

**IAASB Project Proposal — Reporting on Special Purpose Audit Engagements****1. Subject**

Revision of ISA 800, *The Auditor's Report on Special Purpose Audit Engagements*.

**2. Scope and Project Strategy**

Since ISA 800 was last revised in March 1994, many changes have happened in practice that suggest a compelling need to reconsider whether the standards and guidance in ISA 800 remain complete and appropriate to meet the reporting requirements in today's environment. For example, auditors now report on a number of special purpose audit engagements that are not covered by ISA 800. In addition, proposed changes in the IAASB's reporting Standard, ISA 700, "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements," have brought a pressing need to update ISA 800, not least for the content and wording of the special purpose auditor's report.

However, the actual number of reporting issues that could be addressed in a revision of ISA 800 is large and trying to address them all simultaneously within the IAASB's existing resource constraints would be impracticable. Therefore, in order to develop a logical strategy and approach, Staff, with input from the Steering Committee, analyzed the list of potential issues from the perspective of their strategic importance to the marketplace and the need to align ISA 800 with changes being proposed to ISA 600, "The Work of Related Auditors and Other Auditors in the Audit of Group Financial Statements," and ISA 700. Accordingly, priority has been given to addressing the following key issues within the scope of this project:

- a) Reporting on financial information prepared under a comprehensive basis of accounting for a special purpose, addressing cases where:
  - i) The information may be expected to achieve fair presentation or give a true and fair view; and
  - ii) The information will not achieve fair presentation or give a true and fair view.
- b) Reporting on non-general purpose financial information prepared under a non-comprehensive basis of accounting.
- c) Reporting on incomplete sets of financial statements, particularly a single financial statement such as a balance sheet.

Other issues that are of lower priority are summarized in the Appendix and will be addressed in future as and when IAASB has the resources and agenda time available. As part of its mandate, the Task Force will form views as to how best to restructure ISA 800, taking into account those sections that will be revised at a later stage, such as summarized financial statements.

### **3. Issues to be Addressed**

#### **A) REPORTING ON FINANCIAL INFORMATION PREPARED UNDER A COMPREHENSIVE BASIS OF ACCOUNTING FOR A SPECIAL PURPOSE**

##### **i) Financial Information Expected to Achieve Fair Presentation/Give a True and Fair View**

Under the proposed revised ISA 200, “Objective and General Principles Governing an Audit of Financial Statements,” and ISA 700, the concept of fair presentation/true and fair view is closely associated with general purpose financial statements. This raises the question as to the form of report that would be appropriate for other kinds of financial statements that could be expected to, but not necessarily will, achieve fair presentation/give a true and fair view.

It could be argued that the expression of a “present fairly/true and fair” opinion should not be related to an accounting basis that is not an applicable financial reporting framework for general purpose financial statements, as defined in the proposed revised ISAs 200 and 700, because the basis of accounting used may not result in virtually all circumstances in financial statements that achieve a fair presentation.

Therefore, consideration needs to be given to whether ISA 800 should be revised to dissociate the expression of a “present fairly/true and fair” opinion from audits of financial information prepared under a comprehensive basis of accounting for a special purpose. For example, an alternative might be for the expression of an opinion that states that the financial information “has been prepared, in all material respects, in accordance with (the identified basis of accounting).”

If it is not possible to completely dissociate “present fairly/true and fair” from audits of such financial information (for example, certain jurisdictions have legal requirements that necessitate the use of “present fairly/true and fair” for special purpose audits), consideration needs to be given to the circumstances under which it would not be appropriate to report on the “present fairly/true and fair” basis.

##### **ii) Financial Information that will not Achieve Fair Presentation/True and Fair View**

The project will consider addressing circumstances where the financial information reported on is prepared under a comprehensive basis of accounting but does not result in a fair presentation/true and fair view – specifically, reporting on a component of a group

An entity that is a component of a group, such as a subsidiary or branch, may be audited as a standalone entity for statutory purposes. In such a case, the component’s financial statements are required to be prepared in accordance with the applicable financial reporting framework so as to give a true and fair view of the component’s financial position, results and cash flows. In performing such an engagement, the auditor would apply the provisions of ISA 700.

However, a component of a group may also be audited for group consolidation purposes. While the component’s financial schedules for consolidation purposes (“consolidation package”) may be prepared using a comprehensive basis of accounting such as IFRS, the package may not include all the necessary disclosures mandated by the financial reporting framework. Accordingly, although the component’s management may state that the consolidation package has been prepared in accordance with the applicable financial reporting framework, it may not assert that the consolidation package gives a true and fair presentation in accordance with the applicable

financial reporting framework.

Another issue that needs to be addressed is the audit of a component based on a materiality allocated on a group basis by the group auditor. Although the component auditor may render a “presents fairly/true and fair” report on the component’s standalone financial statements based on an audit using a materiality level determined on a standalone basis (as may be the case in a statutory audit), the question arises as to whether the component auditor would be able to render the same type of report when the audit is based on a higher materiality allocated at the group level (as in a group audit), since the extent of audit work in the latter case would be less than when materiality on a standalone basis is used.

Other reporting issues relating to the audit of components of groups include:

- Determining whether a “presents fairly/true and fair” opinion would be appropriate on the component’s consolidation package.
- Determining whether guidance should be provided when the component auditor reports “subject to” completion of outstanding audit procedures, for example, receipt of confirmation of inter-company balances or receipt of an independent valuation report.
- Determining whether there should be identification of the information audited, since in practice such information could be distributed in different schedules and analyses.
- Determining whether guidance needs to be provided in respect of reporting on information required by group management but not required by the applicable financial reporting framework. For example, the component auditor could be asked to report specifically on that information in a separate section of the component auditor’s report, and the question arises as to what an appropriate form of report would be.

#### B) REPORTING ON NON-GENERAL PURPOSE FINANCIAL INFORMATION PREPARED UNDER A NON-COMPREHENSIVE BASIS OF ACCOUNTING

Proposed revised ISA 700 and conforming changes to ISA 200 do not permit the auditor to accept an engagement to audit general purpose financial statements when the financial reporting framework chosen by management is not comprehensive and authoritative, since the application of such a framework will likely result in financial statements that do not present fairly the financial position, financial performance and cash flows of the entity.

However, paragraph 38 of proposed revised ISA 200 states: *“In some cases, the objective of the financial statements will be to meet the financial information needs of specific users. **The information needs of such users will determine the applicable financial reporting framework in such circumstances.** Examples of financial reporting frameworks that address the needs of specific users are: a tax basis of accounting for a set of financial statements that accompany an entity’s tax return; the financial reporting provisions of a government regulatory agency for a set of financial statements to meet the needs of that agency; or a financial reporting framework established by the provisions of an agreement specifying the financial statements to be prepared.”*

The issue to be addressed is whether the applicable financial reporting framework in ISA 800 engagements can be a non-comprehensive basis of accounting, since ISA 800 is presently silent

on this issue. Arguably, limiting the auditor to reporting on special purpose financial statements prepared only in accordance with comprehensive bases of accounting in ISA 800 may be unduly restrictive because:

- i) In practice, the auditor may be asked to perform an engagement where the applicable basis of accounting is non-comprehensive – for example, reporting on a financial presentation prepared on a basis of accounting prescribed in an agreement that does not result in a presentation in accordance with an applicable financial reporting framework or another comprehensive basis of accounting; and
- ii) The applicable basis of accounting is determined by the users of the special purpose financial information according to their specific needs, regardless of whether there is substantial external support for that basis.

#### C) REPORTING ON INCOMPLETE SETS OF FINANCIAL STATEMENTS

The scope of the proposed revised ISA 700 has been explicitly narrowed to apply only to a complete set of general purpose financial statements. As a result, reporting on incomplete sets of financial statements such as a single balance sheet will fall within the scope of ISA 800. A conforming change from the ISA 700 project has been proposed to ISA 800 by including reporting on a single financial statement within the ISA 800 section dealing with engagements to report on a component of financial statements.

However, there is a need to expand guidance for engagements to report on incomplete sets of financial statements to address other issues that include, but are not limited to:

- Whether there are any specific disclosures that should be made;
- Whether there should be cross-referencing from the incomplete set of financial statements to the complete set of financial statements, if appropriate;
- Whether there should be specific materiality considerations; and
- Whether there should be a specific format and wording of the auditor's report, and how to deal with modifications to such a report.

#### **4. Describe Any Implications For Persons Or Groups Other Than the IAASB**

- Public Sector Committee of IFAC, due to special audit reporting often required in respect of public sector entities by governmental agencies.
- National regulators, due to the prevalence of special purpose reporting in practice mainly because of regulatory requirements.

Other than the above, it is not expected that the project will affect other IFAC committees or groups to any significant extent.

#### **5. Consider Whether IT Requires Particular Consideration**

There are no specific IT considerations.

**6. Indicate the Type of Material to Be Published**

A revised ISA 800, along the following proposed timeline:

- Issues paper – September 2004
- Exposure draft – June 2005
- Final approved – March 2006

**7. Resources Required**

- An IAASB task force, including one or more members with experience on the ISA 700 project.
- IAASB technical staff (one).

**8. List Important Sources of Information That Address the Matter Being Proposed**

- U.S. AU Section 623, “Special Reports”
- U.S. AU Section 9623, “Special Reports: Auditing Interpretations of Section 623”
- Proposed revised ISA 700, “The Independent Auditor’s Report on a Complete Set of General Purpose Financial Statements”
- U.S. AU Section 551, “Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents”
- U.S. AU Appendix B, “Analysis of International Standards on Auditing”
- CICA Section 5800, “Special Reports: Introduction”
- CICA Section 5805, “Special Reports – Audit Reports on Financial Information Other than Financial Statements”
- CICA Assurance Exposure Draft, “Auditor’s Report on Financial Statements Prepared using a Basis of Accounting other than Generally Accepted Accounting Principles” (Oct 2002)
- Australia AUS 802, “The Audit Report on Financial Information other than a General Purpose Financial Report”
- Australia AGS 1044, “Audit Reports on Information Provided other than in a Financial Report”
- UK Practice Notes 8 and 9, and Bulletin 1999/6

**9. Factors That May Add To Complexity or Length of Project**

- Delays in finalizing the ISA 700 and 701 projects and the related conforming amendments to ISA 200, and in particular, the issue of whether “true and fair” or “present fairly” should only apply to complete sets of general purpose financial statements.

Prepared by Ken Siong      Date January 21, 2004

**Reporting Issues Recommended to be Deferred until Resources are Available**

- Whether the guidance in ISA 800 on summarized financial statements needs to be revised and expanded.
- Whether the guidance in ISA 800 on financial presentations to comply with contractual agreements needs to be revised.
- Whether to expand guidance on modifications to the auditor's reports in special purpose engagements.
- Whether guidance in ISA 800 on limitation of distribution and use of the special purpose auditor's report should be revised and strengthened.
- Whether to provide guidance regarding the adequacy of disclosures accompanying special purpose financial information.
- Whether the auditor should audit an entity's complete financial statements to be able to express an opinion on specified information that is based on the entity's net income or shareholders' equity.
- Determining how the auditor should address a change in the nature of the engagement, such as when the engagement is started as a special purpose engagement with limitation of use and distribution of the report but management subsequently decides to change the nature of the financial information audited to general purpose financial statements.
- Determining how the auditor should address different levels of service on a given set of financial statements, for example, an audit of the balance sheet but a review of all other statements for the period ending on the date of the audited balance sheet.
- Whether a cash basis of accounting, such as that of IFAC's Public Sector Committee, is a comprehensive basis of accounting as defined in the proposed revised ISA 200.