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Accountability \* Integrity \* Reliability

Comptroller General  
of the United States

United States Government Accountability Office  
Washington, DC 20548

October 31, 2005

Mr. James M. Sylph  
Technical Director  
International Auditing and Assurance Standards Board  
545 Fifth Avenue, 14<sup>th</sup> Floor  
New York, NY 10017

Subject: Proposed International Standards on Auditing (ISA) 701, *The Independent Auditor's Report on Other Historical Financial Information* and proposed ISA 800, *The Independent Auditor's Report on Summary Audited Financial Statements*

Dear Mr. Sylph:

This letter provides the U.S. Government Accountability Office's (GAO) comments on the International Auditing and Assurance Standards Board's (IAASB) proposed ISAs 701 and 800 and on the proposed Conforming Amendments to ISA 200, *Objectives and General Principles Governing an Audit of Financial Statements*, which were issued in June 2005.

GAO strongly supports the consistency between these proposed standards and ISA 700, *The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements* (revised) on issues such as (1) the need for auditors to consider whether financial information may be misleading, and (2) guidance for auditors to follow in situations when they conclude that such information is misleading. We also support the proposed conforming amendment to ISA 200, paragraph 1(d), which states that the term "financial reporting framework designed to achieve fair presentation" acknowledges that (1) it may be necessary for management to provide disclosures beyond those required by the framework, and (2) in extremely rare circumstances, it may be necessary for management to depart from the requirements. These provisions will improve the quality of financial auditing standards by emphasizing that judgments about fair presentation include considerations beyond literal compliance with professional standards.

The enclosure to this letter details GAO's comments on specific provisions of the proposed standards and our responses to the questions set forth in the Explanatory Memorandum that accompanies the proposed standards.

We thank you for considering our comments on these important proposed standards as we work together on issues of mutual interest to the accountability profession.

Sincerely yours,

A handwritten signature in black ink, appearing to read "D. M. Walker", with a long horizontal line extending to the right.

David M. Walker  
Comptroller General  
of the United States

Enclosure

cc:

Mr. Kjell Larsson  
Auditor General of Sweden and  
Chair of the INTOSAI Financial Audit Working Group

The Honorable Christopher Cox, Chairman  
U.S. Securities and Exchange Commission

The Honorable William J. McDonough, Chairman  
U.S. Public Company Accounting Oversight Board

Mr. John Fogarty, Chair  
U.S. Auditing Standards Board

**IAASB Questions set forth in Explanatory Memorandum, pgs 4 – 8:**

**Question 1: Do you agree with the IAASB’s conclusion that the standards and guidance for auditors’ reports on summary audited financial statements should be retained within ISAs? If yes, do you agree that the standards and guidance should be placed in a separate ISA?**

Yes, we agree with the IAASB’s decision to retain the standards and guidance for auditors’ reports on summary audited financial statements within the ISAs. We have no strong preference regarding the placement of the standards and guidance within the ISAs.

**Question 2: Do you agree with the description in paragraph 10, acknowledging that, depending on the circumstances of the engagement, the applicable financial reporting framework may encompass more than just accounting standards and legal requirements?**

Yes, we agree with this statement in paragraph 10. We believe, however, that in order to provide consistency with paragraph 5 of ISA 200, the first bullet in paragraph 10 of the proposed standard should be changed as follows:

10. [last sentence] For purposes of this ISA, the financial reporting framework may also encompass:

- The effect of ~~the~~ legal and ethical requirements environment, including statutes, regulations, court decisions, and professional ethical obligations in relation to accounting matters;

**Question 3: Do you agree with the proposed distinction in paragraphs 15 and 16, and the effect that it has on the form of opinion? If not, clearly explain your preferred distinction and the effect that it has on the form of opinion?**

The proposed distinction in paragraphs 15 and 16 would be consistent with ISA 700 and would provide options for reporting on financial statements prepared in accordance with “other” financial reporting frameworks. An alternative to this approach is currently used in US *Government Auditing Standards*, issued by GAO, which uses the phrase “present fairly” for reporting on both GAAP-basis financial statements as well as other types of financial information but which addresses the difference between GAAP-basis financial statements and other types of financial information with other reporting considerations that are discussed in our response to question 4 below.

**Question 4: Do you agree with the proposals for forming an opinion in paragraphs 23 and 24? If not, clearly explain the reasons for the disagreement?**

Yes, we strongly support the need for auditors to consider whether financial information is misleading in the circumstances, whether or not the reporting framework is designed to give a fair presentation. We also believe that the following elements, from paragraph 24 of the proposed standard, are appropriate for the auditors' consideration of whether the specific information is fairly presented: (1) the nature of the entity and its environment, (2) the nature and objective of the financial information, (3) the applicable financial reporting framework and legal or regulatory requirements, (4) the information needs of the intended users, and (5) other matters, for example, events, transactions, conditions, and practices that may have a significant effect on the engagement.

We also believe it is important for the proposed standard to provide guidance for auditors to follow in evaluating whether financial information prepared in accordance with a framework not designed to achieve a fair presentation is “informative of matters that may affect its use, understanding, and interpretation” as discussed in Section AU 623.09 of auditing standards issued by the Auditing Standards Board of the AICPA and incorporated into US *Government Auditing Standards*. Accordingly, we recommend adding guidance to the proposed standard for auditors to consider matters such as:

- if the information adequately discloses the reporting framework used and how that framework differs from a framework designed to achieve fair presentation,
- if the information includes all other disclosures that are required or are necessary for users to understand and interpret the information, and
- if the financial information is suitably titled and does not use titles that are commonly reserved for information prepared in accordance with a framework designed to achieve a fair presentation.

Additionally, if the IAASB concludes that use of the term “presents fairly” is inappropriate for certain types of financial information presentations, we suggest that the Board consider use of wording other than “properly prepared.” For instance, we recommend using “appropriately” in place of “properly,” which may not adequately convey the auditor’s considerations of whether the information and its presentation are misleading. We also recommend using “represents” or “reflects” in place of “prepared” in order to refer to the underlying matters being communicated rather than the process of assembling the information.

**Question 5: Do you agree that the ISAs should contain standards and guidance for an auditor's report issued as a result of an audit of one or more specific elements, accounts or items of a financial statement?**

Yes, including standards and guidance for an auditor's report on specific elements, accounts or items of financial statements will improve clarity and consistency of application. We believe the guidance also should discuss situations when such a report should not be issued. For instance, if such a report would contradict or overshadow the opinion on the financial statements, it would be a piecemeal opinion and, therefore, should not be issued.

**Question 6: If your response to question 5 is yes, do you agree with the proposed standards and guidance for these types of auditor's report? If not, how should they be amended?**

See our response to question 3 above.

**Question 7: Do you agree with the proposed form of opinion on summary financial statements? If not, provide your preferred form of opinion and reasons for such preference.**

See our response to question 3 above.

Also, we would expand the list of minimum requirements in paragraph 19 of ISA 800 to include disclosure of (1) the type of opinion rendered on the financial statements from which they were derived, regardless of type, and (2) the reasons an opinion other than an unmodified opinion was issued, if applicable. This expansion also will achieve consistency with the requirements of paragraphs 22 and 23 and example reports 3 and 4 of the proposed standard. Therefore, we suggest inserting the following between paragraphs 19(f) and 19(g):

- When the original auditor's report is other than unmodified, include (1) a separate opinion (or disclaimer of opinion) paragraph stating the type of (or disclaimer of) opinion rendered, (2) a description of the basis for the opinion (or disclaimer), and (3) a description of any emphasis of matter paragraphs and/or other matter paragraphs and their effects on the summary financial statements.

The standard also should indicate that auditors need to consider if modifications made in preparing condensed financial statements are so significant that they result in condensed financial statements that are misleading

**Comments on Proposed ISA 701, *The Independent Auditor's Report on Other Historical Financial Statements***

We suggest changing the heading that precedes paragraph 30 from “Restriction on Distribution or Use” to “Intended Purpose and Distribution” to better reflect the subject matter of paragraphs 30-31, and because, as noted in paragraph 30 of the proposed standard, the auditor may not be in the position to control the distribution or use of the other historical financial information. Similarly, the related subheading in the auditor’s report should be changed.

**Comments on Proposed ISA 800, *The Independent Auditor's Report on Summary Audited Financial Statements***

The discussion of criteria in paragraphs 8–12 of the proposed standard (pgs. 38–39 of the Exposure Draft) needs further development. For instance, the proposed standard should state that management is responsible for identifying established criteria and that the auditor is responsible for evaluating the suitability of the criteria identified by management in accordance with guidance in the *International Framework for Assurance Engagements*, which is included in the *Handbook of International Auditing, Assurance, and Ethics Pronouncements, 2005 Edition*, issued by the IAASB. These changes could be included in paragraph 8 of the proposed standard, as follows:

8. The responsible party is responsible for determining the information that needs to be reflected in the summary financial statements, so that they are an appropriate summary of the financial statements from which they have been derived. The responsible party also is responsible for identifying established criteria that can be used to evaluate or measure the information reflected in the summary financial statements. The auditor is responsible for (1) evaluating whether the summary financial statements are an appropriate summary of the financial statements, and (2) assessing the suitability of the criteria, in accordance with the guidance in paragraphs 34 – 38 of the *International Framework for Assurance Engagements*. ~~The auditor needs criteria suitable for such evaluation.~~

Paragraph 12 of the proposed standard should provide better guidance on making criteria available to intended users. This can be done by referring users to the appropriate paragraph of the *Framework*, as follows:

12. Criteria need to be available to the intended users to allow them to understand how the summary financial statements have been prepared. Auditors should refer to the guidance on making criteria available to intended users in paragraph 38 of the *International Framework for Assurance Engagements*.

**Comments on Proposed Conforming Amendments to ISA 200, Objectives and General Principles Governing an Audit of Financial Statements**

The proposed conforming amendments to ISA 200, paragraph 1(d) (page 56 of the Exposure Draft) need a more robust definition of “framework designed to achieve a fair presentation.” We recommend revising paragraph 1(d) of the proposed standard, as follows:

1(d) “Financial reporting framework designed to achieve fair presentation” means a financial reporting framework that (a) is established by an authorized or recognized organization as representing a “fair presentation,” and (b) provides criteria ~~provides a context~~ for the auditor’s evaluation of the fair presentation of the financial statements. Such a framework also and (b) acknowledges, implicitly or explicitly, that to achieve the objective of fair presentation of the financial statements (i) it may be necessary for management to provide disclosures beyond the specific requirements of the framework, or (ii) in extremely rare circumstances, it may be necessary for management to depart from the specific requirements of the framework.