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EXPOSURE DRAFT

PROPOSED STATEMENT ON
AUDITING STANDARDS

REPORTING ON CONDENSED FINANCIAL STATEMENTS
AND SELECTED FINANCIAL DATA

SEPTEMBER 1, 1981

**Prepared by the AICPA Auditing Standards Board
For comment from persons interested in auditing and reporting**

**Comments should be received by December 1, 1981, and addressed to
AICPA Auditing Standards Division, File 2311
AICPA, 1211 Avenue of the Americas, New York, N.Y. 10036**

SUMMARY

This proposed Statement on Auditing Standards provides reporting guidance on

- Condensed financial statements derived from audited financial statements (such as the condensed year-end balance sheet that must be included in the quarterly report filed on SEC Form 10-Q).
- Selected financial data derived from audited financial statements that are required in certain SEC filings according to regulation S-K.

Generally, there is no requirement for the auditor to report on such information. When the auditor does report on this information, however, his report should indicate (a) that the complete financial statements have been examined, (b) the date of the auditor's report on the complete financial statements, (c) the type of opinion expressed, and (d) whether the condensed financial statements or selected financial data have been derived from the audited financial statements.

The proposed SAS applies only to reports on financial information of public entities.

This exposure draft has been sent to

- *practice offices of CPA firms*
 - *members of AICPA Council and technical committee chairmen*
 - *state society and chapter presidents, directors, and committee chairmen*
 - *organizations concerned with regulatory, supervisory, or other public disclosure of financial activities*
 - *persons who have requested copies*
-



American Institute of Certified Public Accountants

1211 Avenue of the Americas, New York, New York 10036 (212) 575-6200

September 1, 1981

Accompanying this letter is an exposure draft of a proposed Statement on Auditing Standards, Reporting on Condensed Financial Statements and Selected Financial Data. A summary of the proposed SAS accompanies this letter.

Comments or suggestions on any aspect of this exposure draft will be appreciated. The AICPA Auditing Standards Board's consideration of responses will be helped if the comments refer to the specific paragraph numbers and include reasons for any suggestions or comments.

In developing guidance, the AICPA Auditing Standards Board considers the relationship between the cost imposed and the benefits reasonably expected to be derived from audits. It also considers differences that the auditor may encounter in the audit of the financial statements of small businesses and, when appropriate, makes special provisions to meet those needs. Thus, the board would particularly appreciate comments on those matters.

Responses should be sent to the AICPA Auditing Standards Division, File 2311, in time to be received by December 1, 1981. For convenience in responding, a postpaid mailer is attached to this exposure draft.

Written comments on the exposure draft will become part of the public record of the AICPA Auditing Standards Division and will be available for public inspection at the offices of the American Institute of Certified Public Accountants after December 15, 1981, for one year.

Sincerely,

James J. Leisenring, Chairman
Auditing Standards Board

D.R. Carmichael, Vice President
Auditing

PROPOSED STATEMENT ON AUDITING STANDARDS
REPORTING ON CONDENSED FINANCIAL STATEMENTS AND
SELECTED FINANCIAL DATA

1. This Statement provides guidance on reporting on

- a. Condensed financial statements that are derived from audited financial statements of a public entity that is required to file, at least annually, complete financial statements with a regulatory agency.¹
- b. Selected financial data that are derived from audited financial statements and included in a document containing (or incorporating by reference) audited financial statements of a public entity.

CONDENSED FINANCIAL STATEMENTS

2. Condensed financial statements are presented in considerably less detail than complete financial statements prepared in accordance with generally accepted accounting principles. APB Opinion No. 28, *Interim Financial Reporting*, paragraph 32, states, "There is a presumption that users of summarized interim financial data will have read the latest published annual report, including the financial disclosures required by generally accepted accounting principles and management's commentary concerning the annual financial results, and that the summarized interim data will be viewed in that context." For this reason, this Statement's reporting guidance for condensed financial statements applies only to public entities that are required to file, at least annually, complete financial statements with a regulatory agency.

3. An auditor is not associated with condensed financial statements

¹ *Public entity* is defined in SAS No. 26, *Association With Financial Statements*, footnote 2.

because he has audited the financial statements from which they have been derived. An auditor is associated with condensed financial statements derived from statements he has audited only when he has consented to use of his name in a report, document, or written communication containing those condensed statements. For example, the auditor may agree to use of his name in Form 10-Q, which is filed with the Securities and Exchange Commission (SEC), or in a filing with the SEC under the Securities Act of 1933 that contains (or incorporates by reference) condensed financial statements derived from audited financial statements, as specified by regulation S-X.²

4. APB Opinion No. 28, footnote 7, states, "It should be recognized

² Regulation S-X governs the presentation of interim financial statements in those filings. Regulation S-X specifies that the following financial statements should be provided in filings on Form 10-Q:

- a. An interim balance sheet as of the end of the most recent fiscal quarter and a balance sheet (which may be condensed to the same extent as the interim balance sheet) as of the end of the preceding fiscal year.
- b. Interim condensed statements of income for the most recent fiscal quarter, for the period between the end of the preceding fiscal year and the end of the most recent fiscal quarter, and for the corresponding periods of the preceding fiscal year.
- c. Interim condensed statements of changes in financial position for the period between the end of the preceding fiscal year and the end of the most recent fiscal quarter and for the corresponding period of the preceding fiscal year.

This interim information need not be audited, and, accordingly, there is no requirement for auditor association with any of the financial statements contained in Form 10-Q. If the auditor has made a review of the interim financial statements, however, he may agree to the reference to his name and the inclusion of his review report in a Form 10-Q. (See SAS No. 36, *Review of Interim Financial Information*, paragraph 23.)

that the minimum disclosures of summarized interim financial data required of publicly traded companies by Part II of this Opinion do not constitute a fair presentation of financial position and results of operations in conformity with generally accepted accounting principles." Because condensed financial statements do not constitute a fair presentation of financial position and results of operations in conformity with generally accepted accounting principles, it is not appropriate for an auditor to report on condensed financial statements in the same manner as he reported on the complete, audited financial statements from which they are derived. To do so might lead users to assume, erroneously, that the condensed financial statements include all the disclosures necessary for complete financial statements. For the same reason, it is desirable that such information be marked as condensed or summarized financial information.

5. The auditor's report on condensed financial statements that are derived from the primary reporting entity's financial statements that he has audited should indicate (a) that the complete financial statements have been examined, (b) the date of the auditor's report on the complete financial statements, (c) the type of opinion expressed,³ and (d) whether the condensed financial statements have been derived from the audited financial statements. The auditor

³ If the auditor's opinion on those financial statements was other than unqualified, the report should describe the nature of, and the reasons for, the qualification, except that no description of a consistency reference is necessary if the change in accounting referred to in the auditor's report does not affect the comparability of the condensed financial statements or selected financial data being presented.

should not express an opinion on the fairness of presentation of the condensed financial statements in conformity with generally accepted accounting principles, nor should he express the opinion that the condensed financial statements are fairly summarized from the complete financial statements, because there are no generally accepted standards to form the basis for such an opinion.⁴

6. The following is an example of the wording that may be used when the auditor reports on condensed financial statements that are derived from financial statements of the primary reporting entity that he has audited and on which he has expressed an unqualified opinion:

We have examined, in accordance with generally accepted auditing standards, the consolidated financial statements of X Company and subsidiaries as of December 31, 19X0, and for the year then ended; and in our report dated February 15, 19X1, we expressed an unqualified opinion on those consolidated financial statements (not presented herein). The accompanying consolidated condensed financial statements have been derived from the financial statements that we examined.

7. Condensed financial statements derived from audited financial statements of the primary reporting entity may be presented on a comparative basis with interim financial information as of a subsequent date that is accompanied by the auditor's review report. In such cases, the auditor would be associated with the condensed financial statements and, accordingly, should report on the association. The following is an exam-

ple of a review report on a condensed balance sheet as of March 31, 19X1, together with the related condensed statements of income and changes in financial position for the three-month periods ended March 31, 19X1 and 19X0, included in Form 10-Q. In this example, the auditor is also associated with a condensed balance sheet derived from the audited financial statements as of December 31, 19X0:

We have reviewed the consolidated condensed balance sheet of ABC Company and subsidiaries as of March 31, 19X1, and the related consolidated condensed statements of income and changes in financial position for the three-month periods ended March 31, 19X1 and 19X0, in accordance with standards established by the American Institute of Certified Public Accountants.

A review of interim financial information in the form of condensed financial statements consists principally of obtaining an understanding of the system for the preparation of interim financial information, applying analytical review procedures to financial data, and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the consolidated condensed balance sheet as of March 31, 19X1, and the related consolidated condensed statements of income and changes in financial position for the three-month periods ended March 31, 19X1 and 19X0, for them to be in conformity with generally accepted accounting principles.

We previously examined and, in our report dated February 15, 19X1, expressed an unqualified opinion on, the consolidated financial statements as of December 31, 19X0, and for the year then ended. The accompanying consolidated condensed balance sheet as of that date has been derived from the financial statements that we examined.

8. Frequently, the auditor is not named or otherwise associated with

condensed financial statements derived from audited financial statements. For example, in a Form 10-Q filing, the auditor would not be associated with the condensed financial statements simply because the condensed balance sheet as of the preceding fiscal year-end is identified as having been summarized from the audited financial statements included in the latest published annual report. However, if the auditor has agreed to be named in such a document, he is associated with the condensed financial statements and should report in accordance with the provisions of paragraph 5.

SELECTED FINANCIAL DATA

9. Certain filings with the SEC must include, for each of the last five fiscal years, certain selected financial data in accordance with regulation S-K, including net sales or operating revenues, income or loss from continuing operations, income or loss from continuing operations per common share, total assets, long-term obligations and redeemable preferred stock, and cash dividends declared per common share. Registrants may include additional items that they believe may be useful.

10. According to Statement on Auditing Standards No. 8, *Other Information in Documents Containing Audited Financial Statements*, the auditor should read such selected financial data and consider whether the data or the manner of their presentation is materially inconsistent with information appearing in the financial statements or with the manner of its presentation.⁵ There is no requirement for the auditor to report on this selected financial data. If the auditor is engaged to report on selected financial data included in a document containing (or incorporating by reference) audited financial statements, however, his report

⁴ Under proposed SEC rules, certain registrants would be required to include in filings, as supplementary information to annual consolidated financial statements, condensed financial statements of the parent company and certain financial-type consolidated subsidiaries. Such condensed information is similar to consolidating information (see SAS No. 29, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents*, paragraphs 16-19), and the auditor may express an opinion on whether that information is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

⁵ SAS No. 8 does not apply to filings under the Securities Act of 1933. For guidance on the auditor's responsibilities for information appearing in such filings, see SAS No. 37, *Filings Under Federal Securities Statutes*.

should be limited to data that are extracted from financial statements that he has examined and on which he has expressed an opinion or data that are derived from amounts presented in such financial statements (for example, working capital). If the selected financial data include both data derived from the audited financial statements and other information (for example, number of employees or square footage of facilities), the auditor's report should specifically identify the data on which he is reporting. The auditor should not, however, express an opinion on the fairness of presentation of such data in conformity with generally accepted accounting principles.

11. The following is an example of an auditor's report that includes an additional paragraph because he is also engaged to report on selected financial data for a five-year period ended December 31, 19X5:

We have examined the balance sheets of ABC Company as of December 31, 19X5 and 19X4, and the related statements of income, retained earnings, and changes in financial position for each of the three years in the period ended December 31, 19X5. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of the ABC Company as of December 31, 19X5 and 19X4, and the results of its operations and the changes in its financial position for each of the three years in the period ended December 31, 19X5, in conformity with generally accepted accounting principles applied on a consistent basis.

We have also examined the balance sheets as of December 31, 19X3, 19X2, and 19X1, and the statements of income, retained earnings, and changes in financial position for the years ended

December 31, 19X2 and 19X1 (none of which are presented herein), and we expressed an unqualified opinion on those financial statements.⁶ The selected financial data for each of the five years in the period ended December 31, 19X5, appearing on page XX, have been derived from the financial statements that we have examined.

12. In introductory material regarding the selected financial data, the client may name the independent auditor or refer to the fact that the data are extracted or derived from financial statements that were examined by the independent auditor. Such a reference does not, in itself, require the auditor to report on the selected financial data. In filings under the Securities Act of 1933, however, the auditor would generally consent to that use of his name in the document and, accordingly, would report on the selected financial data.

⁶ See footnote 3.