GAAS UPDATE SERVICE

CCH a Wolters Kluwer business

Volume 10, Issue 4 **February 28, 2010**

EXPOSURE DRAFT: AICPA Proposed Statement on Auditing Standards, *Engagements to Report on Summary Financial Statements*

PROPOSED EFFECTIVE DATE: Audits of financial statements for periods beginning on or after December 15, 2010

Summary & Highlights

The American Institute of Certified Public Accountants' (AICPA's) Auditing Standards Board (ASB) has issued an exposure draft (ED) of a proposed Statement on Auditing Standards (SAS) titled, *Engagements to Report on Summary Financial Statements*, which would supersede SAS-42 (AU Section 552), *Reporting on Condensed Financial Statements and Selected Financial Data*. To facilitate convergence with the international standards, the proposed standard has been drafted using International Standard on Auditing No. 810, *Engagements to Report on Summary Financial Statements* (ISA-810), as a base. The differences between the ASB's proposed SAS and ISA-810 that have no compelling reason have been eliminated.

The proposed SAS addresses the auditor's responsibilities when reporting on summary financial statements derived from financial statements audited by that same auditor and eliminates reporting on selected financial data. The proposed SAS defines "summary financial statements" as:

> Historical financial information that is derived from financial statements but that contains less detail than the financial statements, while still providing a structured representation consistent with that provided by the financial statements of the entity's economic resources or obligations at a point in time or the changes therein for a period of time.

The proposed SAS makes several changes to existing standards, primarily to converge with ISA 810. Specifically, the proposed SAS:

- Requires the auditor to:
  - Determine the acceptability of the criteria used by management in the preparation of the summary financial statements;
  - Obtain management's acknowledgement and understanding of its responsibilities for the summary financial statements;
  - Request management to provide written representations to the auditor relating to the summary financial statements; and
  - Deny an opinion on the summary financial statements when the auditor's report on the audited financial statements contains an adverse opinion or a disclaimer of opinion.
- Prescribes specific procedures to be performed as the basis for the auditor's opinion on the summary financial statements.
- Prescribes specific elements of the auditor's report, including management's responsibility and a description of the auditor's procedures.
- Clarifies the auditor's responsibilities related to subsequent events and subsequently discovered facts when the date of the auditor's report on the summary financial statements is later than the date of the auditor's report on the audited financial statements.
- Includes requirements relating to comparative, unaudited information presented with summary financial statements, and other information included in a document containing the summary financial statements and related auditor's report.

The proposed SAS would be effective for audits of financial statements for periods beginning on or after December 15, 2010.

Analysis & Explanation

Accepting the Engagement

The proposed SAS prohibits an auditor from accepting an engagement to report on summary financial statements unless the auditor has been engaged to audit the financial statements from which the summary financial statements are derived. Also, before accepting an engagement to report on summary financial statements, the proposed SAS requires the auditor to:

- Determine whether the criteria applied by management in the preparation of the summary financial statements (applied criteria) are acceptable.
- Obtain management's acknowledgement and understanding of its responsibility to:
  - Prepare the summary financial statements in accordance with the applied criteria;
  - Provide the auditor with certain specified written representations;
  - Make the audited financial statements readily available to the intended users of the summary financial statements; and
  - Include the auditor's report on the summary financial statements in any document that contains the summary financial statements and that indicates that the auditor has reported on them.

If the preceding conditions are not met, the auditor is precluded from accepting the engagement to report on the summary financial statements.

Performing Procedures as the Basis for the Auditor's Opinion

The proposed SAS requires the auditor to perform the following procedures, at a minimum, as the basis for the auditor's opinion on the summary financial statements:

- Evaluate whether the summary financial statements:
  - Adequately disclose their summarized nature and identify the audited financial statements;
  - Adequately disclose the applied criteria;
  - Are prepared in accordance with the applied criteria; and
  - Contain the information necessary, and are at an appropriate level of aggregation, so as not to be misleading in the circumstances.
- When the summary financial statements are not accompanied by the audited financial statements, evaluate:
  - Whether the summary financial statements clearly describe where the audited financial statements are available; and
  - Whether the audited financial statements are readily available to the intended users of the summary financial statements.
- Compare the summary financial statements with the related information in the audited financial statements to determine whether the summary financial statements agree with, or can be recalculated from, the related information in the audited financial statements.

Obtaining Written Representations from Management

The proposed SAS requires the auditor to obtain a representation letter from management in which management indicates that:

- It has fulfilled its responsibility for the preparation of the summary financial statements in accordance with the applied criteria and believes the applied criteria are acceptable.
- It will make the audited financial statements readily available to the intended users of the summary financial statements upon issuance of the summary financial statements.

In addition, if the date of the auditor's report on the summary financial statements is later than the date of the auditor's report on the audited financial statements, the representation letter from management should indicate whether:

- Any information has come to management's attention that would cause it to believe that any of the previous representations on the audited financial statements need to be modified; and
- Any events have occurred subsequent to the date of the audited financial statements that may require adjustment of, or disclosure in, the audited financial statements.

The representation letter should be dated as of the date of the auditor's report on the summary financial statements and should cover all summary financial statements and periods referred to in the auditor's report on the summary financial statements.

Forming an Opinion and Reporting on Summary Financial Statements

An auditor's unmodified opinion on the summary financial statements should state that the summary financial statements are consistent, in all material respects, with the audited financial statements from which they have been derived, in accordance with the applied criteria. The proposed SAS stipulates specific elements of the auditor's report and indicates that the auditor's report on the summary financial statements should not be earlier than: (1) the date on which the auditor has obtained sufficient appropriate evidence on which to base his or her opinion; and (2) the date of the auditor's report on the audited financial statements.

If the auditor's report on the audited financial statements contains a qualified opinion, an "emphasis of matter" paragraph, or an "other matter" paragraph, and the auditor expresses an unmodified opinion or an adverse opinion on the summary financial statements, the auditor's report on the summary financial statements should:

- State that the auditor's report on the audited financial statements contains a qualified opinion, an "emphasis of matter" paragraph, or an "other matter" paragraph;
- Describe the basis for the qualified opinion on the audited financial statements, and that qualified opinion, or the "emphasis of matter" paragraph, or "other matter" paragraph in the auditor's report on the audited financial statements; and
- Describe the effect on the summary financial statements, if any.

If the auditor determines that the summary financial statements are not consistent in all material respects with the audited financial statements, and management does not agree to make the necessary changes, the auditor should express an adverse opinion on the summary financial statements.

When the auditor's report on the audited financial statements contains an adverse opinion or a disclaimer of opinion, the proposed SAS indicates that the auditor may choose to withdraw from the engagement to report on summary financial statements (where withdrawal is possible under applicable law or regulation). If the auditor decides not to withdraw, but instead issues a report on the summary financial statements, the proposed SAS requires the auditor to modify the report on the summary financial statements mainly to:

- State that the auditor's report on the audited financial statements contains an adverse opinion or disclaimer of opinion and, as a result, it is inappropriate to express, and the auditor does not express, an opinion on the summary financial statements; and
- Describe the basis for that adverse opinion or disclaimer of opinion.

Restriction or alert included in the report on the summary financial statements. The auditor's report on the audited financial statements may be restricted as to use or may alert readers that the audited financial statements are prepared in accordance with a special purpose framework. In such circumstances, the auditor's report on the summary financial statements should include a similar restriction or alert.

Comparative financial statements. There may be situations when the audited financial statements contain comparative financial statements whereas the summary financial statements do not. In such circumstances, the proposed SAS indicates that the auditor should determine: (1) whether such omission is reasonable; and (2) the effect of an unreasonable omission on the auditor's report on the summary financial statements.

When summary financial statements contain comparatives that were reported on by a predecessor auditor, the predecessor may reissue his or her report on the summary financial statements. However, if the predecessor auditor's report on the prior period's summary financial statements is not reissued with the summary financial statements, the proposed SAS indicates that the successor auditor's report on the summary financial statements should:

- State that the prior period's summary financial statements were audited by a predecessor auditor and the type of opinion expressed (or the reasons for a modified opinion); and
- Indicate the date of that report.

If the summary financial statements contain comparatives that were not reported on (by either the auditor or another auditor), the auditor's report on such statements should state that those statements were not reported on by the auditor and, accordingly, no opinion is expressed on them.

Unaudited information presented with summary financial statements. Unaudited information that is presented with the summary financial statements should be clearly differentiated from the summary financial statements. If the differentiation is not clear, the proposed SAS requires the auditor to request management to change the presentation of the unaudited information. If management refuses to do so, the proposed SAS indicates that the auditor should state in his or her report on the summary financial statements that the unaudited information is not covered by that report and, accordingly, no opinion is expressed on the unaudited information.

Other information in documents containing summary financial statements. There may be situations when other information may be included in a document containing the summary financial statements and related auditor's report. The proposed SAS indicates that the auditor should read such other information to identify material inconsistencies, if any, with the summary financial statements. If the auditor discovers a material inconsistency, the auditor should determine whether the summary financial statements or the other information needs to be revised. If the auditor discovers a material misstatement of fact, the auditor should: (1) discuss the matter with management; and (2) consider appropriate further action, as deemed necessary.

About the Author

George Georgiades, CPA, has more than 29 years of experience in public accounting, including seven years with an international public accounting firm. He currently has his own firm and consults exclusively with CPA firms on technical accounting and auditing issues. He is a member of the American Institute of Certified Public Accountants and the California Society of Certified Public Accountants and is the author of GAAS *Practice Manual* and GAAP *Financial Statement Disclosures Manual*.

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