

Revision of ISA 800, “The Auditor’s Report on Special Purpose Audit Engagements” – Second Issues Paper

Background

1. ISA 800, “The Auditor’s Report on Special Purpose Audit Engagements” was last revised in March 1994. The proposed revised ISA 700, “The Independent Auditor’s Report on a Complete Set of General Purpose Financial Statements” (ED-ISA 700) and proposed conforming amendments to ISA 200, “Objective and General Principles Governing an Audit of Financial Statements” (ED-ISA 200), which were approved in December 2003, not only gave rise to proposed conforming amendments to ISA 800 (ED-ISA 800), but also highlighted the need for a more comprehensive revision.

Task Force

2. The task force members are as follows: Sukanta Dutt (Chair), John Archambault, Josef Ferlings (supported by Wolfgang Böhm), Jonas Hällström (INTOSAI) and John Kelly (South Africa). Since discussing the first issues paper with the IAASB, the task force met during the June 2004 IAASB meeting (Copenhagen) and on July 26-27 in London. It also had a telephone conference on August 18.

Progress to Date

3. In June 2004, a first issues paper containing the task force’s recommendations with regard to the scope of the revision of ISA 800 and on seven of the 13 identified issues was presented to the IAASB. The outcome of these discussions is reflected in the minutes of the June 2004 IAASB meeting.
4. In order to align the scope of the project with that of the proposed revised ISA 700, and to achieve consistency in standards and guidance, the task force has focused on the development of standards and guidance based on the recommendations agreed by the IAASB in June 2004, and on the development of recommendations for the remaining issues relating to the auditor’s report on other historical financial information other than summarized financial information.
5. Recommendations for the issues relating to summarized financial information will be presented to the IAASB at a future meeting.
6. The appendix to this paper contains background information on the issues relating to summarized financial information. The proposed revised ISA 800 submitted for consideration at this meeting contains the existing standards and guidance on summarized financial information and the existing illustrative reports. These have not yet been considered by the task force and will not be dealt with at the September 2004 IAASB meeting.

Proposed Revised Project Timetable

7. The following project timetable is proposed:

| | |
|----------------|---|
| June 2004 | Discussion of first issues paper (seven issues relating to the auditor's report on other historical financial information other than summarized financial information) |
| September 2004 | Discussion of second issues paper (remaining issues relating to the auditor's report on other historical financial information other than summarized financial information) Review of proposed wording for recommendations agreed based on first issues paper and proposed wording based on recommendations in second issues paper |
| December 2004 | Discussion of third issues paper (issues relating to the auditor's report on summarized financial information) Review of proposed wording for recommendations agreed based on first and second issues papers |
| March 2005 | First read of proposed exposure draft |
| June 2005 | Approval of proposed exposure draft |
| December 2005 | Consideration of summary of significant comments |
| March 2006 | Full review of comments received and first read of proposed final standard |
| June 2006 | Approval of proposed final standard |

Issues to be Addressed as Part of this Project

8. With reference to the project proposal, and based on the proposed project scope and priorities, the task force originally identified the following issues to be addressed as part of the proposed revision of ISA 800:

| Issue | Paragraphs in this (second) issues paper | Discussed in June 2004 (first issues paper) | To be dealt with in third issues paper |
|---|--|---|--|
| Scope, introduction and title of the proposed revised ISA 800 | | ✓ | |
| Terminology – “financial reporting framework” | | ✓ | |
| Acceptability of the financial reporting framework | | ✓ | |
| Use of the term “true and fair” / present fairly” | | ✓ | |
| Adequacy of disclosures in other historical financial information | | ✓ | |
| Stating management's and the auditor's responsibility in the auditor's report | 9-12 | | |
| Circumstances that require additional explanatory | 13-14 | | |

| Issue | Paragraphs in this (second) issues paper | Discussed in June 2004 (first issues paper) | To be dealt with in third issues paper |
|---|--|---|--|
| language in the auditor's report | | | |
| Limitation of distribution and use of the auditor's report and standard disclaimers | 15-17 | | |
| The auditor's report on summarized financial statements <ul style="list-style-type: none"> • Nature of the engagement and use of the term "consistent" • Equivalency of different wordings of the opinion on summarized financial statements • Nature, timing and extent of procedures • Dating of the auditor's report | | | ✓ |
| Public sector considerations | | ✓ | |
| Small entity/practitioner considerations | | ✓ | |
| The auditor's report on financial information of a component prepared for inclusion in group financial statements <ul style="list-style-type: none"> • Audit Materiality | The IAASB agreed not to consider this type of auditor's report as part of this project | | |

Issues for Consideration

STATING MANAGEMENT'S AND THE AUDITOR'S RESPONSIBILITY

9. ED-ISA 700, paragraph 25, requires that the auditor's report state that management is responsible for the preparation and the fair presentation of the financial statements in accordance with the applicable financial reporting framework and that this responsibility includes: (a) maintaining internal control relevant to the preparation of financial statements that are free from material misstatement, whether due to fraud or error; (b) selecting and applying appropriate accounting policies that are consistent with the applicable financial reporting framework; and (c) making accounting estimates that are reasonable in the circumstances.
10. ED-ISA 700, paragraphs 28 and 30, requires that the auditor's report include a statement that the responsibility of the auditor is to express an opinion on the financial statements based on the audit. The auditor's report should describe the scope of the audit by stating that the audit was conducted in accordance with ISAs and explain that those standards require that the auditor plan and perform the audit to obtain reasonable, but not absolute, assurance whether the financial statements are free from material misstatement, whether due to fraud or error.
11. Extant ISA 800, paragraph 5, requires that the auditor's report include a statement of the responsibility of the entity's management and the responsibility of the auditor.

12. Consideration should be given as to whether the standards, guidance and examples in extant ISA 800 should be revised to be in line with the proposed standards, guidance and examples in ED-ISA 700.

Recommendation 1:

The task force recommends that the proposed revised ISA 800 should provide for the following to be included in the auditor's report on other historical financial information:

- (a) Identification of the responsible party and a description of the responsible party's responsibility for:
 - (i) In the case of other historical financial information prepared for a special purpose, determining that the applicable financial reporting framework is acceptable in the light of the other engagement circumstances, including the needs of the intended users;
 - (ii) Preparing and presenting the other historical financial information in accordance with the applicable financial reporting framework;
 - (iii) Designing, implementing and maintaining internal control relevant to the preparation and presentation of the other historical financial information that is free from material misstatement, whether due to fraud or error;
 - (iv) Selecting and applying accounting policies that are appropriate in the engagement circumstances; and
 - (v) Making accounting estimates, if any, that are reasonable in the engagement circumstances.
- (b) A statement that the responsibility of the auditor is to express an opinion on the other historical financial information based on the audit.
- (c) A description of the scope of the audit by stating that the audit was conducted in accordance with ISAs applicable in the engagement circumstances, and an explanation that those standards require that the auditor comply with the applicable ethical requirements and that the auditor plan and perform the audit to obtain reasonable assurance whether the other historical financial information is free from material misstatement.
- (d) A description of the audit, stating that:
 - (i) An audit conducted in accordance with ISAs involves performing procedures to obtain audit evidence about the amounts and disclosures in the other historical financial information;
 - (ii) The audit procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the other historical financial information. In making those risk assessments, the auditor considers internal control relevant to the responsible party's preparation and presentation of the other historical financial information as a basis for designing audit procedures that are appropriate in the engagement circumstances, but not for the purpose

of expressing an opinion on the effectiveness of the responsible party's internal control; and

- (iii) An audit also includes evaluating the appropriateness of the accounting policies used, the reasonableness of significant accounting estimates, if any, made by management, as well as the overall presentation in the other historical financial information.
- (e) A statement that the auditor believes that the audit evidence that the auditor has obtained is sufficient and appropriate to draw reasonable conclusions on which to base the auditor's opinion.

The above is based on the standards and guidance in ED-ISA 700. However, paragraph (a)(i) above does not appear in ED-ISA 700, but is considered important in the case of an auditor's report on other historical financial information prepared for a special purpose.

With regard to paragraph (a)(iii), the task force is of the opinion that the provision should also refer to internal controls over the information underlying the other historical financial information, i.e. the books and records. However, this reference does not appear in ED-ISA 700.

The illustrative auditor's reports in the appendices to extant ISA 800 will be revised accordingly.

CIRCUMSTANCES THAT REQUIRE ADDITIONAL EXPLANATORY LANGUAGE IN THE AUDITOR'S REPORT

13. AU Section 623 contains a section that deals with circumstances that, while not affecting the auditor's unqualified opinion, may require that the auditor include additional explanatory language in the auditor's report. These circumstances *inter alia* include:

- Lack of consistency in accounting principles. If there has been a change in accounting principles or in the method of their application, the auditor is required to add an explanatory paragraph to the report (following the opinion paragraph) that describes the change and refers to the note to the financial presentation (or specified elements, accounts, or items thereof) that discusses the change and its effect thereon if the accounting change is considered relevant to the presentation.
- Going concern uncertainties. If the auditor has substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time not to exceed one year beyond the date of the financial statement, the auditor is required to add an explanatory paragraph after the opinion paragraph of the report if the auditor's substantial doubt is relevant to the presentation.
- Comparative financial statements (or specified elements, accounts, or items thereof). If the auditor expresses an opinion on prior-period financial statements (or specified elements, accounts, or items thereof) that is different from the opinion he previously expressed on that same information, the auditor is required to disclose all of the substantive reasons for the different opinion in a separate explanatory paragraph preceding the opinion paragraph of the report.

14. Consideration should be given as to whether standards and guidance on circumstances that require additional explanatory language in the auditor's report on other historical financial information should be included in the proposed revised ISA 800.

Recommendation 2:

The task force debated the standards and guidance in AU Section 623 and recommends that similar standards and guidance should not be included in the proposed revised ISA 800. The task force's reasons are as follows:

- The IAASB has advised the Modified Auditor's Report Task Force not to include additional requirements for emphasis of matter paragraphs in the proposed revised ISA 701, "Modifications to the Independent Auditor's Report."
- Lack of consistency in accounting principles – there is no equivalent requirement for auditor's reports on a complete set of general purpose financial statements.
- Going concern uncertainties – Standards and guidance are provided in ISA 570, "Going Concern," which applies to the audit of other historical financial information.
- Comparative financial statements (or specified elements, accounts or items thereof) – Standards and guidance are provided in ISA 710, "Comparatives," which applies to the audit of other historical financial information.

The task force recommends that the proposed revised ISA 800 should contain a paragraph that clarifies the fact that other ISAs, with the exception of ISA 700, apply to the audit of other historical financial information. The proposed revised ISA 800 should also note that, although ISA 700 (Revised) does not apply to an audit of other historical financial information, ISA 700 (Revised) contains guidance on the elements of the auditor's report that may be useful in the context of an audit of other historical financial information.

**LIMITATION OF USE AND DISTRIBUTION OF THE AUDITOR'S REPORT AND STANDARD
DISCLAIMERS**

15. Extant ISA 800, paragraph 4, states that, to avoid the possibility of the auditor's report being used for purposes for which it was not intended, the auditor may wish to indicate in the report the purpose for which the report is prepared and any restrictions on its distribution and use.
16. It is necessary to strengthen this guidance because without identification of the objective and users of other historical financial information prepared for a special purpose, the auditor's report could be misleading to other users or used for an unintended purpose.
17. Accordingly, consideration should be given as to whether to include/expand the standards and guidance on the following in the proposed revised ISA 800:
- (a) Limitation of use and distribution of the auditor's report.
 - (b) A disclaimer concerning use of the other historical financial information prepared for a special purpose and the auditor's report for any unintended purpose.

- (c) Circumstances (if any) in which the auditor's opinion should include a disclaimer regarding the suitability of the basis of accounting (financial reporting framework) in satisfying the users' needs.

Recommendation 3:

The task force recommends that the proposed revised ISA 800 should provide for the following to be included in the auditor's report on other historical financial information:

An introductory paragraph that identifies the other historical financial information and, in the case of other historical financial information prepared for a special purpose, the purpose for which the financial information has been prepared and the intended users; or that refers to a note in the financial information containing this information. The introductory paragraph should state that the other historical financial information has been audited.

In addition, the proposed revised ISA 800 should contain the following guidance on restriction of distribution and use of the auditor's report on other historical financial information prepared for a special purpose:

The auditor considers including the following statements in an auditor's report on other historical financial information prepared for a special purpose:

- (a) The other historical financial information may not be suitable for a purpose other than the stated purpose and should only be used by the intended users.
- (b) The other historical financial information should not be distributed to parties other than the intended users, unless the auditor's prior written consent has been obtained.

The auditor cannot control the distribution and use of the other historical financial information on which the auditor reports. Although certain entities may be required by a regulator to place the other historical financial information on public record, other entities may inappropriately provide other historical financial information prepared for a special purpose to a broader user group, such as its shareholders, who may use the financial information for a variety of purposes. Broader distribution of other historical financial information prepared for a special purpose does not render it general purpose financial information. However, because of the possible wide distribution and use of such financial information, it is important that the auditor's report clearly communicates to readers the purpose for which it has been prepared and the intended users.

The auditor may also wish to include commentary in the engagement letter indicating that, should the responsible party distribute the other historical financial information to anyone other than the intended users, the auditor accepts no responsibility for any loss or damage suffered by the addressee or any other reader as a result of using the other historical financial information for any other purpose.

As the auditor is required to consider the acceptability of the applicable financial reporting framework, the task force is of the view that it would not be appropriate to provide guidance on circumstances in which the auditor's opinion should include a disclaimer regarding the suitability

of the basis of accounting (financial reporting framework) in satisfying the users' needs (i.e. paragraph 17(c)).

STANDARDS AND GUIDANCE IN EXTANT ISA 800

18. In revising the standards and guidance on other historical financial information other than summarized financial information in extant ISA 800, the task force considered it necessary to process changes in addition to those highlighted in the first and second issues papers. Deleted text in Agenda Item 10-C is followed by an indication of where the text is covered in the proposed revised ISA 800 and whether the concept was changed or whether bold text was changed to explanatory text.

Appendix

Issues to be Addressed in the Third Issues Paper

THE AUDITOR'S REPORT ON SUMMARIZED FINANCIAL STATEMENTS

Nature of the Engagement and Use of the Term "Consistent"

1. The project proposal inter alia recommends that consideration be given to the nature of an engagement to report on summarized financial statements, i.e. whether it is an audit, a related services engagement, or an other assurance engagement, and consequently whether this type of engagement should be included within the scope of the proposed revised ISA 800.
2. According to ED-ISA 200, paragraph 2, the objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. Paragraph 3 states that an audit of financial statements is an assurance engagement, as defined in the International Framework for Assurance Engagements. An "assurance engagement" means an engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the evaluation or measurement of a subject matter against criteria. As discussed in the Framework, a condition for acceptance of an assurance engagement is that the criteria referred to in the definition be "suitable criteria."
3. According to the Glossary of Terms (which may need to be revised once the ISA 700 project is completed), "The *objective* of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an identified financial reporting framework. The phrases used to express the auditor's opinion are 'give a true and fair view' or 'present fairly, in all material respects,' which are equivalent terms. A similar objective applies to the audit of financial or other information prepared in accordance with appropriate criteria." It is not clear whether the reference to "other information" is intended to include summarized financial statements, since there is no applicable financial reporting or suitable (appropriate) criteria, and extant ISA 800 prohibits the expression of a "true and fair view" or "present fairly" opinion on the summarized financial statements – it merely provides for a "consistency report."
4. The project proposal also highlighted the need to clarify what is meant when the auditor states that the summarized financial statements are "consistent" with the audited financial statements from which they are derived. Guidance on consistency that is provided by ISA 720, "Other Information in Documents Containing Audited Financial Statements," paragraph 3, could be considered for this purpose. Such guidance is framed in terms of exception: "A '*material inconsistency*' exists when other information contradicts information contained in the audited financial statements ...". Thus, guidance on consistency could be provided in terms of matters that might give rise to inconsistency, for example, the use of account descriptions in the summarized financial statements that are incompatible with those in the complete set of financial statements.

It should be noted, however, that the Materiality Task Force requested the IAASB to reconsider the ISA 720 guidance because not all inconsistencies are material.

5. Guidance on consistency could alternatively be provided in terms of criteria such as:

- Whether the summarized information is in agreement with, or has been accurately extracted from, the complete set of audited financial statements; or
- Whether, in all material respects, the summarized financial statements contain the information necessary to avoid distorting or omitting significant matters disclosed in the complete set of financial statements, notwithstanding the fact that guidance should still draw readers' attention to the complete set of financial statements for a full and proper understanding of the entity's financial position, financial results and cash flows.
- Determining whether recognition should be given to the fact that there is no codified financial reporting framework for the preparation of summarized financial statements and that the form, content and presentation of such statements are a matter of national law, regulation or practice.

Equivalency of Different Wordings of the Opinion on Summarized Financial Statements

6. Extant ISA 800 requires the auditor to report whether the summarized financial statements are "consistent, in all material respects" with the complete set of financial statements from which they are derived. Other standard setters have chosen different wording for the auditor's report, specifically:

- "fairly stated, in all material respects, in relation to ..." (U.S. Section AU 552, "Reporting on Condensed Financial Statements and Selected Data"); and
- "fairly summarized, in all material respects, ..." (Canadian guideline AuG 25, "Auditor's Report on Summarized Financial Statements").

7. The scope of the auditor's work and the auditor's responsibility may appear to be greater in the cases referred to above than in the case of extant ISA 800 because the term "fairly" implies a certain degree of completeness and representational faithfulness, notwithstanding the fact that the summarized financial statements do not contain all the disclosures required by the applicable financial reporting framework. Thus, consideration needs to be given to whether there is equivalency among the three different wordings, just as there is deemed equivalency between the terms "give a true and fair view" and "present fairly" used to express the auditor's opinion on general purpose financial statements.

Nature, Timing and Extent of Procedures

8. The project proposal recommends that consideration is given to the following issues relating to the nature, timing and extent of procedures to be performed in relation to summarized financial:

Nature of Procedures

- Whether guidance should be provided regarding the nature of the procedures the auditor should undertake in reporting on summarized financial statements. Such procedures might include agreeing summarized financial statements to the complete set of audited financial

statements and evaluating whether, in all material respects, the summarized financial statements contain the information necessary to avoid distorting or omitting significant matters disclosed in the complete set of financial statements.

Extent of Procedures

- Whether to provide guidance to the auditor regarding agreeing the terms of the engagement with management.
- Whether guidance should be provided regarding the extent of the auditor's examination of the financial information included in the summarized financial statements, for example, whether to examine 100% of the summarized financial statements or selected information only.
- Whether the auditor's procedures should include ensuring that all information required to be disclosed in the summarized financial statements by law or regulation is in fact disclosed.

Timing of Procedures

- Whether to provide guidance regarding the timing of the auditor's work, for example, whether the auditor ordinarily undertakes the work on the summarized financial statements at the same time as the audit of the complete set of financial statements so that the auditor's report on the former can be issued at the same time as that on the latter.

Dating of the Auditor's Report

9. The proposed revised ISA 700 and conforming amendments to ISA 560 clarify the date of the auditor's report. It is proposed that this date be based on the date when the auditor has sufficient appropriate audit evidence to draw reasonable conclusions on which to base the auditor's opinion. Frequently, this is the same date as the date of approval of the financial statements, but it could be later. The exposure draft also proposes the following definitions of the date of the financial statements and the dates when the financial statements are considered to be approved and issued:

“Date of the financial statements” is the date of the end of the latest period covered by the financial statements, which is normally the date of the most recent balance sheet in the financial statements subject to audit.

“Date of approval of the financial statements” is the date that the entity's management or those charged with governance determines that a complete set of financial statements, including the related notes, has been prepared and approves such statements. The specific approval process followed by the entity depends on legal or regulatory requirements in the jurisdiction, or would be determined by the entity in the absence of such requirements. In some circumstances, the entity may be required to observe additional governance processes required by custom or regulation after the financial statements have been approved by management that may need to occur before the financial statements are considered “final.” For example, in some jurisdictions, the entity may be required to submit its financial statements to its shareholders for approval. However, this will usually occur at a date substantially later than the date management or those charged with governance approve the financial statements and does not affect the date which is considered to be the date of approval of the financial statements.

“Date the financial statements are issued” is the date that the auditor’s report and financial statements are made available to third parties, which may be, in many circumstances, the date that they are filed with a regulatory authority.

10. With regard to the auditor’s report on summarized financial statements, consideration should be given as to whether the date of the auditor’s report should be the same as that of the auditor’s report on the complete set of financial statements or whether it could be later. If both dates were to be the same, this might avoid giving the impression that the auditor’s report on the summarized financial statements in any way updates the auditor’s report on the complete set of financial statements. However, in practice, there may be circumstances in which the auditor is requested to report on summarized financial statements prepared well after the completion of the audit of, and the issue of the auditor’s report on, the complete set of financial statements. Consequently, it may be preferable for guidance to allow dating of the auditor’s report on the summarized financial statements at a later date.
11. Allowing dating of the auditor’s report on summarized financial statements at a later date; however, may lead to the auditor having a responsibility to consider subsequent events. There are a number of arguments that would indicate that the auditor does not have such a responsibility. One is that since reporting on summarized financial statements is not actually an audit as defined in the Glossary of Terms, the auditor should have no responsibility for subsequent events. Another is the fact that the preparation of summarized financial statements simply involves the extraction of financial information that has already been audited, and the procedures performed by the auditor to provide a basis for the auditor’s report on the summarized financial statements do not involve obtaining any additional evidence regarding the complete set of financial statements. Therefore, it may be necessary to highlight that the auditor has no responsibility to consider subsequent events. Consideration should also be given to whether the auditor’s report on the summarized financial statements should include a statement that the auditor has not considered the effects of any events between the two dates.