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Proposed statement on auditing standards : restricting the use of an auditor's report : and amendments of SAS No. 60, communication of internal control related matters noted in an audit, and SAS No. 75, engagements to apply agreed-upon procedures to specified elements, accounts, or items of a financial statement ;Restricting the use of an auditor's report : and amendments of SAS No. 60, communication of internal control related matters noted in an audit, and SAS No. 75, engagements to apply agreed-upon procedures to specified elements, accounts, or items of a financial

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American Institute of Certified Public Accountants. Auditing Standards Board

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EXPOSURE DRAFT

PROPOSED STATEMENT ON AUDITING STANDARDS

RESTRICTING THE USE OF AN AUDITOR'S REPORT

**AND AMENDMENTS OF SAS NO. 60, *COMMUNICATION OF INTERNAL CONTROL RELATED MATTERS NOTED IN AN AUDIT*, AND
SAS NO. 75, *ENGAGEMENTS TO APPLY AGREED-UPON PROCEDURES TO SPECIFIED ELEMENTS, ACCOUNTS, OR ITEMS OF A FINANCIAL STATEMENT***

JANUARY 26, 1998

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

**Comments should be received by May 6, 1998, and addressed to
Judith M. Sherinsky, Technical Manager, Audit and Attest Standards, File 4275,
AICPA, 1211 Avenue of the Americas, New York, NY 10036-8775
or via the Internet to jsherinsky@aicpa.org**

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Any individual or organization may obtain one copy of this document without charge until the end of the comment period by writing to the AICPA Order Department, Harborside Financial Center, 201 Plaza Three, Jersey City, NJ 07311-3881.

January 26, 1998

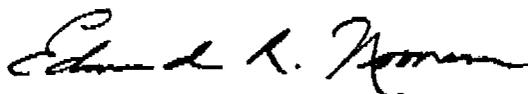
Accompanying this letter is an exposure draft, approved by the Auditing Standards Board (ASB), of a proposed Statement on Auditing Standards (SAS) titled *Restricting the Use of an Auditor's Report*. This proposed Statement provides auditors with guidance that will enable them to determine whether an engagement requires a restricted-use report and, if so, what elements to include in that report. A summary of the significant provisions of the proposed Statement accompanies this letter.

Comments or suggestions on any aspect of this exposure draft will be appreciated. To facilitate the ASB's consideration of responses, comments should refer to specific paragraphs and include supporting reasons for each suggestion or comment.

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

Written comments on the exposure draft will become part of the public record of the AICPA and will be available for public inspection at the offices of the AICPA after June 6, 1998, for one year. Responses should be sent to Judith M. Sherinsky, Technical Manager, Audit and Attest Standards, File 4275, AICPA, 1211 Avenue of the Americas, New York, NY 10036-8775 in time to be received by May 6, 1998. Responses also may be sent by electronic mail via the Internet to jsherinsky@aicpa.org.

Sincerely,



Edmund R. Noonan
Chair
Auditing Standards Board



Thomas Ray
Director
Audit and Attest Standards

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(1997)**

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SUMMARY

WHY ISSUED

This proposed Statement provides guidance to auditors to enable them to determine whether an engagement requires a restricted-use report and, if so, what elements to include in that report. Existing auditing standards for engagements requiring restricted-use reports each contain guidance related to the applicable report. This Statement unifies that guidance.

WHAT IT DOES

This proposed Statement —

- Describes the circumstances in which the use of an auditor's report should be restricted.
- Specifies the language to be used in a restricted-use report.
- Presents the rationale for restricting the use of an auditor's report in each of the circumstances described.
- Replaces the terms *restricted distribution* and *general distribution* with the terms *restricted use* and *general use* because auditors are not responsible for controlling the distribution of the reports they issue.
- Defines the terms *restricted use* and *general use*.
- Clarifies that an auditor may restrict the use of a report that ordinarily is a general-use report.
- Requires that an auditor restrict a "combined" report if it covers subject matter or presentations that ordinarily do not require a restriction on use and subject matter or presentations that require such a restriction. It permits auditors to include a separate general-use report in a document that also contains a restricted-use report.
- Amends paragraph 47 of SAS No. 75, *Engagements to Apply Agreed-Upon Procedures to Specified Elements, Accounts, or Items of a Financial Statement* (AICPA, *Professional Standards*, vol. 1, AU sec. 622), to permit the inclusion of a separate general-use report in a document containing an agreed-upon procedures report. This amendment does not change the requirement that an auditor restrict a "combined" report if it covers subject matter or presentations that ordinarily do not require a restriction on use and also covers agreed-upon procedures. See appendix A herein for the proposed amendment.
- Deletes the words *or other specified third party* from the last sentence of the illustrative report in paragraph 12 of SAS No. 60, *Communication of Internal Control Related Matters Noted in an Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 325), because those words are inconsistent with the guidance in paragraph 10 of SAS No. 60, which does not provide for the addition of other specified third parties as report users. See appendix B herein for the proposed amendment.

HOW IT AFFECTS EXISTING STANDARDS

The proposed Statement would require that conforming changes be made to the guidance in the following documents:

- SAS No. 51, *Reporting on Financial Statements Prepared for Use in Other Countries* (AICPA Professional Standards, vol. 1, AU sec. 534)
- SAS No. 60, *Communication of Internal Control Related Matters Noted in an Audit*
- SAS No. 61, *Communication With Audit Committees* (AICPA, Professional Standards, vol. 1, AU sec. 380)
- SAS No. 62, *Special Reports* (AICPA, Professional Standards, vol. 1, AU sec. 623)
- SAS No. 75 *Engagements to Apply Agreed-Upon Procedures to Specified Elements, Accounts, or Items of a Financial Statement*

PROPOSED STATEMENT ON AUDITING STANDARDS
RESTRICTING THE USE OF AN AUDITOR'S REPORT

INTRODUCTION AND APPLICABILITY

1. This Statement provides guidance to auditors¹ on restricting the use of reports issued pursuant to Statements on Auditing Standards (SASs). This Statement —

- Defines the terms *general use* and *restricted use*.
- Describes the circumstances in which the use of auditors' reports should be restricted.
- Specifies the language to be used in auditors' reports that are restricted as to use.

This Statement is not applicable to service auditors' reports issued under SAS No. 70, *Reports on the Processing of Transactions by Service Organizations* (AICPA, *Professional Standards*, vol. 1, AU sec. 324), or to reports issued under SAS No. 72, *Letters for Underwriters and Certain Other Requesting Parties* (AICPA, *Professional Standards*, vol. 1, AU sec. 634).

GENERAL-USE AND RESTRICTED-USE REPORTS

2. The term *general use* applies to auditors' reports that ordinarily are not restricted to specified parties. Financial statements prepared in accordance with generally accepted accounting principles or certain comprehensive bases of accounting other than generally accepted accounting principles² ordinarily are not restricted as to use.^{3, 4}

3. The term *restricted use* applies to auditors' reports intended only for specified parties. The need for restriction on the use of a report may result from a number of circumstances, including the purpose of the report, the nature of the procedures applied in its preparation, the basis of or

¹ Throughout this Statement, the term *accountant* may be used interchangeably with the term *auditor*. The term *accountant* refers to a person possessing the professional qualifications required to practice as an independent auditor. Those qualifications are described in paragraph 3 of SAS No. 1, *Codification of Auditing Standards and Procedures* (AICPA, *Professional Standards*, vol. 1, AU sec. 110, "Responsibilities and Functions of the Independent Auditor"). An accountant performing an engagement to apply agreed-upon procedures to specified elements, accounts, or items of a financial statement is not required to be the auditor of the financial statements to which the specified elements, accounts, or items relate.

² Paragraph 4 of SAS No. 62, *Special Reports* (AICPA, *Professional Standards*, vol 1, AU sec. 623), defines a comprehensive basis of accounting other than generally accepted accounting principles.

³ However, see paragraph 5f of SAS No. 62 for restrictions on the use of reports on financial statements prepared in conformity with the requirements of the financial reporting provisions of a governmental regulatory agency.

⁴ Nothing in this Statement precludes an auditor from restricting the use of any report.

assumptions used in its preparation, the extent to which the procedures performed generally are known or understood, and the potential for the report to be misunderstood when taken out of the context in which it was intended to be used. Accordingly, such reports are restricted as to use.

4. An auditor should restrict the use of a report in the following circumstances:
 - a. The subject matter of the auditor's report, or the presentation being reported on, is based on measurement or disclosure criteria contained in contractual agreements or regulatory provisions that are not in accordance with generally accepted accounting principles or an other comprehensive basis of accounting (OCBOA). (See paragraph 5.)
 - b. The accountant's report is based on procedures that are specifically designed and performed to satisfy the needs of specified parties who accept responsibility for the sufficiency of the procedures. (See paragraph 6.)
 - c. The auditor's report is issued as a by-product of a financial statement audit and is based on the results of procedures designed to enable the auditor to express an opinion on the financial statements taken as a whole, not to provide assurance on the specific subject matter of the report. (See paragraphs 7 through 11.)

REPORTING ON SUBJECT MATTER OR PRESENTATIONS BASED ON MEASUREMENT OR DISCLOSURE CRITERIA CONTAINED IN CONTRACTUAL AGREEMENTS OR REGULATORY PROVISIONS

5. Reports on subject matter or presentations based on measurement or disclosure criteria contained in contractual agreements or regulatory provisions that are not in accordance with generally accepted accounting principles or an OCBOA are restricted as to use because the basis, assumptions, or purpose of such presentations (contained in such agreements or regulatory provisions) are developed for and directed only to the parties to the agreement or regulatory agency responsible for the provisions.

REPORTING WHEN SPECIFIED PARTIES ACCEPT RESPONSIBILITY FOR THE SUFFICIENCY OF THE PROCEDURES PERFORMED

6. In agreed-upon procedures engagements, the accountant performs procedures that have been agreed to by the specified parties and reports the findings. Because the procedures performed vary with each engagement based on the underlying circumstances and needs of the specified parties, responsibility for the sufficiency of the procedures rests solely with the specified parties, and the reports on the application of such procedures are not appropriate for use by other parties. In addition, only the specified parties are in a position to understand how or whether the selected procedures meet their needs.

REPORTING AS A BY-PRODUCT OF A FINANCIAL STATEMENT AUDIT

7. An auditor may issue certain reports on matters coming to his or her attention during the course of an audit of financial statements. Such reports include, but are not limited to, reports issued pursuant to —

- SAS No. 60, *Communication of Internal Control Related Matters Noted in an Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 325).
- SAS No. 61, *Communication With Audit Committees* (AICPA, *Professional Standards*, vol. 1, AU sec. 380).
- Paragraphs 19 through 21 of SAS No. 62, *Special Reports* (AICPA, *Professional Standards*, vol. 1, AU sec. 623), for reporting on compliance with aspects of contractual agreements or regulatory requirements related to audited financial statements.

8. Reports issued pursuant to the aforementioned auditing standards are based on the results of procedures designed to enable an auditor to express an opinion on the financial statements taken as a whole, not to provide assurance on the specific subject matter of the report. These reports are by-products of an audit of financial statements and are referred to as by-product reports in this Statement.

9. Because issuance of a by-product report is not the primary objective of the engagement, an audit generally includes only limited procedures directed toward the subject matter of that report. Accordingly, because of the potential for misinterpretation or misunderstanding of the limited degree of assurance associated with a by-product report, the use of such reports should be restricted. For example, a report issued under SAS No. 60 should be restricted because the purpose of the engagement is to report on an entity's financial statements, not to provide assurance on its internal control.

10. An auditor may issue a by-product report in connection with other engagements conducted in accordance with generally accepted auditing standards.

11. In consideration of the foregoing, the use of by-product reports should be restricted to an entity's audit committee, management, others within the organization, specified regulatory agencies, and in the case of reports on compliance with aspects of contractual agreements, to the parties to the contract or agreement.

COMBINED REPORTS COVERING BOTH RESTRICTED-USE AND GENERAL-USE SUBJECT MATTER OR PRESENTATIONS

12. When an auditor issues a combined report covering both a) subject matter or presentations that require a restriction on use and b) subject matter or presentations that ordinarily do not require such a restriction, the use of the combined report should be restricted to the specified parties.

ADDING OTHER SPECIFIED PARTIES

13. Subsequent to the completion of an engagement resulting in a restricted-use report, or in the course of such an engagement, an auditor may be asked to consider adding other parties as specified parties.

14. As noted in paragraph 11 of this Statement, the use of by-product reports should be restricted to an entity's audit committee, management, others within the organization, specified

regulatory agencies, and in the case of reports on compliance with aspects of contractual agreements, to the parties to the contract or agreement. An auditor should not agree to add other parties as specified parties of a by-product report.

15. If an auditor is reporting on subject matter or a presentation based on measurement or disclosure criteria contained in contractual agreements or regulatory provisions, as described in paragraph 5 of this Statement, the auditor may agree to add other parties as specified parties based on the auditor's consideration of such factors as the identity of the other parties and the intended use of the report. If the auditor agrees to add other parties as specified parties, the auditor should obtain affirmative acknowledgment, ordinarily in writing, from the other parties of their understanding of the nature of the engagement, the measurement or disclosure criteria used in the engagement, and the related report. If the other parties are added after the auditor has issued his or her report, the report may be reissued or the auditor may provide other written acknowledgment that the other parties have been added as specified parties. If the report is reissued, the report date should not be changed. If the auditor provides written acknowledgment that the other parties have been added as specified parties, such written acknowledgment ordinarily should state that no procedures have been performed subsequent to the date of the report.

16. Guidance concerning the addition of other parties as specified parties in agreed-upon procedures engagements is provided in paragraph 38 of SAS No. 75, *Engagements to Apply Agreed-Upon Procedures to Specified Elements, Accounts, or Items of a Financial Statement* (AICPA, *Professional Standards*, vol. 1, AU sec. 622).

LIMITING THE DISTRIBUTION OF REPORTS

17. Because of the reasons presented in paragraph 3 of this Statement, an auditor should consider informing his or her client that restricted-use reports are not intended for distribution by the client to nonspecified parties.⁵ However, an auditor is not responsible for controlling the distribution of such reports. Accordingly, a restricted-use report should alert readers to the restriction on the use of the report by stating that the report's use is restricted to the specified parties and that use of it by others is not intended.

REPORT LANGUAGE—RESTRICTED USE

18. An auditor's report that is restricted as to use should contain a separate paragraph at the end of the report that includes the following elements:

- a. A statement indicating that the report is intended solely for the information and use of the specified parties
- b. An identification of the specified parties to whom use is restricted
- c. A statement that the report is not intended to be and should not be used by anyone other than the specified parties

An example of such a paragraph is the following:

⁵ In some cases, restricted-use reports are required by law or regulation to be made available to the public.

This report is intended solely for the information and use of [*the specified parties*]⁶ and is not intended to be and should not be used by anyone other than the specified parties.

EFFECTIVE DATE

19. This Statement is effective for reports issued after November 30, 1998. Early application of the provisions of this Statement is permitted.

⁶ The report may list the specified parties or refer the reader to the specified parties listed elsewhere in the report. For reports on engagements performed in accordance with U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, the specified parties may be identified as "federal awarding agencies and pass-through entities."

APPENDIX A

PROPOSED AMENDMENT OF PARAGRAPH 47 OF SAS NO. 75, ENGAGEMENTS TO APPLY AGREED-UPON PROCEDURES TO SPECIFIED ELEMENTS, ACCOUNTS, OR ITEMS OF A FINANCIAL STATEMENT

This amendment would permit auditors to include a separate general-use report in a document containing an agreed-upon procedures report. It would not change the requirement that an auditor restrict a "combined" report if it covers subject matter or presentations that ordinarily do not require a restriction on use and also covers agreed-upon procedures.

New language is shown in boldface italics; deleted language is shown by strike-through.

Combined ~~or Included~~ Reports Covering Both Restricted-Use and General-Use Subject Matter or Presentations

47. When an accountant performs services pursuant to an engagement to apply agreed-upon procedures to specified elements, accounts, or items of a financial statement as part of or in addition to another form of service, this Statement applies only to those services described herein; other Standards would apply to other services. Other services may include an audit, review, or compilation of a financial statement, attest services performed pursuant to the Statements on Standards for Attestation Engagements, or a nonattest service. Reports on applying agreed-upon procedures to specified elements, accounts, or items of a financial statement may be ~~included or~~ combined with reports on such other services, provided the types of services can be clearly distinguished and the applicable standards for each service are followed. However, since an accountant's report on applying agreed-upon procedures to specified elements, accounts, or items of a financial statement is restricted to the specified users, ~~including or combining such a report with reports on other services results in restriction of all the included reports to the specified users.~~ ***parties, if an accountant issues a combined report covering agreed-upon procedures and also covering subject matter or presentations that ordinarily do not require a restriction on use, the use of the combined report should be restricted to the specified parties.***

APPENDIX B

PROPOSED AMENDMENT OF PARAGRAPH 12 OF SAS NO. 60, *COMMUNICATION OF INTERNAL CONTROL RELATED MATTERS NOTED IN AN AUDIT*

This amendment would delete the words *or other specified third party* from the last paragraph of the illustrative report in paragraph 12 of SAS No. 60 because those words are inconsistent with the guidance in paragraph 10 of SAS No. 60, which does not provide for the addition of other specified third parties as report users.

Deleted language is shown by strike-through.

12. The following is an illustration of the sections of a report encompassing the above requirements.

In planning and performing our audit of the financial statements of the ABC Corporation for the year ended December 31, 19XX, we considered its internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control. However, we noted certain matters involving the internal control and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the organization's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

[Include paragraphs to describe the reportable conditions noted.]

This report is intended solely for the information and use of the audit committee (board of directors, board of trustees, or owners in owner-managed enterprises), management, and others within the organization (or specified regulatory agency ~~or other specified third party~~).