

# Accounting and Auditing

Conducted by:

THE COMMITTEE ON ACCOUNTING AND AUDITING PROCEDURE  
ERNEST L. HICKS, CPA, Chairman

## AUDITS AND INTERNAL CONTROL

The AICPA Committee on Auditing Procedure published a booklet in 1949 describing the nature of internal control and its importance to the independent auditor. The substance of this material has been incorporated into Statement on Auditing Procedure No. 33, Chapter 5. The study and evaluation of existing internal control are necessary to determine the nature and extent of auditing procedures to be applied to support an opinion on financial statements.

### REVIEW AND EVALUATION OF INTERNAL CONTROL

Many auditors use internal control questionnaires to help them determine the extent to which the characteristics of a properly coordinated system exist in a given situation. In some cases it may be helpful to prepare a procedural flow chart in sufficient detail to give a clear picture of the documentation and paper flow through all phases of the system. In still other engagements a narrative description may be used to document the system review.

---

### FOR THE COMMITTEE ON ACCOUNTING AND AUDITING PROCEDURE

Chairman: Ernest L. Hicks, CPA  
Arthur Young & Company

Contributor this Month:

Philip B. Chenok, CPA, Main Lafrentz &  
Co.

The study and evaluation should include the organizational structure of the company under examination, its financial and accounting procedures, the work of employees responsible for the financial and accounting function and the safeguards over assets and accounting records. Specific conclusions should be reached as to whether the system can be expected to produce reliable information and whether it is operating effectively.

For each major accounting function (e.g., sales, receivables, cash receipts, purchases, payables, cash disbursements, etc.) the auditor should consider whether:

- Authority and responsibility for performance are clearly established;
- Authorization, recording, review and approval are performed by employees not responsible for operating or custodial activities;
- Transactions are reviewed internally in such a manner that material errors are discovered promptly;
- Forms, etc., specifically provide for documentation that transactions have been authorized, recorded and reviewed for propriety and accuracy;
- Cross-checks and other proof devices are adequate and are effectively used.

Sufficient tests of transactions should be made to enable the auditor to conclude whether the client's controls are operating effectively. If it appears that control weaknesses exist, the examination should be extended so that the auditor is satisfied that they do not

THE NEW YORK CERTIFIED PUBLIC ACCOUNTANT MAY 1967 • 375

الاستشارات  
للحسابات

materially affect the financial statements.

#### AUDIT PROGRAMS

It is desirable for the working papers to make it clear that the design of the audit program was based upon the study and evaluation of internal control. Ideally, an auditor not connected with the engagement should be able to tell from the working papers how the program was derived from the evaluation. This may be accomplished (1) through a separate memorandum citing control weaknesses and stating the nature and extent of audit procedures to be applied to the affected areas or (2) by citing such weaknesses and procedures in a comments section of the internal control questionnaire, if one is used. Alternative controls should also be cited if they overcome apparent deficiencies.

Audit programs should be tailored to fit the existing system of internal control. Some firms use preprinted programs covering standard audit steps (e.g. reconcile bank account), modifying them in the light of the client's system. Spaces are provided for the addition of procedures peculiar to a particular engagement; inapplicable procedures are eliminated.

#### PROGRAM MODIFICATIONS

Audit programs prepared following initial evaluation of controls are often

modified during the course of an engagement if tests indicate that the system is not functioning as planned. Modifications may involve the reduction or elimination of certain procedures, the extension of other procedures or the application of new procedures, shifting emphasis on details, etc. Reasons for and evidence of such modifications would ordinarily appear in the working papers.

#### STATISTICAL SAMPLING

Statistical sampling has application both to tests of internal controls and to other audit tests. The Special Report of the AICPA Committee on Statistical Sampling on "The Relationship of Statistical Sampling to Generally Accepted Auditing Standards" may be used as a guide in deciding what statistical "reliability" and "precision" are satisfactory for a particular application.

#### VERY WEAK SYSTEMS

It should also be recognized that in extremely rare situations the system may be so inadequate that even the most exhaustive procedures would not enable the auditor to form an opinion on the financial statements. Clients should be advised if the system is so weak that an opinion cannot be given, and a disclaimer should clearly so state.

---

"The CPA certificate, is it a license to practice or a mark of competence?"