of that type being examined. Neither does it mean that every type of evidence indicated will be available for every assertion of a given type in any examination. Also, the auditor may not deem it necessary to obtain all of the types of evidence available for a given assertion. He will select one or more of those types that are available for a given assertion in a particular examination. This selection will depend upon his professional judgment as to the specific requirements for determining the validity of that assertion.

<sup>24</sup>Mautz and Sharaf, p. 101.

"Future events"

Assertions of "future events" were discussed earlier in this chapter. The need for a separate class relating specifically to this type of assertion was pointed out then.

Despite the fact that they are already rendering opinions on financial statements involving estimates of the future, most CPAs might voice vigorous opposition to extending the coverage of their opinions to include assertions of "future events" such as forecasted and budgeted amounts. This might be especially true with respect to opinions in clients' reports to third parties; for example, the published annual report.

Sufficient evidence is presumably available to satisfy the auditor concerning the estimates of the future involved in the traditional financial statements. His opinion, however, relates to the over-all reliability of these statements and not specifically to any estimates of the future involved therein. Some CPAs may be willing to attest to the fact that a particular plan or budget has been approved, for example, by the Board of Directors. But most would probably question their ability to obtain "sufficient competent evidential matter" to support an opinion relating specifically to the reliability of an assertion of "future events."

Nevertheless, as mentioned previously, the types of evidence generally available for judging the reliability of

such an assertion would appear to be essentially the same as those for judging assertions of "value-judgment quantities" and "qualitative conditions" involving estimates of the future. This would include all of the basic types of audit evidence except "examination by the auditor" and "calculation by the auditor." However, "calculation by the auditor" would naturally be the applicable evidence for verifying the mathematical accuracy of a projection of the future.

The amount of unfilled orders is an example of evidence that could be obtained to judge the reliability of a sales forecast. Labor and other types of contracts could be examined as evidence for judging the reliability of certain budgeted amounts. Certain historical financial data would serve as evidence for determining the reliability of budgeted and forecasted amounts. The reader can probably conceive of many examples of "subsequent actions by the company and others" which would, at least to some extent, support projections of the future.

Of course the ability to obtain "sufficient competent evidential matter" to support an opinion on an assertion of "future events," the same as for any other type of assertion, will vary depending upon the circumstances in a particular examination and the professional competence and judgment of the auditor performing the examination. The suggestion here is not that the CPA can vouch that sales,



for example, will be \$100,000,000 next year. Anything short of possessing divine powers would preclude this possibility. The auditor does not actually vouch for the accuracy of traditional financial statement information either. His opinion relates to the over-all reliability of the statements.

However, if the auditor can obtain "sufficient competent evidential matter" in a particular examination to support an opinion relating specifically to the reliability of an assertion of "future events," there are significant ethical implications which would require him to accompany his opinion with an explicit statement that he does not vouch for the accuracy of that projection. These ethical implications pertaining to the association of a CPA's name with projections of the future are discussed in Chapter V.

This chapter is concerned with verification and the general availability of evidence. It appears reasonable to conclude that evidence is generally available for judging the reliability of assertions of "future events." The following statements seem especially pertinent to the present discussion:

Auditors have a natural and understandable reluctance to extend the area of their responsibility by increasing the scope of their examinations to include verification of such data as budgets, financing plans, and capital expenditure programs . . .

We contend that any assertion having a basis of corporate action and planning can be subjected to

useful verification and confirmed or negated by more or less convincing evidence . . . To invade this new area of service, he need but extend his probabilities a little further. The same techniques will apply, the same kinds of evidence will be found, the same problems of judgment will be met.<sup>25</sup>

However, verification is only one of several considerations relating to whether or not the attest function can be extended to include assertions of "future events," or any other kind of additional information. As mentioned previously, ethical implications and economic feasibility are discussed in Chapter V. Of special significance is the possible lack of adequate criteria for judging the "fairness" of additional information presented in the annual report. The auditor uses "generally accepted accounting principles" to judge the fairness of the traditional financial statement presentations.<sup>26</sup> Mautz and Sharaf point out that "with no generally accepted guide, auditors' opinions would become so personal as to be of little value to anyone."<sup>27</sup> Are there, for example, some sort of "generally accepted principles" to guide the auditor in judging the methodology employed in arriving at forecasts and budgeted amounts? This and related questions are discussed in Chapter IV in connection with reporting standards.

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<sup>25</sup>Ibid., p. 192.

<sup>26</sup>Ibid., p. 47.

<sup>27</sup>Ibid., p. 48.

### Summary: Assertions and Audit Evidence

The additional information included in this study consists of basically the same types of assertions as those in the financial statements. It would seem reasonable to conclude, therefore, that the basic types of evidence generally available for judging the reliability of this additional information would be essentially the same as those for judging the reliability of financial assertions. For example, an assertion of physical existence (things present), whether outside or within the financial statements, logically leads to "examination by the auditor" as the applicable type of evidence. The evidence to support any mathematical assertion in the annual report would be "calculation by the auditor." Some of the other assertion-evidence relationships may not be as obvious, but a careful examination of the nature of a given assertion will reveal that there is only a limited number of basic types of evidence generally available to support that assertion. An analysis of the additional information included in this study revealed that the Mautz and Sharaf classification of audit evidence is broad enough to cover all of the kinds of evidence generally available for judging the reliability of this information.

### Audit Techniques

Audit techniques are the devices or methods available to the auditor for obtaining competent evidential matter. They are the vehicles or means

available for use in performing an audit.<sup>28</sup>

Audit techniques are not to be confused with audit procedures:

Audit procedures are ways of applying techniques to particular phases of a particular audit. They are the processes developed from the techniques to fit given circumstances and given conditions.<sup>29</sup>

Audit techniques are directly related to audit evidence. The applicable audit technique or techniques for obtaining each of the basic types of evidence are indicated below:

<u>Type of evidence</u>	<u>Applicable techniques</u>
1. Examination by auditor	Physical examination and count
2. Calculation by auditor	Recomputation
3. Statements by independent third parties	Confirmation
4. Authoritative documents	Examination of documents
5. Statements by company personnel	Inquiry
6. Subsidiary or detail records	Examination of records
7. Satisfactory internal control procedures	Examination of documents Inquiry Observation Retracing bookkeeping procedures Scanning

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<sup>28</sup>C. A. Moyer, "Relationship of Audit Programs to Audit Standards, Principles, Techniques, and Procedures," The Journal of Accountancy, XCIV (December, 1952), 687.

<sup>29</sup>Ibid.

<u>Type of evidence</u>	<u>Applicable techniques</u>
8. Subsequent actions by the company and others	Confirmation Examination of documents Inquiry Observation
9. Interrelationships with other data	Coordination with related data Scanning <sup>30</sup>

Others have suggested classifications of basic audit techniques with fewer classes and in different terms, but the classification suggested by Professors Mautz and Sharaf encompasses essentially all of the available techniques for obtaining audit evidence. These techniques appear sufficiently self-descriptive for the purposes of this study. However, the reader who is unfamiliar with any of the techniques should refer to the discussion of audit techniques in Professor Mautz's auditing textbook.<sup>31</sup>

#### Verification

Some of the additional information included in this study is already verified to a certain extent during the regular audit examination of financial statements. But this information is generally not covered by the auditor's opinion. Examples of the latter are employment costs; advertising expenditures; educational and charitable contributions; type and location of company facilities; and sales

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<sup>30</sup>Mautz and Sharaf, p. 101.

<sup>31</sup>R. K. Mautz, Fundamentals of Auditing (2d ed.; New York: John Wiley & Sons, Inc., 1964), pp. 77-86.

and earnings by major product groups or divisions. Sales and earnings by major product groups or divisions are not verified directly, but are verified indirectly to some extent in the verification of the company's total sales and earnings. The general procedures for verifying any breakdown of sales or earnings would be essentially the same as those for verifying total sales or earnings. There may be some accounting problems (involving for example, the allocation of joint costs between groups or divisions and the allocation of revenues and expenses between quarters), but there would not seem to be any significant verification (per se) problems involved in extending the attest function to include earnings and sales breakdowns. However, extending opinion coverage to any information which is verified to a certain extent now would undoubtedly require considerably more verification work in most cases; especially with respect to sales and earnings by major product groups or divisions. The problems involved in extending the attest function to include this information as well as most of the other additional information included in this study seem to relate primarily to economic and other considerations which are discussed in Chapters IV, V, and VI.

Several examples are presented in Table 2 to illustrate the general applicability of the traditional verification procedure to the additional information included in this study. Not all of the types of evidence pertaining to

TABLE 2

EXAMPLES OF THE VERIFICATION OF ADDITIONAL INFORMATION

<u>Information</u>	<u>Type of Evidence</u>	<u>Applicable Technique and General Procedure</u>
1. Index of selling prices	Calculation by auditor	Recomputation: recalculate the index
2. Unfilled orders	Statements by independent third parties	Confirmation: obtain written confirmations from customers
	Authoritative documents	Examination of documents: examine orders
	Subsequent actions by the company	Examination of documents: examine shipping records
3. Suppliers and subcontractors with less than a certain number of employees (small businesses)	Statements by independent third parties	Confirmation: obtain written statements from businesses as to number of employees
4. Dividend record	Authoritative documents	Examination of documents: examine published stock records (independent investment services)
5. Price range of company's stock (New York Stock Exchange)	Authoritative documents	Examination of documents: examine Wall Street Journal

TABLE 2--Continued

<u>Information</u>	<u>Type of Evidence</u>	<u>Applicable Technique and General Procedure</u>
6. Type of shareholder and shares held by each shareholder	Statements by independent third parties  Statements by independent third parties  Authoritative documents  Detail records	Confirmation: obtain written statement as to price range from Exchange  Confirmation: obtain written confirmation from transfer agent  Examination of documents: examine carbon copy of stock certificates  Examination of records: examine stockholders ledger
7. Voting at annual stockholders' meeting	Statements by independent third parties  Authoritative documents	Confirmation: obtain written statement from transfer agent as to shareholders entitled to vote and shares eligible to be voted  Examination of documents: examine minute book for record of voting
8. Business or professional affiliations of directors	Statements by independent third parties	Confirmation: obtain written statements from organizations affiliated with



TABLE 2--Continued

<u>Information</u>	<u>Type of Evidence</u>	<u>Applicable Technique and General Procedure</u>
	Authoritative documents	Examination of documents: examine annual reports of organizations affiliated with
9. Attendance at Board meetings	Statements by company personnel	Inquiry: obtain written statement listing dates of all Board meetings from company secretary
	Authoritative documents	Examination of documents: examine minute book to determine attendance at meetings
10. College degrees received by officers and employees	Statements by independent third parties	Confirmation: obtain written confirmations from colleges
	Authoritative documents	Examination of documents: examine personnel records
11. Employees of the company	Authoritative documents	Examination of documents: examine individual earnings records and personnel records
12. Employee turnover	Authoritative documents	Examination of documents: examine authorizations to place new employees on payroll and remove old ones from the payroll

TABLE 2--Continued

<u>Information</u>	<u>Type of Evidence</u>	<u>Applicable Technique and General Procedure</u>
13. Interviews conducted at colleges, and graduates hired	Statements by independent third parties	Confirmation: obtain written confirmations from placement directors
14. Labor contracts signed; duration, provisions, etc.	Authoritative documents	Examination of documents: examine contracts
	Statements by independent third parties	Confirmation: obtain written confirmations from unions
15. Hours worked per week	Detail records	Examination of records: examine payroll summary
	Authoritative documents	Examination of documents: examine clock cards
16. Disabling injuries	Statements by company personnel	Inquiry: obtain written statement from company physician
	Statements by independent third parties	Confirmation: obtain written statement from independent physician
	Authoritative documents	Examination of documents: examine medical records

**TABLE 2--Continued**

<b><u>Information</u></b>	<b><u>Type of Evidence</u></b>	<b><u>Applicable Technique and General Procedure</u></b>
17. Type and location of company facilities	Examination by auditor	Physical examination: examine facilities
18. Facilities completed during the year	Authoritative documents	Examination of documents: examine purchases invoices if purchased, or work orders, time cards, etc. if constructed by company
19. Ownership of facilities	Statements by independent third parties	Confirmation: obtain written confirmation from company attorneys
20. Leased facilities	Authoritative documents	Examination of documents: examine leases
	Statements by independent third parties	Confirmation: obtain written confirmation from lessors
21. Planned facilities	Subsequent actions by the company and others	Observation: observe construction has begun on facilities
	Authoritative documents	Examination of documents: examine purchase contracts; examine minute book (approved by Board)

TABLE 2--Continued

<u>Information</u>	<u>Type of Evidence</u>	<u>Applicable Technique and General Procedure</u>
22. Estimated size of natural resource reserves	Statements by independent third parties	Confirmation: obtain written confirmation from independent engineer or geologist
23. Number of patents received during the year	Examination by auditor	Physical examination and count: examine letters patent
	Statements by independent third parties	Confirmation: obtain written confirmation from company attorneys; obtain written confirmation from issuing bodies
24. Government contracts awarded during the year	Authoritative documents	Examination of documents: examine contracts
	Statements by independent third parties	Confirmation: obtain written confirmation from company attorneys
25. Antitrust actions, judgments, and appeals	Statement by independent third parties	Confirmation: obtain written confirmation from company attorneys

a given item are indicated in most of the examples. Also, the general procedures illustrated are not necessarily the only ways of obtaining the type or types of evidence indicated. The procedures employed to verify a given item may vary considerably depending upon the circumstances in a particular examination.

#### Special verification problems

In verifying the additional information the auditor would be confronted with the same kinds of problems he has now. For example, he would still have to question the genuineness of documentary evidence and the competence of independent third parties from whom written or oral statements could be obtained. In addition to the usual verification problems, there appear to be some special problems involved because of the unique nature of some of the kinds of additional information.

Industry data.--It would be virtually impossible to verify industry data in the same manner that most company data can be verified. For example, the auditor would not be able to verify the sales for each company in the industry in the same manner that he verifies his client's sales. Of course, this is assuming that not all of the companies in the industry are his clients. It is highly unlikely that they would be.

A possible alternative would be to use the audited sales figure in the annual report of each company in the in-

dustry as evidence. It is quite doubtful, however, if these reports would be available in time for the auditor to express an opinion on industry sales in the client's annual report. Also, this latter procedure would not be applicable for items such as unit sales, employee turnover, and safety rates. These items are not reported by very many companies, and are not covered by the auditor's opinion when they are reported.

Probably the only practicable way to verify industry data would be to examine the report from which the data was obtained.<sup>32</sup> The auditor could then render an opinion to the effect that the industry data presents fairly what it purports to present--a certain kind of industry data as reported by a particular trade association or other organization.

Index of company's selling prices.--The auditor may not be able to obtain sufficient evidence in all cases to satisfy himself as to the validity of base year data. Where the latter is true it would not appear that he could express an unqualified opinion as to the reliability of the index for the year under examination. He may, however, be able to render some sort of qualified opinion wherein he states that sufficient evidence could not be obtained concerning the base year data.

Features of new products.--If the descriptions of

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<sup>32</sup>In addition, the auditor may want to confirm the report with the particular trade association or other organization that reported the data.

the features of new products have any basis in fact, it would seem that this information could be verified. If they are merely subjective opinions the auditor could not verify this information. In most cases the primary type of evidence for verifying these descriptions would probably be statements by independent experts.

Some practitioners question the value of CPAs attesting to information where the primary or only evidence is a statement by an independent expert. These practitioners feel that CPAs would not add anything by attesting to something that another independent expert had already "attested" to. Confirmation from an independent expert, however, is an accepted audit procedure. This procedure appears to be a legitimate means of verifying certain kinds of information. Because this problem does not relate to verification per se, but rather to the value of rendering opinions specifically on information where this procedure is the only or primary means of obtaining evidence to support that information, further discussion of this question is reserved for Chapters V and VI.

#### Summary

Probably the primary determinant of whether or not the attest function can be extended to include additional information is the auditor's ability to verify that information. Verification is essentially a matter of obtaining

sufficient evidence to provide a rational basis for judging the reliability of assertions made by others. Since the additional information included in this study consists of basically the same types of assertions as those in the financial statements, it was concluded that the types of evidence generally available for judging the reliability of this information would be essentially the same as those types of evidence generally available for judging the reliability of financial statement assertions.

It would appear that evidence is generally available for judging the reliability of the additional information included in this study. But, whether sufficient evidence can be obtained to afford a reasonable basis for an opinion on any information, financial statement or additional, will depend upon the circumstances in a particular examination and the professional competence and judgment of the auditor performing the examination.

Verification, however, is but one important consideration relating to whether or not the attest function can be extended to include the additional information. The economic feasibility of extension would seem to be a crucial factor in determining whether extension is possible. This factor is discussed in Chapter V. The reporting problems involved in rendering an opinion on information outside the conventional financial statements must also be considered. Reporting problems are discussed in the next chapter.



## CHAPTER IV

## REPORTING CONSIDERATIONS

In the preceding chapter it was concluded that the kinds of additional information discussed in this study could in general be verified. Before the attest function could be extended to include this information, however, certain reporting problems would have to be resolved. These problems, as discussed in this chapter, relate to:

1. The coverage of additional information presented for two years or more. Would there be any significant problems involved in covering additional information presented for a period of two years or more?
2. The identification of additional information covered by the auditor's opinion. How would the additional information covered by the auditor's opinion be identified?
3. The nature of the auditor's opinion on the additional information. What would be the nature of the auditor's opinion regarding the additional information?

Because of the great variety of kinds of information involved the comments in this chapter are of necessity somewhat general in nature. However, they should serve to point out the reporting problems involved in rendering an opinion

on information outside the conventional financial statements (with accompanying footnotes and supporting schedules).

As mentioned in Chapter II, repeats of financial statement information are generally not covered by the auditor's opinion. These repeats involve the presentation of basic financial statement information elsewhere in the annual report; for example, in the president's letter, financial review, "highlights," or long-term "summary." This information is covered by the auditor's opinion in the basic financial statements, but when repeated elsewhere in the annual report it is generally not covered. Repeats of financial statement information are considered as "additional information" in the remainder of this study.

#### Coverage of Additional Information Presented for Two Years or More

This study is concerned with whether or not the CPA's attest function can be extended to include certain additional information. Some of this information is frequently presented for a period of two years or more. CPAs already render opinions in many cases on data covering two years or more. For example, certified income and retained earnings statements for three years are required in registration statements filed with the Securities and Exchange Commission under the Securities Act of 1933 and the Securities Exchange Act of 1934.

The American Institute of Certified Public Account-

ants' Committee on Accounting Procedure states:

The presentation of comparative financial statements in annual and other reports enhances the usefulness of such reports and brings out more clearly the nature and trends of current changes affecting the enterprise. Such presentation emphasizes the fact that statements for a series of periods are far more significant than those for a single period and that the accounts for one period are but an instalment of what is essentially a continuous history.

In any one year it is ordinarily desirable that the balance sheet, the income statement, and the surplus statement be given for one or more preceding years as well as for the current year . . .<sup>1</sup>

The Institute's survey of six hundred 1965 annual reports indicates that 507 of the companies presented all three basic financial statements on a comparative basis. Another 77 presented either one or two of the basic financial statements in comparative form.<sup>2</sup> The survey also indicates that the auditor's opinion referred to two years or more in nearly 14 per cent of the reports. That is, the statements covered by the auditor's opinion were covered for two years or more.<sup>3</sup>

The examination of 89 annual reports undertaken for this study indicated that all 89 companies presented an income statement for two years, 87 presented a balance sheet for two years, and 87 per cent of those that presented re-

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<sup>1</sup>American Institute of Certified Public Accountants, Accounting Research and Terminology Bulletins (Final ed.; New York: American Institute of Certified Public Accountants, 1961), Accounting Research Bulletin No. 43, p. 15.

<sup>2</sup>Accounting Trends and Techniques, 1966, p. 21.

<sup>3</sup>Ibid., pp. 310-11.

tained earnings statements did so on a comparative basis. The examination also indicated that in nearly 16 per cent of the reports the financial statements covered by the auditor's opinion were covered for a period of two years.

There would not appear to be any significant problems involved in covering additional information presented for two years or more. This is assuming of course that the additional information for the prior year or years has been or can be verified. If the auditor has not audited the information for the prior year or years he would probably not be able to obtain "sufficient competent evidential matter" in most cases to provide a reasonable basis for an opinion on the information for the prior year or years. If the auditor is able to render an opinion on information presented for a period of two years or more, however, he should insist on any adjustments of prior year data which he feels are necessary for a fair comparison of the current year's information with that of the prior year or years (for example, restatement of financial and accounting data because of a pooling of interests).

Other "statements" covering two years or more

The "highlights" and long-term "summary" type of presentations, as mentioned in Chapter II, are generally not covered by the auditor's opinion. Most annual reports include one or both of these "statements." The American Institute's survey indicates that 39 per cent more of the

companies presented a "highlights" type of statement in their 1965 annual reports than did 10 years previously in 1955 (508 companies in 1965 as opposed to 366 in 1955). A long-term "summary" was presented by 118 per cent more companies in 1965 than in 1955 (464 companies in 1965 as opposed to 213 in 1955).<sup>4</sup>

The greatest number of "highlights" presentations cover two years. The most common period covered by the long-term "summary" is 10 years. These "statements" contain primarily financial and accounting data, but often include other information as well. Most of these presentations contain some ratio and per share data. Because these ratio and per share figures involve either financial statement information, additional information, or a combination of both it does not appear necessary to treat them separately in this study. The only additional assertion involved in ratio and per share presentations is mathematical. There should be no particular difficulty involved in auditing these items if the underlying information is subject to adequate verification.

Since most ratio and per share data are presented outside the basic financial statements they are generally not covered by the auditor's opinion. However, when these data are presented in the basic financial statements they

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<sup>4</sup>Ibid., p. 26.

are covered. For example, the survey of 89 annual reports conducted for this study revealed that 65 of the companies presented "cash dividends per share of common stock" and 24 companies presented "earnings per share" in the financial statements covered by the auditor's opinion. The Institute's survey does not include figures on "earnings per share" presentations but does indicate that five hundred and forty-three companies made 1743 references to "cash dividends per share of common stock" in their 1965 annual reports; 409 of these references were in the basic financial statements and footnotes. The "highlights" and long-term "summary" statements contained 807 of these presentations.<sup>5</sup>

The "highlights" statement appears near the front of the annual report and affords readers a brief summary of certain significant data. The content of "highlights" presentations varies substantially, but they usually include sales, earnings, and dividend data. In addition, they often contain other information such as the number of employees, the number of shareholders, income taxes, capital expenditures, and working capital. Robert K. Mautz, in referring to this type of presentation, states:

I wonder if this may not be the commencement of a new financial statement, a very simple one, yet perhaps a very useful one. Perhaps there are many readers who either cannot understand or do not need the more sophisticated presentations in the formal statements, yet who find this little sum-

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<sup>5</sup>Ibid., p. 246.

mary very helpful.<sup>6</sup>

Although the "highlights" and long-term "summary" statements are generally not covered by the auditor's opinion, the examination of 89 annual reports did indicate that two long-term "summaries" were covered--International Business Machines Corporation's "Ten-Year Comparative Consolidated Statement of Operations" and Caterpillar Tractor Company's "Significant Trends since incorporation April 15, 1925." Both of these "summaries" are located near the back of the report which is the usual location for such presentations.

International Business Machines Corporation's "summary" includes the following information for a ten-year period:

- Gross income
- Net earnings before income taxes
- U. S. Federal and foreign income taxes
- Net earnings for the year
- Earnings per share
- Cash dividends
- Dividends per share
- Stock dividends and splits
- Shares sold
- Number of shares outstanding
- Net investment in factories, offices,  
rental machines and parts
- Long-term indebtedness
- Net current assets
- Number of stockholders

Caterpillar presents the following information for a forty-

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<sup>6</sup>Proceedings of the Eighth Annual Institute on Accounting (Boulder, Colorado: University of Colorado, 1961), p. 37.

one-year period:

Sales  
 Profit  
 Profit as a percentage of sales  
 Profit per share  
 Cash dividends on common stock  
 Dividends per share  
 Materials, supplies, services  
 purchased, etc.  
 Wages, salaries and contributions  
 for employee benefits  
 U. S. and foreign income taxes  
 Income taxes as a percentage of sales  
 Land, buildings, machinery and equip-  
 ment purchased  
 Depreciation and amortization  
 Average number of employees  
 Number of shareholders

Herman W. Bevis states:

The evolution by managements of the long-term historical summary is one of the most important improvements in corporate financial reporting in recent times. Such a summary recognizes and compensates for the fallibility of single-year statistics and is entirely consonant with the long-term and continuous nature of corporate operations.<sup>7</sup>

Bevis states further:

In most financial reports to stockholders, the CPA's opinion is directed only to this year's financial statements. This is true even though data for at least two years are usually presented in conventional financial statements and data covering many prior years are contained in historical summaries. This concentration of the CPA on the current year would seem to be an anachronism. It would suggest that he has not grasped as much as has management the growing meaningfulness of the historical summary in reports of the large, publicly owned corporation. The CPA's professional skill and competence can be utilized to improve the usefulness of historical summaries. Although he has been consulted informally

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<sup>7</sup>Bevis, Corporate Financial Reporting in a Competitive Economy, p. 178.



regarding them by most managements, and in some cases has enlarged his opinion on financial statements to cover them, there seems every good reason why historical summaries should invariably be accompanied by a CPA's opinion as to their fair presentation.<sup>8</sup>

The recent substantial increase in the number of "funds" statements covered by the auditor's opinion could probably be considered as an extension of the CPA's attest function. The "highlights" and long-term "summary" statements would seem to be prime candidates for the next extension of the attest function in the annual report.

Identification of Additional  
Information Covered by  
the Auditor's Opinion

A major reporting problem would probably be how to identify the additional information covered by the auditor's opinion. If all of this information was located in a relatively few presentations where all of the information included was covered, these presentations could easily be referred to in the auditor's report. However, the additional information is literally scattered throughout the annual report--in the president's letter, the financial review, the "highlights" and long-term "summary" statements, and other sections of the report. The form of presentation varies substantially also. This information is presented in statement, summary, chart, schedule, graph, and text form.

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<sup>8</sup>Ibid., pp. 188-89.

Both the "highlights" and long-term "summary" statements would provide excellent vehicles for extending opinion coverage to the information contained therein. Coverage of these "statements" could be indicated by a reference in the auditor's report to the titles of the statements and perhaps the pages on which they are presented. The auditor could refer to some of the other presentations such as summaries, schedules, charts, and graphs in a similar manner, but his report may become somewhat unwieldy if the number of such presentations is very great. Perhaps an index of the presentations covered could be attached to the auditor's report, with a reference in the report to the effect that the presentations in the index were covered.

It would probably be more difficult, however, to indicate coverage of information included in textual presentations where some of the information in the presentation was not covered by the auditor's opinion. Instead of indicating each line covered, even in an index, it would probably be more practicable to employ other methods for identifying the information covered. Some methods which could be used to indicate coverage are:

1. Present the information covered on a different colored background than the information not covered.
2. Present the information covered in different colored lettering than the information not covered.
3. Underline the information covered.

Of course, color could also be used to identify nontextual presentations such as summaries, charts, and schedules which are covered by the auditor's opinion.

It may even be desirable to refer to the auditor's report at the bottom of presentations which are covered by the auditor's opinion. This reference could be in the form of a note indicating, for example, "See auditor's report on page X." The latter would probably be especially desirable for those presentations which are not in close proximity to the auditor's report.

Perhaps some of the additional information could be combined with other presentations. Certainly, a reduction in the number of presentations covered would make identification of the information covered an easier task. For example, certain additional information could be presented within the income statement or a schedule supporting that statement. This would involve information which is essentially a breakdown of items already presented in the income statement. Examples of the latter include sales and earnings by major product groups or divisions and employment costs. At present, however, most CPAs apparently do not feel that disclosure of such information is necessary for the fair presentation of a company's results of operations.

Another possibility would be to combine information pertaining to a particular major area in a new type of presentation. For example, data pertaining to personnel could

be included in a statement entitled, for example, "Statement of Personnel Information." This statement would include information described under "Personnel information" in Appendix B of this study. However, it may not be desirable to combine all of the additional information in such presentations. Some additional information is an integral part of presentations where all of the information included would probably not be covered by the auditor's opinion. For example, removing certain additional information from the president's letter would probably diminish substantially the value of that presentation. The assumption here, of course, is that retention of the original presentation is considered desirable.

It would probably be preferable to place much of the additional information covered by the auditor's opinion in close proximity to the auditor's report. This would make it easier to indicate that the information was covered. However, it would probably not be desirable or feasible to move all of the kinds of additional information included in this study to the back of the annual report.

#### Nature of the Auditor's Opinion on the Additional Information

"Generally accepted auditing standards" include four reporting standards relating to the auditor's report:

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 either contain an expression of opinion regarding the financial statements, taken as a whole, or an assertion to the effect that an opinion cannot be expressed. When an over-all opinion cannot be expressed, the reasons therefor should be stated. In all cases where an auditor's name is associated with financial statements the report should contain a clear-cut indication of the character of the auditor's examination, if any, and the degree of responsibility he is taking.<sup>9</sup>

The remainder of this chapter is devoted to discussing the applicability of these reporting standards if the attest function is extended to include the "additional information."

In effect, the first three reporting standards provide the auditor with general criteria for judging the fairness of financial statement presentations. The first two criteria are referred to as required in the short-form audit report which has been generally adopted by the profession. The opinion paragraph of this report reads:

In our opinion, the accompanying balance sheet and statement(s) of income and retained earnings present fairly the financial position of X Company at June 30, 19\_\_, 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. (*Italics mine.*)<sup>10</sup>

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<sup>9</sup>Committee on Auditing Procedure, Statements on Auditing Procedure No. 33, p. 16.

<sup>10</sup>Ibid., p. 57.

The basic financial statements are not considered to be fair presentations of financial position and results of operations unless they are presented "in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year." Adequate disclosure of all significant information pertaining to financial position and results of operations is also considered necessary for fair presentation. The applicability of these criteria for judging the fairness of "additional information" presentations is discussed below.

Conformity with "generally accepted accounting principles"

The Committee on Auditing Procedure states:

The term "principles of accounting" as used in reporting standards is construed to include not only accounting principles and practices but also the methods of applying them.<sup>11</sup>

The Committee states further:

The determination of whether financial statements are presented in accordance with "generally accepted accounting principles" requires exercise of judgment as to whether the principles employed in the statements have found general acceptance. The determination further requires a familiarity with alternative principles, sometimes more than one, which may be applicable to the transaction or facts under consideration, and a realization that an accounting principle may have only limited usage but still have general acceptance.

Generally accepted accounting principles evolve and change. Pronouncements issued by authoritative bodies of the American Institute of Certified Public Accountants give recognition to such changes. The

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<sup>11</sup>Ibid., p. 40.

first reporting standard contemplates that the independent auditor will be alert to such pronouncements. He must also be alert to changes which become acceptable through common usage by business although not a subject of an Institute pronouncement.<sup>12</sup>

It is beyond the scope of this study to enter into a lengthy discussion of "generally accepted accounting principles." It seems sufficient for purposes of this study to accept that there are certain accounting practices and procedures which have substantial authoritative support, and these practices and procedures are what the auditor uses in most cases to judge the fairness of financial statement presentations.<sup>13</sup> Paul Grady lists the sources for determining if a particular practice or procedure has substantial authoritative support:

1. In the practices commonly found in business. This does not follow from the mere fact that a practice exists, but from the fact that experience of the business has demonstrated that the practice produces dependable results for the guidance of management and for the information of investors and others.
2. The requirements and views of stock exchanges as leaders in the financial community; similarly the views and opinions of commercial and investment bankers would be entitled to weight.
3. The regulatory commissions' uniform systems of accounts and accounting rulings exercise a dominant influence on the accounting practices of

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<sup>12</sup>Ibid., pp. 40-41.

<sup>13</sup>In those rare cases where "generally accepted accounting principles" are not applicable the auditor must rely upon his judgment in determining the adequacy of the practices and procedures employed.

the industries subject to their jurisdiction . . .

4. The regulations and accounting opinions of the Securities and Exchange Commission have the controlling authority over reports filed with the Commission. The Commission and its chief accountants have demonstrated a high degree of objectivity, restraint and expertness in dealing with accounting matters. The regulations and opinions issued to date are entitled to acceptance by their merit as well as on the basis of the statutory authority of the Commission.

5. The affirmative opinions of practicing and academic certified public accountants constitute authoritative support for accounting principles or practices. These may be found in oral or written opinions, expert testimony, textbooks and articles.

6. Published opinions by committees of the American Accounting Association and of the American Institute of CPAs.<sup>14</sup>

Obviously, "generally accepted accounting principles" are not applicable for judging the fairness of some of the additional information included in this study. The Committee on Auditing Procedure indicates that "the first standard of reporting does not apply to statements which do not purport to present financial position and results of operations."<sup>15</sup> The Committee indicates further:

In reporting on statements which do not so purport, the independent auditor should make sure that there is a clear representation of what they do present and of the basis on which they have been prepared. He should express his opinion as to whether or not

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<sup>14</sup>Paul Grady, Inventory of Generally Accepted Accounting Principles for Business Enterprises, Accounting Research Study No. 7 (New York: American Institute of Certified Public Accountants, 1965, pp. 52-53.

<sup>15</sup>Committee on Auditing Procedure, Statements on Auditing Procedure No. 33, p. 88.



the statements fairly present the data on the basis indicated.<sup>16</sup>

It is at least questionable, however, whether or not the latter statements preclude the auditor from using "generally accepted accounting principles" to judge the fairness of presentations which do not purport to present financial position or results of operations if "generally accepted accounting principles" exist which are applicable to those presentations.

Richard C. Lytle states:

In an effort to develop some tentative answers to the audit reporting problems involved with funds statements, I have discussed the matter with a number of leading CPAs who have recognized the problems and given them considerable thought.<sup>17</sup>

Based upon these discussions, Lytle states:

There appears to be general agreement that a funds statement should ordinarily be considered as an additional statement presented to provide useful information not otherwise readily available, rather than as a basic financial statement necessary for the fair presentation of financial position and results of operations.<sup>18</sup>

Lytle states further:

It does not appear that the independent auditor's opinion with respect to the funds statement itself must refer to conformity with generally accepted accounting principles.<sup>19</sup>

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<sup>16</sup>Ibid.

<sup>17</sup>"Auditor's Report on Funds Statement" (Accounting and Auditing Problems), The Journal of Accountancy, CXVI (November, 1963), 74.

<sup>18</sup>Ibid.

<sup>19</sup>Ibid.

However, Arthur Andersen & Company in rendering an opinion on the statement of source and disposition of funds presented in Texaco's 1965 annual report indicates:

In our opinion, the accompanying consolidated balance sheet and consolidated statements of income, retained earnings used in the business and source and disposition of funds present fairly the financial position of Texaco Inc. and subsidiary companies as of December 31, 1965, and the results of their operations and the source and disposition of funds for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. (Italics mine.)

Similarly, Arthur Young & Company's opinion on the statement of source and disposition of working capital in Lockheed Aircraft's 1965 annual report reads:

In our opinion, the statements mentioned above present fairly the consolidated financial position of Lockheed Aircraft Corporation and subsidiaries at December 26, 1965 and December 27, 1964, the consolidated results of their operations and the source and disposition of their consolidated working capital for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis during the period. (Italics mine.)

Apparently, the auditors in the above cases felt that "generally accepted accounting principles" were applicable to the funds statement even though presentation of this statement was not considered necessary for a fair presentation of financial position and results of operations. In fact, the auditor referred to the funds statement as being presented "in conformity with generally accepted accounting principles" in 68 per cent of the opinions expressed on that

statement in the 89 reports examined for this study.

There was no reference to financial position or results of operations in 98 per cent of the opinions rendered on the funds statement. The auditor simply indicated that the statement presented fairly the information shown therein, or presented fairly whatever the title of the statement indicated; for example, if the title was "statement of source and application of funds" the auditor indicated that the statement presented fairly the sources and applications of funds. In one report, however, the auditor's opinion did refer to the basic financial statements and the funds statement as presenting fairly the company's financial position and results of operations!

Much of the additional information is financial and accounting information. Disclosure of this information is apparently not considered necessary for the fair presentation of financial position and results of operations under present standards of disclosure.<sup>20</sup> However, "generally accepted accounting principles" probably exist which could be used at least to some extent to judge the fairness of most of this additional financial and accounting information. Certainly,

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<sup>20</sup>Some readers may question the applicability of this statement to financial statement information which is repeated elsewhere in the annual report. It is the repeating of this information that is not considered necessary for the fair presentation of financial position and results of operations, and not the original disclosure of the information in the basic financial statements.

"generally accepted accounting principles" could be used to judge the fairness of financial statement information repeats. It appears that they could also be used to a certain extent to judge the fairness of revenue and expense items included in Appendix B of this study. The auditor would not necessarily have to refer to conformity with these "principles" in his opinion, but it seems he could use them to aid him in judging the fairness of most of the additional financial and accounting information. That is, in determining whether or not the information presents fairly what it purports to present he could use "generally accepted accounting principles" as a guide.

However, appropriate "principles" for judging the fairness of some of the additional financial and accounting information may need to be determined or developed. The Financial Executives Institute has already begun a study pertaining to the reporting of earnings and sales by product lines.<sup>21</sup> A subcommittee of the American Institute of Certified Public Accountants' Accounting Principles Board is also studying this area.<sup>22</sup>

Where "generally accepted accounting principles" are

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<sup>21</sup>"SEC Will Move Cautiously on Conglomerate Reporting Rules" (news report), The Journal of Accountancy, CXXIII (March, 1967), 7.

<sup>22</sup>"Accounting Principles Board Adds Two New Subcommittees" (news report), The Journal of Accountancy, CXXIII (March, 1967), 12.

not applicable for judging the fairness of additional information the auditor would have to decide whether or not the information presents fairly what it purports to present in accordance with the basis on which it was prepared. Much of the additional information included in this study involves the assertion of facts which are either valid or not. That is, there are no alternative procedures for determining the item or items involved. This information purports to present a particular fact or set of facts. It either does or does not do so. For example, if the price range of a company's stock on the New York Stock Exchange was to be covered by the auditor's opinion, the auditor would verify this fact and express his opinion as to whether or not the information presents fairly what it purports to present--the price range of the company's stock on the New York Stock Exchange. Similarly, if certain director, officer, and employee data was to be covered, the auditor would verify the facts involved and render his opinion as to whether or not the information presents fairly what it purports to present--for example, business or professional affiliations of directors, ages and years service with the company, and so forth.

Each kind of additional information included in this study purports to present something. If "generally accepted accounting principles" apply to that information the auditor should attempt to verify conformity with these "principles." If "generally accepted accounting principles" do not apply

he should attempt to determine if that information presents fairly what it purports to present in accordance with the basis on which it was prepared. That basis is either expressed or implied in the presentation of the additional information.

Some of the additional information is prepared in accordance with a fairly standard methodology. This methodology could be used by the auditor to judge the fairness of the information involved. For example, there are standard methods for constructing selling price indices and determining a company's balance-of-payments position.

Forecasts and budgets seem to present a special problem. Before an auditor could express an opinion on the fairness of such projections it seems imperative that he must be able to determine the reasonableness of the methodology employed in arriving at these projections. It appears that appropriate methods for arriving at forecasts and budgets need to be determined or developed. These methods could then be used to appraise the methodology employed by a particular company in arriving at a forecast or budget on which an auditor was engaged to render an opinion.

Finally, if the auditor feels that certain terms employed in the presentation of any kind of additional information may be misleading to the reader, he should insist that these terms be clearly defined in the presentation. For example, if a company reports on the number of small busi-

nesses with which it placed orders or contracts during the year, the term "small business" should be clearly defined. Similarly, if the client reports on Research and Development expenditures or number of Research and Development employees, the auditor should probably insist that the client indicate what types of expenditures are included under Research and Development expenditures and what types of employees are included in the total number of Research and Development employees.

In summary, where "generally accepted accounting principles" are not applicable for judging the fairness of a given kind of additional information the auditor must determine if that information presents fairly what it purports to present on whatever basis it was prepared. For much of the additional information this would involve little more than obtaining "sufficient competent evidential matter" to support the validity of the assertions involved.

It may be necessary to determine or develop additional "principles" to enable the auditor to judge adequately the fairness of certain financial and accounting information. For example, at present there is no authoritative pronouncement on how joint costs should be allocated when reporting externally upon earnings by major product groups or divisions. If a CPA expresses an opinion on this type of information, Albert Bows suggests:

Since this type of reporting adds a new dimen-

sion in reporting--management's judgment as to the allocation of joint costs to the different segments of the business--the CPA probably should disclose the general basis of allocation of these costs until an opinion is rendered by APB. In this way different viewpoints under varying circumstances will be apparent. This will help investors in trying to compare results attributed to different segments by different companies.<sup>23</sup>

Also, it appears that appropriate methods for arriving at budgeted and forecasted amounts need to be determined or developed. The methodology employed in arriving at forecasts and budgets would probably be the major factor in judging the fairness of these presentations. If the auditor could not determine the reasonableness of the methodology he certainly could not render an opinion as to the fairness of the projections. Until such time as appropriate methodology is determined or developed it does not seem that the independent auditor could render an effective opinion as to the fairness of such projections.

### Consistency

The Committee on Auditing Procedure states:

The objective of the consistency standard is: (1) to give assurance that the comparability of financial statements as between periods has not been materially affected by changes in the accounting principles employed or in the method of their application; or (2) if comparability has been materially affected by such changes, to require a statement of the nature of the changes and their

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<sup>23</sup>Albert J. Bows, Jr., "Problems in Disclosure of Segments of Conglomerate Companies," The Journal of Accountancy, CXXII (December, 1966), 36.



effects on the financial statements.<sup>24</sup>

It would appear that the auditor should be concerned with significant changes in the basis upon which the additional information is presented, whether that information is presented "in accordance with generally accepted accounting principles" or otherwise. If he feels that changes in the basis significantly affect the comparability of current year information with prior year information of the same kind it seems the nature of such changes and their effects on the additional information should be disclosed. Presumably, fair presentation requires comparability of information as between periods in most cases. The auditor must decide where the consistency standard is applicable and then determine whether the pertinent procedures have been consistently observed in the particular case.

#### Adequate disclosure

"Adequate disclosure" relates primarily to the types and quantities of information that should be disclosed in a given presentation. To repeat, the third reporting standard is:

Informative disclosures in the financial statements are to be regarded as reasonably adequate unless otherwise stated in the report.<sup>25</sup>

Certainly, for any kind of presentation to be considered

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<sup>24</sup>Committee on Auditing Procedure, Statements on Auditing Procedure No. 33, p. 42.

<sup>25</sup>Ibid., p. 16.

fair adequate disclosure of all significant information pertaining to whatever the presentation purports to present is essential.

It is presently assumed in general that adequate disclosure of all significant information pertaining to a company's financial position and results of operations is achieved through presentation of the information generally included in the basic financial statements and accompanying footnotes. It is questionable whether or not such an assumption conforms entirely with the needs of annual report readers for pertinent information relating to the financial condition and operations of a company.

John L. Fox indicates:

Disclosure now requires recognition of the two main groups using financial reports to shareholders, the sophisticated present or potential investor (individual, company or pension fund) and the security analyst representing a bank or brokerage firm (the public's investment adviser).<sup>26</sup>

One does not need to look far in the literature to realize that the latter group in particular desires much more information than typically included within the confines of the basic financial statements and footnotes.<sup>27</sup> Much of this

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<sup>26</sup>John L. Fox, "'Useful Comparability' in Financial Reporting," The Journal of Accountancy, CXVIII (December, 1964), 46.

<sup>27</sup>See, e.g., Anderson, Corporate Reporting for the Professional Investor, and Charles T. Horngren, "Disclosure: What Next?," Independent Auditing Standards, ed. J. C. Ray (New York: Holt, Rinehart and Winston, Inc., 1964), pp. 396-409.

information is among the additional information included in this study. It may be that future standards of disclosure for the fair presentation of financial position and results of operations will encompass some of this information.

The concern in this study, however, is whether or not a particular presentation of additional information adequately discloses all significant information pertaining to whatever that presentation purports to present. There seems to be a significant difference between applying the concept of adequate disclosure to the basic financial statements which purport to present over-all financial position and results of operations, and applying it to the multifarious presentations of additional information throughout the annual report.

That is, in applying the standard of adequate disclosure to the basic financial statement presentations the auditor must decide whether those presentations adequately disclose all significant information pertaining to financial position and results of operations. The presentations of additional information do not purport to present over-all financial position and results of operations. These presentations purport to present many different kinds of additional information, both financial and nonfinancial. They either do or do not present the specific information which they purport to present. For example, if a company reports that certain facilities were completed during the year, that

is all it purports to present--certain facilities completed during the year. It does not seem necessary that the company disclose all new facilities for the presentation to be considered fair. Similarly, if a company reports that cash dividends have been paid for X number of consecutive quarters, that is all it purports to present. In other words, for most of the presentations of additional information adequate disclosure is not a question. That is, the company purports to present what it reports and no more.

However, standards of disclosure could be established for some of the areas in which additional information is presented. The following standards might be appropriate, for example, in reporting on new facilities:

1. If a company reports on new facilities it should report on all important new facilities. (It probably would anyway.)
2. If a company reports on new facilities it should report their type, location, cost, size, and so forth.

Whether or not standards of disclosure that require a company to increase disclosure in areas outside the financial statements should be established is another matter. Since the reporting of additional information is purely voluntary it is rather doubtful if such standards would be feasible.

Whether or not the auditor should require more disclosure in a particular presentation must depend upon his judgment as to whether fair presentation of the information involved requires more disclosure. In most cases more dis-

closure would probably not be necessary for fair presentation. That is, the company purports to present only what is reported.

However, there do seem to be some areas in which additional information is being presented that may require more disclosure than a particular company is providing before an auditor would want to express an opinion that the information involved presents fairly what it purports to present. This may be the case in areas where management reports only the favorable aspects or limits the presentation of unfavorable aspects (that is, favorable or unfavorable to the reporting company). Although the reporting of additional information is entirely within the realm of management prerogative, such selective reporting may be misleading and hence unfair. Some examples of cases where the auditor may feel that more disclosure is required for fair presentation are as follows:

1. If a company reports on the results of unionization elections fair presentation may require that the results of all such elections be disclosed.
2. If a company reports on strikes fair presentation may require that all strikes be disclosed.
3. If a company reports on earnings by major product groups or divisions fair presentation would seem to require that the results of operations of all major groups or divisions be disclosed, whether they are profitable or not, and regardless of the amount of profit or loss involved.

In summary, the auditor would have to decide whether those presentations of additional information that he is engaged to express an opinion on adequately disclose whatever they purport to present. For most presentations of additional information the standard of adequate disclosure is satisfied if the company merely presents what it purports to present. In some cases this may not involve all of the information in a particular area. If a company purports to present only certain information in a given area the presentation is not necessarily unfair. However, if the auditor feels that selective reporting in a given area may be misleading to the reader he should insist upon adequate disclosure of all significant information relating to that area, both favorable and unfavorable, before rendering an unqualified opinion as to the fairness of the particular presentation.

#### Expression of opinion

The Committee on Auditing Procedure states:

The objective of the fourth reporting standard is to prevent misinterpretation of the degree of responsibility the independent auditor is assuming whenever his name is associated with financial statements.<sup>28</sup>

Unless an auditor has been engaged to express an opinion on additional information in the annual report he is not at present required to refer in any way to this information in

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<sup>28</sup>Committee on Auditing Procedure, Statements on Auditing Procedure No. 33, p. 56.

his report. However, if an auditor is engaged to express such an opinion the fourth reporting standard would be applicable with respect to the additional information involved. In his report the auditor should either express an opinion regarding the information or indicate that he cannot express an opinion and why.

If the additional information presents fairly what it purports to present the auditor should so indicate. If he takes exception to the fairness of a given presentation for any reason, he would have to express either a qualified or an adverse opinion. It would probably be a rare case where an auditor was engaged to render an opinion on a particular kind of additional information, and his examination was limited to the extent that he felt it was necessary to disclaim an opinion. Of course, if this was the case he would have to disclaim an opinion. In all cases where the auditor feels that an unqualified opinion is unwarranted he should clearly indicate in his report the reason or reasons therefor; for example, inability to obtain "sufficient competent evidential matter," the information does not present fairly what it purports to present on the basis indicated, and so forth.

Assuming compliance with "generally accepted auditing standards," to the extent applicable in a particular case, a reference in the auditor's report to compliance with these standards would seem appropriate for indicating the general

nature of the auditor's examination with respect to the additional information included in this study.

### Summary

Before a CPA can render an opinion on a company's basic financial statements he must determine whether those statements present fairly the company's financial position and results of operations. This involves obtaining "sufficient competent evidential matter" to afford a reasonable basis for his opinion. It also involves determining whether or not the statements are presented in accordance with "generally accepted accounting principles" applied on a basis consistent with that of the preceding period. The auditor must also decide if all significant information pertaining to the company's financial position and results of operations has been adequately disclosed.

At present none of the additional information included in this study is generally considered necessary for the fair presentation of a company's financial position and results of operations. Before a CPA could render an opinion on any of this information he would have to determine what the information does purport to present, and then determine whether it presents fairly what it purports to present. This would involve obtaining "sufficient competent evidential matter" to afford a reasonable basis for his opinion. It would also involve determining whether or not the additional information under examination is presented fairly in accord-



ance with the basis upon which it was prepared. In most cases the auditor would also be concerned with whether or not the basis upon which the information was presented was consistently applied. He would also have to decide if all significant information pertaining to whatever the additional information purports to present is adequately disclosed.

In general, it would appear that the auditor could satisfy himself concerning the fair presentation of the additional information included in this study. However, rendering opinions on most of this additional information is an uncharted area, and the auditor would necessarily have to proceed with caution. Appropriate standards may need to be established before an auditor would be willing to accept the responsibility for expressing an opinion on certain kinds of additional information. For example, it is doubtful if there are adequate guides to enable the auditor to judge the fairness of projections of the future such as forecasts and budgets. As mentioned previously, study has already commenced relating to product line reporting.

Although the auditor could arrive at a reasonable judgment as to whether or not most of the additional information presents fairly what it purports to present, there are other important considerations pertaining to whether or not he can extend his opinion coverage

to these items. These considerations are discussed in the following chapter.

## CHAPTER V

## OTHER CONSIDERATIONS

The verification and reporting aspects of extending the CPA's attest function to certain additional information in the annual report were discussed in the two preceding chapters. Several other important considerations relating to the extension of the attest function are discussed in this chapter. These considerations are as follows:

1. Ethical implications of extension
2. Economic feasibility of extension
3. Legal implications of extension
4. Applicability of the profession's general and field work standards if the attest function is extended

Ethical Implications of Extension

Any profession must have an ethical base for its activities. A code of ethical conduct is imperative for effective service to the public. John L. Carey and William O. Doherty state that "a code of professional ethics is a voluntary assumption of self-discipline above and beyond the requirements of the law."<sup>1</sup> Carey and Doherty state the purposes of a code of professional ethics as follows:

It serves the highly practical purpose of notifying the public that the profession will protect the public interest. The code in effect is an announce-

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<sup>1</sup>Carey and Doherty, p. 3.

ment that, in return for the faith which the public reposes in them, members of the profession accept the obligation to behave in a way that will be beneficial to the public.

The ethical code also provides members of the profession with guides to the type of behavior which the historical experience of the profession as a whole has indicated is most likely to attract the confidence of the public.<sup>2</sup>

The American Institute of Certified Public Accountants has adopted a code of professional ethics. The present Code is, of course, subject to modification or revision as the need arises, but nevertheless should provide a sufficient basis for discussing the ethical implications of extending the CPA's attest function to the additional information. It does not appear necessary to repeat the entire Code in this study. The reader is referred to the Carey and Doherty book for a rather thorough discussion of the present Code. A complete text of the Code is included in Appendix B of that book.<sup>3</sup>

The important questions regarding the Code of Professional Ethics seem to be:

1. Would the Code apply to the function of expressing opinions on the additional information included in this study?
2. If the Code is applicable would extension of the CPA's attest function to any of the additional information be a violation of the Code?

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<sup>2</sup>Ibid., pp. 3-4.

<sup>3</sup>Ibid., pp. 183-90.

### Applicability of the Code

There appears to be no logical reason why CPAs should not be held to the same high standards of ethical conduct regardless of the kind of information on which they express opinions. Carey and Doherty state:

The rules of ethics, . . . are the foundation of public confidence.

Public confidence may be even more important to a certified public accountant than to other professional man. The CPA must have not only the confidence of those who become his clients, but also the confidence of those who rely on his reports. His service may be of little value to a client if a bank, for example, will not have faith in his report. And the bank, or the credit agency, or the government agency, or other "third parties" who may rely on the report, will have faith in it only if they believe that the CPA has a responsibility to look out for their interests, as well as the client's.

Since all the countless third parties who may rely on the reports of certified public accountants cannot know the CPAs personally, it is essential that they must have confidence in CPAs generally--<sup>4</sup> as a group which can be trusted by all concerned.<sup>4</sup>

It would appear essential that the public have confidence in CPAs regardless of the kind of information to which they attest. John L. Carey states:

CPAs. . . will not be trusted unless they observe high standards of ethical conduct. The public could hardly comprehend how different standards of ethical conduct could be applied to the same individual when he engages in different types of work. The very proposition would suggest that he was less ethical in one type of work than another. (*Italics mine.*)<sup>5</sup>

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<sup>4</sup>Ibid., p. 5.

<sup>5</sup>Carey, The CPA Plans for The Future, p. 321.

There would seem to be no question regarding the applicability of the same standards of ethical conduct to the same type of work (attest function) even if the kind of information involved is different.

The American Institute of Certified Public Accountants' Committee on Professional Ethics has issued opinions concerning the applicability of the Code of Professional Ethics to tax practice and management advisory services. The Committee concludes, in effect, that all of the rules except those relating exclusively to the expression of opinions on financial statements apply to both the tax practice and management advisory services functions.<sup>6</sup> It would seem that all of the rules, including those relating solely to the expression of opinions, would apply to the CPA's attest function even if the attestation involves additional information beyond the traditional financial statements. However, because those rules relating to the expression of opinions refer only to financial statements an opinion by the Committee on Professional Ethics or certain modifications in the rules themselves would probably be desirable to indicate the applicability of the entire Code to an extended attest function. For example, it might be desirable to modify those rules referring specifically to the expression of opinions on financial statements to indicate their applicability to the expression of opinions on presentations of additional information as well.

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<sup>6</sup>Carey and Doherty, pp. 208-09.

Assertions of "Future Events"

Some readers may feel that Rule 2.04 of the Code prohibits extension of the CPA's attest function to include assertions of "future events" in published annual reports.

Rule 2.04 reads:

A member or associate shall not permit his name to be used in conjunction with any forecast of the results of future transactions in a manner which may lead to the belief that the member or associate vouches for the accuracy of the forecast.<sup>7</sup>

The Committee on Professional Ethics has issued an opinion pertaining to this rule, but the opinion relates specifically to the preparation of special purpose financial statements anticipating results of future operations for management. This opinion states that "a member must disclose the source of the information used and the major assumptions made, and he must indicate that he does not vouch for the accuracy of the forecast."<sup>8</sup> The question here, however, is whether the expression of opinions on projections of the future included in published annual reports would be a violation of Rule 2.04.

Carey and Doherty, in referring to this rule, indicate:

The reasons for this rule are evident. Opinions of CPAs on financial statements showing current financial position and the results of past operations, based on adequate examination, are relied upon to an

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<sup>7</sup>Ibid., p. 187.

<sup>8</sup>Ibid., p. 200.

extent which indicates a high degree of public confidence.

The CPA certificate has acquired such prestige that the appearance of the name of a certified public accountant in conjunction with financial data inevitably adds credibility.

Public confidence would be impaired if certified public accountants commonly permitted their names to be used in conjunction with forecasts of the results of future transactions, or other data not susceptible to adequate substantiation.<sup>9</sup>

Of course, it is not possible in general to verify assertions of future events as adequately as assertions of past events and the present existence of things. However, it is questionable whether or not this reason alone is sufficient to preclude CPAs from rendering opinions on management's projections of the future. If a CPA could obtain "sufficient competent evidential matter" to satisfy himself regarding the reliability of a given projection, and if he was able to appraise adequately the reasonableness of the methodology employed in arriving at the projection, it seems he could render some sort of an opinion as to the fairness of that projection. However, as pointed out in Chapter IV, it appears that before CPAs could render effective opinions on items such as budgeted and forecasted amounts, appropriate standards for judging the reasonableness of the methods employed in arriving at those projections need to be determined or developed. If appropriate standards could be

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<sup>9</sup>Ibid., p. 73.



established it seems that CPAs could render opinions as to the fairness of assertions of future events. Rule 2.04 of the Code of Professional Ethics, however, would require that the auditor indicate clearly that he does not vouch for the accuracy of such projections.

Some readers may question whether a statement to the effect that the auditor does not vouch for the accuracy of a projection would adequately protect the public interest. The public has apparently placed considerable reliance on the CPA's opinion regarding financial statements. Even if a CPA disclaims any responsibility for the accuracy of a given projection the public might assume that the projection is more reliable than it actually is because of the prestige attributed to his opinion. The CPA's opinion would be rendered with respect to the fairness of the projection itself, but the public might hold him responsible to some extent for the actual results. Unwarranted reliance upon projections covered by CPAs' opinions might substantially diminish public confidence in the attest function. Perhaps the mere fact that a CPA disclaimed responsibility for the accuracy of a projection on which he rendered an opinion would reduce public confidence in his opinions.

### Conclusions

An examination of the Code of Professional Ethics

led to the following conclusions:

1. The Code of Professional Ethics would be applicable to the function of expressing opinions on the additional information.
2. With the possible exception of projections of the future, extension of the attest function to the additional information would not be a violation of the Code. Extension of the attest function to projections of the future might be a violation of the Code.

#### Economic Feasibility of Extension

In Chapter III it was concluded that the kinds of additional information discussed in this study could in general be verified. This conclusion was arrived at without giving consideration to the time and cost that would be involved in verifying this information in addition to the traditional financial statement information. The essential questions with respect to the economic feasibility of extending the attest function to include the additional information would appear to be:

1. Could the additional information be adequately verified in sufficient time to render an opinion with respect to that information in the company's published annual report?
2. If the answer to (1) is yes, could the extended audit be provided at a fee which the client could reasonably afford to pay (that is, a fee which would not be prohibitive regardless of the desirability of having the additional information covered by the auditor's opinion)?

Of course, the time and cost that would be involved in ex-

tending the attest function to include the additional information would depend primarily upon how much of the information was to be covered in a particular engagement and the nature of that information. No one company reports all of the kinds of additional information discussed in this study, and it might be that few companies would want to have all of the additional information reported covered by the auditor's opinion. The fee necessitated by an audit involving all or most of the additional information reported by a company may well be prohibitive in many cases.

The CPA's opinion on financial statements relates to the statements as a whole. His opinion on the additional information would generally relate to specific kinds of information. This would probably require a more detailed examination with respect to that information than is usually required in the verification of financial statement information. Verification would still be conducted on a selected test basis wherever practicable, but the tests would probably have to be more extensive to support an opinion on specific kinds of additional information than those conducted in the examination of financial statements. Even separate disclosure of a given item within the financial statements would probably require extending the scope of the examination. Some of the additional information is verified to a certain extent in the usual examination of financial statements, but additional work would probably be required in

most cases to afford a reasonable basis for an opinion regarding that information.

It would seem that most of the larger public accounting firms could provide the staff to verify the additional information adequately in time to render an opinion regarding that information in the company's annual report. However, it might be that the type of staff required to perform this additional work would be a significant factor in determining whether or not sufficient staff could be provided. At present, there appears to be a general shortage of supervisory level personnel in the larger public accounting firms. Therefore, whether or not junior level staff could perform this additional work might be a major determinant of the firm's ability to verify the additional information adequately on a timely basis.

Whether or not such an examination could be provided at a fee which the client could reasonably afford to pay would depend primarily upon the kinds and amounts of additional information to be covered in a particular audit, and the level of personnel required to verify that information.

Even if a timely and adequate audit of the additional information could be performed at a fee which the client could reasonably afford to pay, this in itself would not mean that the CPA's attest function could be extended to this information. Certainly, the final determinant of whether the CPA's attest function could be extended would be the

client's willingness to pay to have the additional information attested to by the CPA. It would seem that there are only two basic reasons why the client would be willing to pay to have the additional information covered:

1. Coverage was required, for example, by the Securities and Exchange Commission or the New York Stock Exchange. At present, the company is not even required to report this information, let alone have it attested to by a CPA.
2. The client was convinced of the value of having the additional information covered.

It appears that extending the attest function to any of the additional information, in the near future at least, will depend upon the client being convinced of the value of voluntarily having this information attested to by a CPA. Therefore, some consideration is given to the value of having the additional information covered by the CPA's opinion in Chapter VI.

#### Legal Implications of Extension

Under common law, a CPA may be held legally responsible to his client for ordinary negligence. He may be held responsible for fraud or gross negligence to third parties who relied upon his opinion. However, a CPA may be held legally responsible for ordinary negligence to third parties who relied upon his opinion with respect to financial statements in a registration statement filed with the Securities and Exchange Commission under the Securities Act of 1933.

R. James Gormley and Robert M. Trueblood define the legal terms mentioned above as follows:

Negligence (or ordinary negligence) is the failure of an accountant to perform or report on a professional engagement with the due care and competence reasonably expected of members of his profession.

Gross negligence is an extreme, flagrant, or reckless departure from standards of due care and competence in performing or reporting on professional engagements--as contrasted with the thoughtless slip, honest blunder, or error of judgment which amounts to ordinary negligence.

The fraud of deceit is an intentional false representation of a material fact or opinion made to induce a person's reliance, and under circumstances in which the person justifiably does rely upon the false representation to his injury. The courts have said that an auditor commits the fraud of deceit in issuing an audit opinion if his audit has been so negligent as to justify the jury or a judge in concluding that the auditor could have had no genuine belief in the truth of his opinion. Evidence of negligence, and especially of gross negligence, on the part of the auditor may be considered by the trier-of-fact in deciding whether the facts support or do not support an inference that the auditor committed deceit. Evidence of heedlessness and reckless disregard of consequences may be considered in deciding whether or not the necessary element of intention was present to warrant a finding of fraud.<sup>10</sup>

Unfortunately, as Gormley and Trueblood point out:

A trier-of-fact has no objective means of detecting what specific acts of human behavior will transform due care into negligence, negligence into gross negligence, or gross negligence into fraud. There are no clear lines of demarcation between the

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<sup>10</sup>R. James Gormley and Robert M. Trueblood, "Liability of Professional Accountants to Clients and Others," The Quarterly (Touche, Ross, Bailey & Smart), XII (March, 1966), 7.

categories.<sup>11</sup>

Recently there has been an increase in the number of lawsuits brought against auditors by third parties who claim that they have suffered financial losses as a result of having relied upon the auditor's opinion. A recent editorial states:

An increasing number of claims against auditors, some of them for millions of dollars, naturally arouses anxiety in the accounting profession. And well it may. The implications are extremely serious, both for accounting firms and for the public.<sup>12</sup>

This editorial states further:

No one contends that auditors should be excused from the consequences of serious shortcomings in their professional work. All professional men are answerable at law for observing the standards of competence which prevail in their professions. Accountants are no exception, and do not wish to be. But accounting firms are at a peculiar disadvantage in that the numbers of people who might rely on an auditor's opinion, and the amounts involved, are virtually unlimited. This is not generally true of other professions. . . .

Unhappily, the law of accountants' liability is as yet far from clear. The distinctions among negligence, gross negligence, and negligence "so gross as to warrant an inference of fraud" must be made subjectively by juries and judges who are usually unfamiliar with auditing procedures. It may seem to them, in the light of hindsight, that if financial statements turn out to be wrong, the auditor should have found the errors.<sup>13</sup>

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<sup>11</sup>Ibid., 8.

<sup>12</sup>"The Specter of Auditors' Liability" (editorial), The Journal of Accountancy, CXX (September, 1965), 33.

<sup>13</sup>Ibid.

Robert Trueblood, in a recent article, states:

Fundamentally, in my view, the spate of lawsuits reflects lack of understanding of what an accounting firm does do, and does not do, in making an audit.<sup>14</sup>

Many lawsuits against auditors may be attributable in part to the lack of public understanding concerning the nature and limitations of the attest function. But this fact affords little solace to auditors who bear the cost of legal defense, suffer adverse publicity, and perhaps pay damages even though the claims may be unfounded.

Uncertainties concerning their legal responsibilities might tend to make most CPAs somewhat apprehensive about extending the coverage of their opinions to additional information beyond the financial statements. John L. Carey points this out in the following statements:

The uncertainties of the CPA's legal liabilities may impede full discharge of his social obligation. The absence of any limits on financial claims which may be asserted against CPA firms, together with the vagueness of existing definition of their liability, constitute a threat to the very existence of a CPA firm every time it puts its name on an opinion on financial statements, offers tax advice or performs services for management.

The presence of this threat has an inhibiting effect on the profession's initiative. It induces defensive and protective attitudes. It may deter CPAs from the free expression of their professional opinions in matters which might be helpful to their clients and to the public.

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<sup>14</sup>Robert M. Trueblood, "A Season of Head-Hunting?," The Illinois CPA, XXIX (Spring, 1967), 4.



Any extension of the CPA's attest function, . . . to data other than the conventional balance sheet and income statement, could be discouraged by its possible effects on legal liability.<sup>15</sup>

Perhaps a declaration by the profession of more specific auditing standards would afford the public and the judiciary a better understanding of the CPA's attest function, and lead to a sharper definition of his legal responsibilities. Mautz and Sharaf state:

It is our considered opinion that the ten generally accepted auditing standards are not sufficient to mark out with any satisfactory degree of accuracy the limits of an auditor's responsibility on any engagement and that only in the most general way do they provide to those outside the profession any indication at all of the quality and extent of performance to be expected from independent auditors.<sup>16</sup>

It would certainly seem that an auditor should not be held legally responsible for losses suffered by others if his examination has been performed honestly and in accordance with the standards adopted by the profession. The profession should put forth an all-out effort to educate the public regarding the nature and limitations of the CPA's attest function.

Many CPAs might not be willing to extend the coverage of their opinions without some assurance that they would not be subjected to unreasonable legal responsibilities. However, the mere fact that extended coverage might involve greater

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<sup>15</sup>Carey, The CPA Plans for The Future, pp. 408-09.

<sup>16</sup>Mautz and Sharaf, p. 113.

exposure to legal claims would not appear to be sufficient grounds for a CPA's refusal to extend his attest function. But it would appear that he should have an adequate understanding of the nature and extent of his legal liabilities before deciding whether or not to accept the additional responsibility.

#### Applicability of General and Field Work Standards

The applicability of the standards of field work and the general standards to audit examinations involving the additional information is discussed in this section. The general standards relate to the auditor's personal qualifications and the quality of his work. The standards of field work relate to the actual conduct of his examination. These standards are:

##### General Standards

1. The examination is to be performed by a person or persons having adequate technical training and proficiency as an auditor.
2. In all matters relating to the assignment an independence in mental attitude is to be maintained by the auditor or auditors.
3. Due professional care is to be exercised in the performance of the examination and the preparation of the report.

##### Standards of Field Work

1. The work is to be adequately planned and assistants, if any, are to be properly supervised.
2. There is to be a proper study and evaluation of the existing internal control as a basis

for reliance thereon and for the determination of the resultant extent of the tests to which auditing procedures are to be restricted.

3. Sufficient competent evidential matter is to be obtained through inspection, observation, inquiries and confirmations to afford a reasonable basis for an opinion regarding the financial statements under examination.<sup>17</sup>

The primary concern in this study is with extension of the CPA's attest function to include additional information in the annual report. The function would be the same, only the information to which the auditor was attesting would be different. "Generally accepted auditing standards" are general criteria for judging the quality of the CPA's attest function. It would appear that the value of a CPA's opinion to clients and third parties would depend upon his adherence to these standards regardless of the kind of information under examination. That is, the fact that his opinion related to information outside the conventional financial statements would not seem to make conformance with these standards of quality any less important.

#### General Standards

The three general standards indicate, in effect, that the auditor must be competent, independent with respect to the client, and must perform his work with due care. It seems rather doubtful that an opinion rendered on additional

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<sup>17</sup>Committee on Auditing Procedure, Statements on Auditing Procedure No. 33, pp. 15-16.

information in the annual report by an auditor who did not possess these personal qualities would be of much if any value to clients and third parties.

#### Reliance on other experts

The additional information included in this study could in general be verified by CPAs. However, the only or primary procedure for obtaining evidence with respect to some of this information would be to obtain opinions from other independent experts. The reason is that CPAs are generally not qualified to verify this information adequately by other procedures. Examples of this kind of information would include most descriptions of the features of new products and the size of natural resource reserves.

Obtaining opinions from independent experts is an accepted auditing procedure for verifying certain kinds of information which form a part of the financial statements upon which the auditor renders his opinion. However, some practitioners question the value of extending the CPA's attest function to additional information in the annual report if the only or primary evidence to support that information would be a statement by an independent expert. These practitioners feel that CPAs would not add anything by rendering opinions specifically on additional information in the annual report that another independent expert had already "attested" to. The value of attesting to this kind

of information is discussed further in Chapter VI.

### Standards of Field Work

The applicability of the first standard of field work would appear to be obvious. Certainly, the work should be adequately planned and assistants should be properly supervised in any audit engagement. The second standard of field work, however, relating to the study and evaluation of internal control would only apply to that information which is subject to internal controls. Industry data, for example, would not be subject to internal controls. Much of the additional information is financial and accounting information, and would be subject to the same kinds of controls as financial statement information.

The American Institute of Certified Public Accountants' Committee on Auditing Procedure differentiates accounting controls from administrative controls as follows:

Accounting controls comprise the plan of organization and all methods and procedures that are concerned mainly with, and relate directly to, safeguarding of assets and the reliability of the financial records. . . .

Administrative controls comprise the plan of organization and all methods and procedures that are concerned mainly with operational efficiency and adherence to managerial policies and usually relate only indirectly to the financial records.  
 . . .<sup>18</sup>

The Committee states further:

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<sup>18</sup>Ibid., p. 28.

The independent auditor is primarily concerned with the accounting controls. Accounting controls, . . . generally bear directly and importantly on the reliability of financial records and require evaluation by the auditor. Administrative controls, . . . ordinarily relate only indirectly to the financial records and thus would not require evaluation. If the independent auditor believes, however, that certain administrative controls may have an important bearing on the reliability of the financial records, he should consider the need for evaluating such controls. For example, statistical records maintained by production, sales or other operating departments may require evaluation in a particular instance.<sup>19</sup>

The reliability of some of the additional information might be significantly affected by certain administrative controls. Auditors in general are not qualified to evaluate all kinds of administrative controls effectively. However, it does not appear that extension of the attest function to any of the additional information included in this study would require the evaluation of administrative controls which auditors in general could not evaluate adequately. Because the additional information subject to internal controls is probably either financial and accounting information or closely related to financial and accounting information, the auditor would probably not have any particular difficulty in evaluating internal controls pertaining to this information in most cases. The third standard of field work was discussed in Chapter III.

This chapter has included a discussion of the ethi-

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<sup>19</sup>Ibid., pp. 32-33.

cal, economic, and legal implications of extending the CPA's attest function. It has also included a discussion of the applicability of the profession's general and field work standards if the attest function is extended. The following chapter is devoted primarily to a summarization of the major conclusions arrived at in this study, and to some general observations concerning the value of having the additional information covered by the CPA's opinion.

## CHAPTER VI

SUMMARY OF MAJOR CONCLUSIONS AND  
SOME GENERAL OBSERVATIONS  
CONCERNING THE VALUE  
OF EXTENDING THE  
ATTEST FUNCTION

Major Conclusions

The CPA's attest function with respect to information in corporate annual reports is usually confined to the examination of, and expression of an opinion regarding the basic financial statements, including footnotes, and in some reports certain supporting schedules. In recent years there has been a considerable increase in the number of companies presenting "funds" statements in their annual reports, and similarly, in the number of these presentations covered by the CPA's opinion. The remainder of the information in the annual report, however, is generally not covered by the CPA's opinion.

As pointed out in Chapter I, there appears to be enough support for the propositions that (1) information in the annual report should be reliable, and (2) the attest function adds credibility to representations made by one party to another to justify considering the possibility of extending the CPA's attest function with respect to information in the annual report. The primary purpose of this



study is to examine the possibility of extending the CPA's attest function to include certain additional information in the annual report (this information is described in Chapter II and in Appendix B).

The ability to verify the additional information is essential, but this alone is not sufficient support for concluding that the profession can extend its attest function. Several other significant factors must be considered, including the ethical, economic, legal, and reporting implications of extension. The major conclusions in this study are as follows:

1. The kinds of additional information discussed in this study could in general be verified.

Since the additional information included in this study consists of basically the same types of assertions as those in the financial statements, it was concluded that the types of evidence generally available for judging the reliability of this information would be essentially the same as those types of evidence generally available for judging the reliability of financial statement assertions. However, whether sufficient evidence can be obtained to afford a reasonable basis for an opinion on any information, financial statement or additional, will depend upon the circumstances in a particu-

lar examination and the professional competence and judgment of the auditor performing the examination.

2. The auditor could arrive at a reasonable judgment as to whether or not most of the additional information presents fairly what it purports to present.

However, it appears that adequate guides for judging the fairness of projections of the future such as forecasts and budgets need to be established. Perhaps additional guides need to be established for some of the other information as well; for example, product line information.

3. The "highlights" and long-term "summary" statements would seem to be prime candidates for extension of the attest function in the annual report. Most annual reports include one or both of these presentations. Both of these statements provide, in summary form, significant information which is for the most part closely related to the basic financial statements. The assumption is, of course, that the information included in these statements for prior years has been or could be verified adequately.
4. With the possible exception of projections of the future, extension of the attest function to the

additional information would not be a violation of the Code of Professional Ethics. Extension of the attest function to projections of the future might be a violation of the Code.

A statement to the effect that the CPA does not vouch for the accuracy of a given projection might not effectively prevent undue reliance upon his opinion regarding that projection, or perhaps the mere fact that CPAs disclaimed responsibility for the accuracy of projections covered by their opinions would diminish public confidence in the attest function.

5. CPAs might not be willing to extend the coverage of their opinions because of uncertainties concerning the nature and extent of their legal responsibilities.

These uncertainties might tend to make most CPAs somewhat apprehensive about extending their opinions to include additional information beyond the financial statements. The recent rash of lawsuits against auditors has probably contributed greatly to this apprehension. Many of these suits may be attributable in part to public misunderstanding concerning the nature and limitations of the attest function. But this fact provides little solace to auditors who bear the

cost of legal defense, suffer adverse publicity, and perhaps pay damages even though the claims may be unfounded.

6. The time and cost that would be involved in extending the attest function to include the additional information would depend primarily upon how much of the information was to be covered in a particular engagement, the nature of that information, and the type of staff required to verify the information.

Perhaps these economic factors will limit the extent to which the coverage of the CPA's opinion can be extended to additional information in the annual report.

7. It seems that extending the attest function to any of the additional information, in the near future at least, will depend upon the client being convinced of the value of voluntarily having this information attested to by a CPA.

Therefore, some consideration is given to the value of having the additional information covered by the CPA's opinion in the remainder of this chapter.

#### Value of Attestation

As mentioned above, extension of the CPA's attest

function to any of the additional information, in the near future at least, will probably depend upon the client being convinced of the value of having this information covered. It is beyond the scope of this study to establish the importance of any particular item of additional information, and similarly, to establish the social value of the CPA's attest function. However, it seems that there is enough support for the proposition that the attest function adds credibility to representations made by one party to another, to justify making some general observations concerning the value of having the additional information covered by the CPA's opinion.

Two of the primary reasons why the client might want to have the additional information attested to by a CPA are:

1. To promote public confidence in the company by assuring shareholders and other third parties that the information can be relied upon.
2. To relieve the client of some of his responsibility for the reliability of the information.

It would seem that the client might be more inclined to want this information covered if it was being relied upon for decision-making purposes.

Much of the additional information in the annual report apparently is presented in response to the needs of investors (both present and prospective) and their representa-

lives (financial analysts and investment counselors) for relevant investment decision information. Some of this information may even be as relevant if not more relevant for decision-making purposes than the information covered by the CPA's opinion. Some of the additional information is used by other third parties, such as creditors and employees, in making other types of decisions, but the principal decisions based upon annual report information seem to be investment oriented.

Some of the kinds of information discussed in this study which seem to be relevant to investment decisions are:

Sales by major product groups or divisions

Index of selling prices

Unfilled orders

Advertising expenditures

Earnings by major product groups or divisions

Director and officer data

Employment costs

Size of natural resource reserves

Budgeted capital expenditures

Employee data (number of employees, years service with the company, and turnover)

Research and development expenditures

Patents received

Government contracts awarded to the company

The possibility that third parties may be relying upon some of the additional information for decision-making

purposes would seem to impose a social responsibility upon the client to give serious consideration to having this information attested to by the CPA. The usefulness for decision-making purposes of information which is not attested to is at least subject to question.

Perhaps the CPA's present standards of disclosure do not afford a fair presentation of a company's financial position and results of operations if important investment decision information is being presented outside the financial statements covered by his opinion. It would appear that the profession has a social responsibility to give serious consideration to whether any of the additional information is necessary for a fair presentation. If it is necessary it should be covered.

The author's opinion is that much of the additional information discussed in this study is important for evaluating the status, progress, and future prospects of a company. This information would seem to be significant enough to users of the annual report to call for attestation by the CPA. It would appear that the CPA should either require or recommend that the client have all relevant decision information in the annual report covered by his opinion.

In addition to the importance of the additional information, any decision as to whether or not the attest function should be extended to include this information should involve consideration of the following:

1. As mentioned in Chapter V, some practitioners question the value of extending the CPA's attest function to additional information in the annual report if the only or primary evidence to support that information would be a statement by another independent expert. However, there may be some value in attesting to this kind of information inasmuch as most readers of the annual report are not in a position to verify the information themselves. That is, as attesters, CPAs might add something by assuring readers that the information is presented fairly even if the opinion of another expert (who does not render opinions in corporate annual reports) is the only or primary evidence to support that information. It would be desirable, however, to refer to the other expert's opinion in the CPA's report.
2. There are a few items which the reader could verify easily himself. These would include the company's dividend record and the price range of its stock. The CPA would, therefore, not add much by attesting to items such as these.

In conclusion, it appears that it would be desirable to have much of the additional information discussed in this study covered by the CPA's opinion. Probably the only sig-



nificant barriers to extending the attest function to most of this information are the economic and legal implications of such an extension. Perhaps future developments, such as the clarification of legal responsibilities and the development of procedures which lessen time and cost limitations, will reduce the effect of these barriers.

The CPA should take advantage of the opportunity to extend his service to society wherever desirable and feasible. Failure to do so may well jeopardize or weaken the CPA's position as the principal attester in our society.

## APPENDIX A

LIST OF 89 COMPANIES WHOSE ANNUAL  
REPORTS FOR 1965 WERE EXAMINED

1. Aluminum Company of America
2. American Can Company
3. American Home Products Corporation
4. American Machine & Foundry Company
5. American Sugar Company
6. The American Tobacco Company
7. The Anaconda Company
8. Armco Steel Corporation
9. Armour and Company
10. The Babcock & Wilcox Company
11. The Bendix Corporation
12. The Boeing Company
13. The Borden Company
14. Borg-Warner Corporation
15. Burlington Industries, Inc.
16. Carrier Corporation
17. Caterpillar Tractor Co.
18. Chrysler Corporation
19. Cities Service Company
20. Cluett, Peabody & Co., Inc.
21. Colgate-Palmolive Company
22. Continental Baking Company

23. Continental Can Company, Inc.
24. Continental Motors Corporation
25. Corn Products Company
26. Crane Co.
27. Crown Zellerbach Corporation
28. E. I. du Pont de Nemours & Company
29. Eastman Kodak Company
30. Ex-Cell-O Corporation
31. The Firestone Tire & Rubber Company
32. FMC Corporation
33. Ford Motor Company
34. General American Transportation Corporation
35. General Dynamics Corporation
36. General Electric Company
37. General Foods Corporation
38. General Motors Corporation
39. General Telephone & Electronics Corporation
40. Genesco Inc.
41. Georgia-Pacific Corporation
42. The Gillette Company
43. The Glidden Company
44. The B. F. Goodrich Company
45. The Goodyear Tire & Rubber Company
46. Honeywell Inc.
47. Ingersoll-Rand Company
48. International Business Machines Corporation

49. International Harvester Company
50. International Paper Company
51. Johns-Manville Corporation
52. Litton Industries, Inc.
53. Lockheed Aircraft Corporation
54. McGraw-Hill, Inc.
55. Midland-Ross Corporation
56. Minnesota Mining and Manufacturing Company
57. Monsanto Company
58. Motorola, Inc.
59. National Biscuit Company
60. National Dairy Products Corporation
61. National Distillers and Chemical Corporation
62. National Lead Company
63. North American Aviation, Inc.
64. Owens-Illinois Glass Company
65. Chas. Pfizer & Co., Inc.
66. Pittsburgh Plate Glass Company
67. Pullman Incorporated
68. Radio Corporation of America
69. Ralston Purina Company
70. Republic Steel Corporation
71. Reynolds Metals Company
72. R. J. Reynolds Tobacco Company
73. The Singer Company
74. Socony Mobil Oil Company, Inc.

75. Sperry Rand Corporation
76. Standard Brands Incorporated
77. Standard Oil Company (New Jersey)
78. J. P. Stevens & Co., Inc.
79. Swift & Company
80. Texaco Inc.
81. Time Incorporated
82. Union Carbide Corporation
83. United Aircraft Corporation
84. United States Gypsum Company
85. United States Rubber Company
86. United States Steel Corporation
87. Westinghouse Electric Corporation
88. Weyerhaeuser Company
89. Whirlpool Corporation

APPENDIX B

TYPES OF ASSERTIONS: ADDITIONAL  
INFORMATION

Other Financial and Accounting Information

Type of Assertion

Sales

1. By major product groups or divisions

Sales of X dollars by the specific group or division during the year under examination

Past events  
Simple quantitative  
Mathematical

Implied: Receivable or receipts from customers equal to the dollar amount of sales

Past events (receipts)  
Existence of nonphysical things (receivables)  
Qualitative (collectibility of receivables)  
Value-judgment quantities (receivables)  
Simple quantitative (receipts)  
Mathematical

2. By customers, industries, or markets served

Sales of X dollars by the company to the specific customer, industry, or market during the year under examination

Same as (1)

Implied: Receivables or receipts equal to the dollar amount of sales

Same as (1)

3. Government sales

Sales of X dollars by the company to the U. S. Government during the year under examination

Same as (1)

Implied: Receivables or receipts from the U. S. Government equal to the dollar amount of sales

Same as (1)

	<u>Type of Assertion</u>
4. <u>Quarterly sales</u>	
Sales of X dollars by the company during the particular quarter under examination	Same as (1)
Implied: Receivable or receipts from customers equal to the dollar amount of sales	Same as (1)
5. <u>Unit sales</u>	
Sale of X number of units by the company during the year under examination	Same as (1)
Implied: Receivables or receipts from customers for the sale of X number of units	Same as (1)
6. <u>Index of selling prices</u>	
Index of the company's selling prices during the year under examination	Mathematical
Implied: Sale of X-Y number of units at X-Y prices during the year under examination, and during the base period	Past events Simple quantitative Mathematical
7. <u>Sales forecast</u>	
Sales of X dollars by the company during the <u>next</u> year	Future events Mathematical



Type of Assertion

8. Industry sales

Sales of X dollars or sale of X number of units by the industry during the year under examination

Past events  
Simple quantitative  
Mathematical

Unfilled orders

1. Total backlog

Unfilled orders of X dollars at the end of the year under examination (funded and unfunded)

Existence of nonphysical things  
Simple quantitative  
Mathematical

2. Government backlog

Unfilled U. S. Government orders of X dollars at the end of the year under examination (funded and unfunded)

Same as (1)

Advertising expenditures

1. Current

The company paid X dollars during the year under examination for advertising

Past events  
Simple quantitative  
Mathematical

2. By media

The company paid X dollars during the year under examination for advertising through X medium

Same as (1)

Type of Assertion

3. Budgeted

The company has X dollars budgeted for advertising expenditures during the next year

Future events  
Mathematical

Suppliers and subcontractors

1. Total dollar amount of contracts or orders

Contracts or orders totaling X dollars were let to or placed with subcontractors or suppliers during the year under examination

Past events  
Simple quantitative  
Mathematical

2. Number of suppliers and subcontractors

X number of firms in (1)

Simple quantitative  
Mathematical

3. Number of small businesses among suppliers and subcontractors

X number of small business firms in (2)

Simple quantitative  
Mathematical

Implied: Less than a certain number of employees

Existence of physical things not present

Earnings

1. By major product groups or divisions

Earnings of X dollars by the specific group or division during the year under examination

Past events  
Value-judgment quantities  
Mathematical

	<u>Type of Assertion</u>
Implied: Revenues and expenses included in calculation of the earnings	Past events Simple quantitative Value-judgment quantities Mathematical
2. <u>Quarterly earnings</u>	
Earnings of X dollars by the company during the particular quarter under examination	Same as (1)
Implied: Revenues and expenses included in calculation of the earnings	Same as (1)
3. <u>Earnings forecast</u>	
Earnings of X dollars by the company during the <u>next</u> year	Future events Mathematical
<u>Dividend record</u>	
1. <u>Consecutive quarterly or annual dividends</u>	
The company has paid cash dividends to shareholders for X number of consecutive quarters or years including the year under examination	Past events Simple quantitative Mathematical
2. <u>Consecutive years maintained or increased dividend</u>	
The company has paid cash dividends to shareholders for X number of consecutive years including the year under examination; and the dividend for each consecutive year has been equal to or greater than the preceding year	Past events Simple quantitative Mathematical

Type of Assertion

Price range of company's stock

The price range (high and low: NYSE) of the company's stock during the year under examination

Past events

Shareholder and Personnel Information

Shareholder information

1. Type of shareholder, number of each, and number of shares held by each type

There are X number of each type of registered shareholder, and each type holds X number of shares at the end of the year under examination

Existence of physical things not present  
Simple quantitative  
Mathematical

2. Frequency distribution of holdings

X number of registered shareholders hold X-Y number of shares at the end of the year under examination

Same as (1)

3. Voting at annual meeting

X number of shareholders were entitled to vote and X number voted; X number of shares were eligible to be voted and X number were voted at the annual meeting which took place during the year under examination

Past events  
Simple quantitative  
Mathematical

Type of Assertion

Personnel information

1. Director data

- a. The company's directors have the listed business or professional affiliations

Existence of nonphysical things  
(affiliations)

Implied: They are directors of the company

Existence of nonphysical things  
Existence of physical things present or not present (they exist)

- b. X number of years old, X number of years service as directors of the company, and X number of years service with the company

Past events  
Simple quantitative  
Mathematical

- c. Attendance at X number of regular Board meeting during the year under examination

Past events  
Simple quantitative  
Mathematical

2. Officer data

- a. The company's officers hold the positions indicated

Existence of nonphysical things  
(positions)  
Existence of physical things present (they exist)

- b. X number of years old and X number of years service with the company

Past events  
Simple quantitative  
Mathematical

- c. They hold degrees from the colleges indicated (implied: received in the past)

Past events

Type of Assertion

3. Officer and director changes

Certain changes (new assignments, retirements, deaths, etc.) in the officer and director ranks took place during the year under examination

Past events

4. Employee data

a. X number of people are employees of the company at the end of the year under examination

Existence of nonphysical things  
(they are employees)  
Existence of physical things  
present (they exist)  
Simple quantitative  
Mathematical

b. X number of employees have X-Y years service with the company as of the end of the year under examination

Past events  
Simple quantitative  
Mathematical

c. The company's employee turnover rate for the year under examination

Mathematical

Implied: X number of departures and X number hired during the year under examination

Past events  
Simple quantitative  
Mathematical

d. The industry or all industry turnover rate for the year under examination

Mathematical

Implied: X number of departures and X number hired during the year under examination

Past events  
Simple quantitative  
Mathematical

Type of Assertion

5. Employment costs

- |   |  |
|---|--|
| a. The company's total employment cost for the year under examination was X dollars | Past events<br>Simple quantitative<br>Mathematical |
| b. Employee benefits (total and specific types: X dollars)                          | Same as (a)  |
| c. Salaries and wages: X dollars  | Same as (a)  |
| d. Officer and director salaries: X dollars   | Same as (a)  |

6. Education data

- |  |  |
|--|--|
| a. The company paid a total of X dollars during the year under examination for educational assistance to X number of employees who completed X number of courses | Past events<br>Simple quantitative<br>Mathematical |
| b. X number of employees have college degrees and X number have doctorates (implied: received in the past)   | Past events<br>Simple quantitative<br>Mathematical |
| c. X number of interviews were conducted at X number of colleges, and X number of graduates were hired during the year under examination                         | Past events<br>Simple quantitative<br>Mathematical |

7. Training and development programs

- |  |  |
|--|--|
| a. The company's programs cost X dollars during the year under examination | Past events<br>Simple quantitative<br>Mathematical |
|--|--|

Type of Assertion

b. During the year under examination, X number of employees participated; and training totaled X number of man-hours

Same as (a)

8. Labor relations data

a. X number of labor contracts were signed during the year under examination (Union/s, duration, provisions, number of employees covered, and number of plants involved)

Past events  
Simple quantitative  
Mathematical

b. X number of votes for and X number of votes against unionization in election/s which took place during the year under examination (Union, number of employees involved, and number of plants involved)

Same as (a)

c. There were X number of strikes during the year under examination (Union/s, duration, number of employees idled, and location)

Same as (a)

d. Employees lost X dollars of wages, and the company lost X number of man-hours of work during the strikes

Same as (a)

9. Safety data

a. The company's frequency and severity rates for the year under examination

Mathematical

Implied: X number of disabling injuries and X number of days lost; and X number of man-hours worked

Past events  
Simple quantitative  
Mathematical



	<u>Type of Assertion</u>
b. The industry or all industry rates for the year under examination	Mathematical
Implied: X number of disabling injuries and X number of days lost; and X number of man-hours worked	Past events Simple quantitative Mathematical
10. <u>Hours worked per week</u>	
The company's hourly employees worked an average of X number of hours per week during the year under examination	Mathematical (average)
Implied: X number of hourly employees worked a total of X number of hours per week during the year under examination	Past events Simple quantitative Mathematical
11. <u>Suggestion plans</u>	
a. X number of suggestions were submitted by employees during the year under examination	Past events Simple quantitative Mathematical
b. During the year under examination, X number of suggestion awards were made to employees, totaling X dollars	Same as (a)
12. <u>Awards and honors received</u>	
Certain awards and honors were received by officers and directors during the year under examination	Past events

Type of Assertion

Facilities and Products Information

Facilities

1. Floor area

The company owns X number of sq. ft., leases X number of sq. ft., and carries on activities in Government facilities with a total floor area of X number of sq. ft., at the end of the year under examination

Existence of physical things present (facilities)  
Qualitative (owned, leased, and Government owned)  
Simple quantitative  
Mathematical

2. Company facilities

a. Type and location of company facilities

Existence of physical things present  
Qualitative (owned)

b. Type and location of certain facilities completed during the year under examination

Past events  
Existence of physical things present  
Qualitative (owned)

Size, capacity, and cost

Past events (cost and capacity)  
Simple quantitative  
Mathematical  
If capacity has not been realized yet: Future events

c. Type and location of certain facilities in process of construction at the end of the year under examination

Existence of physical things present  
Qualitative (owned)

Type of Assertion

2. c. (continued)

Size, capacity, and cost

Future events  
Mathematical  
Cost to date: Past events  
Simple quantitative

Projected completion date

Future events

d. Type and location of certain facilities  
planned at the end of the year under  
examination

Future events

Size, capacity, and cost

Future events  
Mathematical

Projected completion date

Future events

3. Natural resources

a. The company drilled X number of wells  
during the year under examination; X  
number of producers and X number dry

Past events  
Existence of physical things  
present  
Qualitative (owned)  
Simple quantitative  
Mathematical

b. Size of company's natural resource  
reserves; for example, X number of  
acres of timberland and X tons of  
phosphate

Existence of physical things  
present  
Qualitative (owned)  
Simple quantitative  
Value-judgment quantities (if  
estimated)  
Mathematical

Type of Assertion

4. Capital expenditures

The company has X dollars budgeted for capital expenditures during the next year

Future events  
Mathematical

Products

1. Number and nature of products

a. X number of products

Simple quantitative  
Mathematical

b. Produced by the company

Past events  
Existence of physical things  
present (they exist)

2. Championships won and records set using company's products

Certain championships were won and certain records were set during the year under examination using the company's products

Past events

3. Major sales or orders

a. X number of units ordered or sold  
(a particular customer)

Existence of nonphysical things  
(unfilled order)  
Past events (sale)  
Simple quantitative  
Mathematical

b. Dollar amount of order or sale

Simple quantitative  
Mathematical

Type of Assertion

4. Production

The company produced X number of units of X product during the year under examination

Past events  
Simple quantitative  
Mathematical

5. Research and development

a. The company expended X dollars during the year under examination for R&D

Past events  
Simple quantitative  
Mathematical

b. X dollars of (a) was financed by the Government or others

Past events (if reimbursed)  
Existence of nonphysical things  
(receivable: if not reimbursed  
as of end of year)  
Simple quantitative  
Mathematical

c. The company has X dollars budgeted for R&D expenditures during the next year

Future events  
Mathematical

d. There are X number of employees in R&D

Existence of nonphysical things  
(they are R&D employees)  
Existence of physical things  
present (they exist)  
Simple quantitative  
Mathematical

e. X number of employees have degrees in science, engineering, etc.; X number of research people have advanced degrees (implied: received in the past)

Past events  
Simple quantitative  
Mathematical

	<u>Type of Assertion</u>
f. Certain awards were received during the year under examination for research achievement	Past events
g. The company received X number of U. S. and X number of foreign patents during the year under examination	Past events Existence of physical things present (letters patent) Simple quantitative Mathematical
h. Sales of X dollars by the company during the year under examination from products introduced within the past so many years	Past events (sales during the year, and introduced within past so many years) Simple quantitative Mathematical
i. The company introduced certain products during the year under examination	Past events Existence of physical things present (they exist)
Features of the new products	Qualitative
Examples are presented on page 50 of Chapter II in this study	

Governmental and Social Contribution Information

Governmental

1. Government contracts

X-year contract, totaling X dollars, for X number of units of X product awarded to the company by the U. S. Government during the year under examination

Past events  
Simple quantitative  
Mathematical

Type of Assertion

2. Antitrust

- |  |   |
|--|---|
| a. Antitrust actions against the company                   | Past events (actions brought in the past) |
| b. Judgments and appeals during the year under examination | Past events                               |

Social contribution

1. Balance-of-payments position

The company's net contribution was X dollars during the year under examination	Mathematical
Implied: X dollars of exports	Past events
X dollars of dividends from abroad received	Simple quantitative
X dollars of royalties from abroad received	Mathematical
X dollars of other income from abroad received	
X dollars of imports	
X dollars new investments outside the U. S.	
X dollars of dividends paid to shareholders in other countries	
by the company during the year under examination	

Type of Assertion

2. Pollution abatement expenditures

The company has invested or has authorized a total of X dollars for pollution abatement facilities as of the end of the year under examination

Existence of physical things present (existing facilities)  
Qualitative (owned)  
Existence of nonphysical things (authorization)  
Past events (invested)  
Simple quantitative  
Mathematical

3. Educational and charitable contributions

a. The company contributed a total of X dollars for educational and charitable purposes during the year under examination

Past events  
Simple quantitative  
Mathematical

b. The company contributed X dollars for educational purposes (for example, grants, fellowships, and scholarships) during the year under examination

Same as (a)

c. During the year under examination, X number of employees gave a total of X dollars to X number of schools through the company's matching gift plan

Same as (a)

Implied: Payments or payables equal to employee contributions

Past events (payments)  
Existence of nonphysical things (payables)  
Simple quantitative  
Mathematical



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## VITA

Robert Wayne Clarke was born in Rome, New York, on April 14, 1934. He attended public schools in Rome and Syracuse, New York, graduating from Syracuse Central High School in June, 1952.

He served in the United States Air Force for four years, receiving an honorable discharge in March, 1957.

He attended Syracuse University, Syracuse, New York, and received the Beta Alpha Psi, Alpha Kappa Psi, Financial Executives Institute, and New York State Society of Certified Public Accountants Scholarship Awards. He graduated from Syracuse Magna Cum Laude in June, 1961. In August, 1962, he received his M.B.A. degree from Syracuse University.

In September, 1962, he began doctoral study at the University of Illinois. He was a teaching assistant in the Department of Accountancy until September, 1964, when he was promoted to the rank of Instructor. In 1964, he was awarded the Outstanding Teacher Award at the University of Illinois.

While at the University of Illinois, he received American Accounting Association, Haskins & Sells Foundation, and University of Illinois Fellowships. During academic year, 1966-67, he was awarded an Arthur Andersen & Co. Doctoral Dissertation Fellowship.

He is a member of Phi Kappa Phi, Beta Gamma Sigma,  
and Beta Alpha Psi.