

## AU-C Section 800

# ***Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks***

**Source:** SAS No. 122; SAS No. 125; SAS No. 127.

**Effective for audits of financial statements for periods ending on or after December 15, 2012.**

### NOTE

In February 2017 the Auditing Standards Board issued SAS No. 132, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern* (sec. 570), which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2017, and can be viewed in the appendix of section 570.

## Introduction

### Scope of This Section

**.01** AU-C sections 200–700 apply to an audit of financial statements. This section addresses special considerations in the application of those AU-C sections to an audit of financial statements prepared in accordance with a special purpose framework, which is a cash, a tax, a regulatory, a contractual, or an other basis of accounting. This section does not purport to address all special considerations that may be relevant in the circumstances. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

**.02** This section is written in the context of a complete set of financial statements prepared in accordance with a special purpose framework. Section 805, *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*, addresses special considerations relevant to an audit of a single financial statement or of a specific element, account, or item of a financial statement.

**.03** Section 910, *Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country*, addresses circumstances in which an auditor practicing in the United States is engaged to report on financial statements that have been prepared in accordance with a financial reporting framework generally accepted in another country not adopted by a body designated by the Council of the AICPA (Council) to promulgate generally accepted accounting principles (GAAP) when such audited financial statements are intended for use outside the United States.

**.04** Section 806, *Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements*, addresses the auditor's responsibility and the form and content of

the report when the auditor is requested to report on the entity's compliance with aspects of contractual agreements or regulatory requirements in connection with the audit of financial statements.

## Effective Date

.05 This section is effective for audits of financial statements for periods ending on or after December 15, 2012.

## Objective

.06 The objective of the auditor, when applying generally accepted auditing standards (GAAS) in an audit of financial statements prepared in accordance with a special purpose framework, is to address appropriately the special considerations that are relevant to

- a. the acceptance of the engagement,
- b. the planning and performance of that engagement, and
- c. forming an opinion and reporting on the financial statements.

## Definitions

.07 For purposes of GAAS, the following terms have the meanings attributed as follows:

**Special purpose financial statements.** Financial statements prepared in accordance with a special purpose framework. (Ref: par. .A1)

**Special purpose framework.** A financial reporting framework other than GAAP that is one of the following bases of accounting: (Ref: par. .A2–.A5)

- a. **Cash basis.** A basis of accounting that the entity uses to record cash receipts and disbursements and modifications of the cash basis having substantial support (for example, recording depreciation on fixed assets).
- b. **Tax basis.** A basis of accounting that the entity uses to file its tax return for the period covered by the financial statements.
- c. **Regulatory basis.** A basis of accounting that the entity uses to comply with the requirements or financial reporting provisions of a regulatory agency to whose jurisdiction the entity is subject (for example, a basis of accounting that insurance companies use pursuant to the accounting practices prescribed or permitted by a state insurance commission).
- d. **Contractual basis.** A basis of accounting that the entity uses to comply with an agreement between the entity and one or more third parties other than the auditor.
- e. **Other basis.** A basis of accounting that uses a definite set of logical, reasonable criteria that is applied to all material items appearing in financial statements.

The cash basis, tax basis, regulatory basis, and other basis of accounting are commonly referred to as *other comprehensive bases of accounting*.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

**.08** Reference to *financial statements* in this section means "a complete set of special purpose financial statements, including the related notes."<sup>1</sup> The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information. The requirements of the applicable financial reporting framework determine the form and content of the financial statements and what constitutes a complete set of financial statements.

**.09** Reference to *GAAP* in GAAS means generally accepted accounting principles promulgated by bodies designated by Council pursuant to the "Compliance With Standards Rule" (ET sec. 1.310.001) and the "Accounting Principles Rule" (ET sec. 1.320.001) of the AICPA Code of Professional Conduct. [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

## Requirements

### Considerations When Accepting the Engagement

#### **Acceptability of the Financial Reporting Framework (Ref: par. .A6–.A9)**

**.10** Section 210, *Terms of Engagement*, requires the auditor to determine the acceptability of the financial reporting framework applied in the preparation of the financial statements.<sup>2</sup> In an audit of special purpose financial statements, the auditor should obtain an understanding of

- a. the purpose for which the financial statements are prepared,
- b. the intended users, and
- c. the steps taken by management to determine that the applicable financial reporting framework is acceptable in the circumstances.

#### **Preconditions for an Audit (Ref: par. .A10)**

**.11** Section 210 requires the auditor to establish whether the preconditions for an audit are present, including determining whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable.<sup>3</sup> In an audit of special purpose financial statements, the auditor should obtain the agreement of management that it acknowledges and understands its responsibility to include all informative disclosures that are appropriate for the special purpose framework used to prepare the entity's financial statements, including

- a. a description of the special purpose framework, including a summary of significant accounting policies, and how the framework differs from GAAP, the effects of which need not be quantified.
- b. informative disclosures similar to those required by GAAP, in the case of special purpose financial statements that contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP.

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<sup>1</sup> Paragraphs .14 and .A9 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

<sup>2</sup> Paragraph .06a of section 210, *Terms of Engagement*.

<sup>3</sup> Paragraph .06 of section 210.

- c. a description of any significant interpretations of the contract on which the special purpose financial statements are based, in the case of special purpose financial statements prepared in accordance with a contractual basis of accounting.
- d. additional disclosures beyond those specifically required by the framework that may be necessary for the special purpose financial statements to achieve fair presentation. (Ref: par. .A11)

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

## Considerations When Planning and Performing the Audit (Ref: par. .A12–.A15)

.12 Section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, requires the auditor to comply with all AU-C sections relevant to the audit.<sup>4</sup> In planning and performing an audit of special purpose financial statements, the auditor should adapt and apply all AU-C sections relevant to the audit as necessary in the circumstances of the engagement.

.13 Section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, requires the auditor to obtain an understanding of the entity's selection and application of accounting policies.<sup>5</sup> In the case of special purpose financial statements prepared in accordance with a contractual basis of accounting, the auditor should obtain an understanding of any significant interpretations of the contract that management made in the preparation of those financial statements. An interpretation is significant when adoption of another reasonable interpretation would have produced a material difference in the information presented in the financial statements.

## Forming an Opinion and Reporting Considerations

.14 When forming an opinion and reporting on special purpose financial statements, the auditor should apply the requirements in section 700, *Forming an Opinion and Reporting on Financial Statements*. When, in forming an opinion, the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary, the auditor should apply the requirements in section 705, *Modifications to the Opinion in the Independent Auditor's Report*. (Ref: par. .A16)

## Description of the Applicable Financial Reporting Framework (Ref: par. .A17–.A18)

.15 Section 700 requires the auditor to evaluate whether the financial statements adequately refer to or describe the applicable financial reporting framework.<sup>6</sup> In an audit of special purpose financial statements, the auditor should evaluate whether the financial statements are suitably titled, include a summary of significant accounting policies, and adequately describe how the special purpose framework differs from GAAP. The effects of these differences need not be quantified.

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<sup>4</sup> Paragraph .20 of section 200.

<sup>5</sup> Paragraph .12c of section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

<sup>6</sup> Paragraph .18 of section 700, *Forming an Opinion and Reporting on Financial Statements*.

.16 In the case of special purpose financial statements prepared in accordance with a contractual basis of accounting, the auditor should also evaluate whether the financial statements adequately describe any significant interpretations of the contract on which the financial statements are based.

***Fair Presentation (Ref: par. .A19–.A23)***

.17 Section 700 requires the auditor to evaluate whether the financial statements achieve fair presentation.<sup>7</sup> In an audit of special purpose financial statements when the special purpose financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP, the auditor should evaluate whether the financial statements include informative disclosures similar to those required by GAAP. The auditor should also evaluate whether additional disclosures, beyond those specifically required by the framework, related to matters that are not specifically identified on the face of the financial statements or other disclosures are necessary for the financial statements to achieve fair presentation.

***Auditor's Report***

.18 Section 700 addresses the form and content of the auditor's report. In the case of an auditor's report on special purpose financial statements, the

- a. explanation of management's responsibility for the financial statements should also make reference to its responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances, when management has a choice of financial reporting frameworks in the preparation of such financial statements.
- b. auditor's report should also describe the purpose for which the financial statements are prepared or refer to a note in the special purpose financial statements that contains that information, when the financial statements are prepared in accordance with
  - i. a regulatory or contractual basis of accounting or
  - ii. an other basis of accounting, and the auditor is required to restrict use of the auditor's report pursuant to paragraph .06a–b of section 905, *Alert That Restricts the Use of the Auditor's Written Communication*. (Ref: par. .A24)

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

***Alerting Readers in an Emphasis-of-Matter Paragraph That the Financial Statements Are Prepared in Accordance With a Special Purpose Framework (Ref: par. .A25)***

.19 Except for the circumstances described in paragraph .21, the auditor's report on special purpose financial statements should include an *emphasis-of-matter* paragraph,<sup>8</sup> under an appropriate heading, that

- a. indicates that the financial statements are prepared in accordance with the applicable special purpose framework,
- b. refers to the note to the financial statements that describes that framework, and

<sup>7</sup> Paragraph .17 of section 700.

<sup>8</sup> Paragraphs .06–.07 of section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*.

- c. states that the special purpose framework is a basis of accounting other than GAAP.

***Restricting the Use of the Auditor's Report in an Other-Matter Paragraph (Ref: par. .A26–.A27)***

.20 Except for the circumstances described in paragraph .21, the auditor's report on special purpose financial statements should include an *other-matter* paragraph,<sup>9</sup> under an appropriate heading, that restricts<sup>10</sup> the use of the auditor's report when the special purpose financial statements are prepared in accordance with

- a. a contractual basis of accounting,
- b. a regulatory basis of accounting, or
- c. an other basis of accounting when required pursuant to paragraph .06a–b of section 905.

[As amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125. As amended, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

***Regulatory Basis Financial Statements Intended for General Use (Ref: par. .A28)***

.21 If the special purpose financial statements are prepared in accordance with a regulatory basis of accounting, and the special purpose financial statements together with the auditor's report are intended for general use, the auditor should not include the *emphasis-of-matter* or *other-matter* paragraphs required by paragraphs .19–.20. Instead, the auditor should express an opinion about whether the special purpose financial statements are presented fairly, in all material respects, in accordance with GAAP. The auditor should also, in a separate paragraph, express an opinion about whether the financial statements are prepared in accordance with the special purpose framework.

***Auditor's Report Prescribed by Law or Regulation (Ref: par. .A29–.A32)***

.22 If the auditor is required by law or regulation to use a specific layout, form, or wording of the auditor's report, the auditor's report should refer to GAAS only if the auditor's report includes, at a minimum, each of the following elements:

- a. A title
- b. An addressee
- c. An introductory paragraph that identifies the special purpose financial statements audited
- d. A description of the responsibility of management for the preparation and fair presentation of the special purpose financial statements
- e. A reference to management's responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances when required by paragraph .18a

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<sup>9</sup> Paragraph .08 of section 706.

<sup>10</sup> See paragraphs .06a–b and .07 of section 905, *Alert That Restricts the Use of the Auditor's Written Communication*. [Footnote amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125.]

- f. A description of the purpose for which the financial statements are prepared when required by paragraph .18b
- g. A description of the auditor's responsibility to express an opinion on the special purpose financial statements and the scope of the audit, that includes
  - i. A reference to GAAS and, if applicable, the law or regulation
  - ii. A description of an audit in accordance with those standards
- h. An opinion paragraph containing an expression of opinion on the special purpose financial statements and a reference to the special purpose framework used to prepare the financial statements (including identifying the origin of the framework) and, if applicable, an opinion on whether the special purpose financial statements are presented fairly, in all material respects, in accordance with GAAP when required by paragraph .21
- i. An *emphasis-of-matter* paragraph that indicates that the financial statements are prepared in accordance with a special purpose framework when required by paragraph .19
- j. An *other-matter* paragraph that restricts the use of the auditor's report when required by paragraph .20
- k. The auditor's signature
- l. The auditor's city and state
- m. The date of the auditor's report

**.23** If the prescribed specific layout, form, or wording of the auditor's report is not acceptable or would cause an auditor to make a statement that the auditor has no basis to make, the auditor should reword the prescribed form of report or attach an appropriately worded separate report.

## Application and Other Explanatory Material

### Definitions

#### ***Special Purpose Financial Statements and Special Purpose Frameworks*** **(Ref: par. .07)**

**.A1** Special purpose financial statements may be prepared for use by regulatory bodies, the parties to a contract or agreement, or other specified parties. For example, a loan agreement may require the borrower to prepare consolidated financial statements for the lender presented on a contractual basis of accounting, which is not in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) or International Financial Reporting Standards promulgated by the International Accounting Standards Board.

**.A2** There may be circumstances when a regulatory or contractual basis of accounting is based on a general purpose framework, such as U.S. GAAP, but does not comply with all the requirements of that framework.<sup>11</sup> An example is a contract that requires financial statements to be prepared in accordance with most, but not all, of U.S. GAAP. If the financial statements purport to be prepared in accordance with a general purpose framework and such financial

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<sup>11</sup> The term *general purpose framework* is defined in paragraph .11 of section 700.

statements are materially misstated due to a departure from that framework, section 705 applies.

**.A3** When it is acceptable in the circumstances of the engagement to report, in accordance with this section, on special purpose financial statements that purport to be prepared in accordance with a regulatory or contractual basis of accounting that is based on a general purpose framework, it is inappropriate for the description of the applicable financial reporting framework in the special purpose financial statements to imply full compliance with the general purpose framework. In the example of the contract in paragraph .A2, the description of the applicable financial reporting framework would refer to the financial reporting provisions of the contract, rather than make reference to U.S. GAAP. The requirements in paragraphs .19–.21 are designed to avoid misunderstandings about compliance with the general purpose framework.

**.A4** Financial statements prepared in accordance with a cash basis, tax basis, or an other basis of accounting may be the only financial statements an entity prepares. Such special purpose financial statements may be used by users other than those for whom the financial reporting framework is designed. Despite the broad distribution of the financial statements, the financial statements are still considered to be special purpose financial statements for purposes of GAAS. The requirement in paragraph .19 is designed to avoid misunderstandings about the framework used to prepare the financial statements. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

**.A5** Certain regulators, including state and local government legislators, regulatory agencies, or departments, require financial statements to be prepared in accordance with a financial reporting framework that is based on U.S. GAAP but does not comply with all of the requirements of U.S. GAAP. Such frameworks are regulatory bases of accounting, as defined in paragraph .07. In some circumstances, however, the cash or tax basis of accounting may be permitted by a regulator. For purposes of this section, the cash and tax bases of accounting are not regulatory bases of accounting. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

## Considerations When Accepting the Engagement

### ***Acceptability of the Financial Reporting Framework (Ref: par. .10)***

**.A6** In the case of special purpose financial statements, the financial information needs of the intended users are a factor in determining the acceptability of the financial reporting framework applied in the preparation of the financial statements.

**.A7** The applicable financial reporting framework may encompass the financial reporting standards established by an organization that is authorized or recognized to promulgate standards for special purpose financial statements. In that case, those standards will be presumed acceptable for that purpose if the organization follows an established and transparent process involving deliberation and consideration of the views of relevant stakeholders. In some circumstances, law or regulation may prescribe the financial reporting framework to be used by management in the preparation of special purpose financial statements for a certain type of entity. For example, a regulator may establish financial reporting provisions to meet the requirements of that regulator. In the absence of indications to the contrary, such a financial reporting framework is

presumed acceptable for special purpose financial statements prepared by such an entity.

**.A8** The acceptability of the financial reporting framework in the circumstances of the engagement is determined by considering whether the framework exhibits attributes normally exhibited by acceptable financial reporting frameworks. Section 210 discusses the attributes of acceptable financial reporting frameworks, which provide management with an appropriate basis for preparing the financial statements and the auditor with suitable criteria for auditing the financial statements.<sup>12</sup> In the case of a special purpose framework, the relative importance to a particular engagement of each of the attributes normally exhibited by acceptable financial reporting frameworks is a matter of professional judgment. For example, for purposes of establishing the value of net assets of an entity at the date of its sale, the seller and purchaser may have agreed that conservative estimates of allowances for uncollectible accounts receivable are appropriate for their needs, even though such financial information may be biased when compared with financial information prepared in accordance with a general purpose framework. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

**.A9** In the case of financial statements prepared in accordance with a contractual basis of accounting, the parties to the contract or agreement may need to agree on the significant interpretations of the contract on which the special purpose financial statements are based. If agreement cannot be reached, the auditor may determine that the framework is not acceptable.

#### ***Preconditions for an Audit (Ref: par. . 11)***

**.A10** Section 210 also requires the agreed-upon terms of the audit engagement to include references to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content.<sup>13</sup> The auditor may discuss with management and, when appropriate, those charged with governance how an audit report on financial statements prepared in accordance with a special purpose framework differs from an audit report on financial statements prepared in accordance with a general purpose framework. Discussing the expected form and content of the auditor's report may assist management in understanding its responsibilities related to the audit engagement.

#### ***Achieving Fair Presentation (Ref: par. . 11 d)***

**.A11** In accordance with section 700, the auditor's evaluation of whether the financial statements achieve fair presentation in accordance with the applicable financial reporting framework requires consideration of<sup>14</sup>

- a. the overall presentation, structure and content of the financial statements and
- b. whether the financial statements, including the related notes, represent the underlying transactions and events in a manner that achieves fair presentation.

Also see paragraphs .A19–.A23 of this section.

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<sup>12</sup> Paragraphs .A2-.A3 of section 210, *Terms of Engagement*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

<sup>13</sup> Paragraph .10f of section 210. [Footnote renumbered by the issuance of SAS No. 127, January 2013.]

<sup>14</sup> Paragraph .17 of section 700. [Footnote renumbered by the issuance of SAS No. 127, January 2013.]

## Considerations When Planning and Performing the Audit (Ref: par. .12–.13)

**.A12** Section 200 requires the auditor to comply with (a) relevant ethical requirements relating to financial statement audit engagements and (b) all AU-C sections relevant to the audit. It also requires the auditor to comply with each requirement of an AU-C section unless, in the circumstances of the audit, the entire AU-C section is not relevant or the requirement is not relevant because it is conditional and the condition does not exist. In rare circumstances, the auditor may judge it necessary to depart from a relevant presumptively mandatory requirement in an AU-C section by performing alternative audit procedures to achieve the intent of that requirement.<sup>15</sup>

**.A13** An AU-C section is relevant to the audit when the AU-C section is in effect and the circumstances addressed by the AU-C section exist.<sup>16</sup> In an audit of special purpose financial statements, some of the requirements within the relevant AU-C sections may need to be adapted by the auditor. For example, in section 320, *Materiality in Planning and Performing an Audit*, judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group.<sup>17</sup> In an audit of special purpose financial statements, those judgments may be based on a consideration of the financial information needs of the intended users.

**.A14** In the case of special purpose financial statements, such as those prepared in accordance with a contractual basis of accounting, management may agree with the intended users on a threshold below which misstatements identified during the audit will not be corrected or otherwise adjusted. The existence of such a threshold does not relieve the auditor from the requirement to determine materiality in accordance with section 320 for purposes of planning and performing the audit of the special purpose financial statements. With respect to interpretations of the contract on which the special purpose financial statements are based, the auditor may determine that an interpretation is significant based on qualitative considerations.

**.A15** Communication with those charged with governance in accordance with GAAS is based on the relationship between those charged with governance and the financial statements subject to audit, in particular, whether those charged with governance are responsible for overseeing the preparation of those financial statements. In the case of special purpose financial statements, those charged with governance may not have such a responsibility; for example, when the financial information is prepared solely for management's use. In such cases, the requirements of section 260, *The Auditor's Communication With Those Charged With Governance*, may not be relevant to the audit of the special purpose financial statements, except when the auditor is also responsible for the audit of the entity's general purpose financial statements or, for example, has agreed to communicate with those charged with governance of the entity relevant matters identified during the audit of the special purpose financial statements.

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<sup>15</sup> Paragraphs .16, .20, and .24–.26 of section 200. [Footnote renumbered by the issuance of SAS No. 127, January 2013.]

<sup>16</sup> Paragraph .20 of section 200. [Footnote renumbered by the issuance of SAS No. 127, January 2013.]

<sup>17</sup> Paragraph .02 of section 320, *Materiality in Planning and Performing an Audit*. [Footnote renumbered by the issuance of SAS No. 127, January 2013.]

## Forming an Opinion and Reporting Considerations (Ref: par. .14)

.A16 Appendix A, "Overview of Reporting Requirements," provides an overview of the reporting requirements depending on the special purpose framework. The exhibit, "Illustrations of Auditor's Reports on Special Purpose Financial Statements," contains illustrations of auditor's reports on special purpose financial statements.

### ***Description of the Applicable Financial Reporting Framework*** (Ref: par. .15–.16)

.A17 Terms such as *balance sheet*, *statement of financial position*, *statement of income*, *statement of operations*, and *statement of cash flows*, or similar unmodified titles, are generally understood to be applicable only to financial statements that are intended to present financial position, results of operations, or cash flows in accordance with GAAP. Accordingly, the auditor is required by paragraph .15 to evaluate whether the financial statements are suitably titled. For example, cash basis financial statements might be titled as a statement of assets and liabilities arising from cash transactions or as a statement of revenue collected and expenses paid; a financial statement prepared on a regulatory basis of accounting might be titled as a statement of income—regulatory basis.

.A18 The description of how the special purpose framework differs from GAAP ordinarily only includes the material differences between GAAP and the special purpose framework. For example, if several items are accounted for differently under the special purpose framework than they would be under U.S. GAAP, but only the differences in how depreciation is calculated are material, a brief description of the depreciation differences is all that would be necessary, and the remaining differences need not be described. The differences need not be quantified.

### ***Fair Presentation*** (Ref: par. .17)

.A19 Financial statements, including the related notes, that achieve a fair presentation include all informative disclosures that are appropriate for the applicable financial reporting framework, including matters that affect their use, understanding, and interpretation. Also refer to paragraph .A11.

.A20 When the special purpose financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP, informative disclosures similar to those required by GAAP are necessary to achieve fair presentation. For example, financial statements prepared on a tax basis or on a modified cash basis of accounting usually reflect depreciation, long-term debt, and owners' equity. Thus, the informative disclosures for depreciation, long-term debt, and owners' equity in such financial statements would be comparable to those in financial statements prepared in accordance with GAAP.

.A21 Disclosures in special purpose financial statements may substitute qualitative information for some of the quantitative information required by GAAP or may provide information that communicates the substance of those requirements. For example, disclosing estimated percentages of revenues, rather than amounts that GAAP presentations would require, may sufficiently convey the significance of sales or leasing to related parties or major customers.

.A22 The auditor is required by paragraph .17 to evaluate whether additional disclosures, beyond those specifically required by the framework, related

to matters that are not specifically identified on the face of the financial statements or other disclosures may be necessary for the special purpose financial statements to achieve fair presentation. For example, these disclosures may include matters about related party transactions, restrictions on assets and owners' equity, subsequent events, and significant uncertainties. In such circumstances, the special purpose financial statements would include the same disclosure required by GAAP or disclosure that communicates the substance of those requirements.

**.A23** Appendix B, "Fair Presentation and Adequate Disclosures," provides additional guidance on evaluating the adequacy of disclosures in financial statements prepared in accordance with a special purpose framework, including matters related to the presentation of financial statements.

### **Auditor's Report (Ref: par. .18b)**

**.A24** When the special purpose financial statements are prepared in accordance with a regulatory or contractual basis of accounting or an other basis of accounting that requires an alert that restricts the use of the auditor's report pursuant to paragraph .06a–b of section 905, the auditor is required by paragraph .18b to describe the purpose for which the financial statements are prepared or refer to a note in the financial statements that contains that information. This is necessary to avoid misunderstandings when the special purpose financial statements are used for purposes other than those for which they were intended. The note to the financial statements may also describe any significant interpretations of the contract on which the financial statements are based. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

### **Alerting Readers in an Emphasis-of-Matter Paragraph That the Financial Statements Are Prepared in Accordance With a Special Purpose Framework (Ref: par. .19)**

**.A25** Special purpose financial statements may be used for purposes other than those for which they were intended. To avoid misunderstandings, paragraph .19 requires the auditor to include an *emphasis-of-matter* paragraph in the auditor's report that alerts users of the auditor's report that the financial statements are prepared in accordance with a special purpose framework and that the basis of accounting is a basis of accounting other than GAAP.

### **Restricting the Use of the Auditor's Report in an Other-Matter Paragraph (Ref: par. .20)**

**.A26** Special purpose financial statements prepared in accordance with a contractual or regulatory basis of accounting are suitable only for a limited number of users who can be presumed to have an adequate understanding of such bases of accounting. For example, special purpose financial statements prepared in accordance with a contractual basis of accounting are developed for and directed only to the parties to the contract or agreement. Accordingly, the alert that restricts the use of the auditor's report is required due to the nature of the report and the potential for the report to be taken out of the context in which the auditor's report was intended to be used. Section 905, *Alert That Restricts the Use of the Auditor's Written Communication*, addresses adding other parties as specified parties. [As amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125.]

**.A27** In the case of special purpose financial statements prepared in accordance with a cash or tax basis of accounting, the auditor may consider it necessary in the circumstances of the engagement to include an alert that restricts the use of the auditor's report. [As amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125.]

**Regulatory Basis Financial Statements Intended for General Use**  
(Ref: par. .21)

**.A28** Special purpose financial statements prepared in accordance with a regulatory basis of accounting may be intended for general use. Such special purpose financial statements are intended for general use when the financial statements together with the auditor's report are intended for use by parties other than those within the entity and the regulatory agencies to whose jurisdiction the entity is subject or when the financial statements together with the auditor's report are distributed by the entity to parties other than the regulatory agencies to whose jurisdiction the entity is subject, either voluntarily or upon specific request. In such circumstances, the *emphasis-of-matter* and *other-matter* paragraphs described in paragraphs .19–.20 are not required because the auditor is required, in accordance with paragraph .21, to express an opinion about whether the special purpose financial statements are prepared in accordance with GAAP and an opinion about whether the financial statements are prepared in accordance with the special purpose framework.

**Auditor's Report Prescribed by Law or Regulation** (Ref: par. .22–.23)

**.A29** The auditor may be required to comply with legal or regulatory requirements in addition to GAAS. When this is the case, the auditor may be required to use a layout, form, or wording in the auditor's report that differs from that described in this section, such as when printed forms or schedules designed or adopted by the bodies with which they are to be filed prescribe the wording of the auditor's report.

**.A30** When the differences between the legal or regulatory requirements and GAAS relate only to the layout, form, and wording of the auditor's report and, at a minimum, each of the elements identified in paragraph .22 are included in the auditor's report, the auditor's report may refer to GAAS. Accordingly, in such circumstances the auditor is considered to have complied with the requirements of GAAS, even when the layout, form, and wording used in the auditor's report are specified by legal or regulatory reporting requirements. Section 210 addresses circumstances in which law or regulation prescribes the layout, form, or wording of the auditor's report in terms that are significantly different from the requirements of GAAS.<sup>18</sup>

**.A31** Some report forms can be made acceptable by inserting additional wording to include the elements identified in paragraph .22. Other report forms can be made acceptable only by complete revision because the prescribed language of the report calls for statements by the auditor that are not consistent with the auditor's function or responsibility; for example, a report form that requests the auditor to certify the financial statements.

**.A32** This guidance can be applied to other circumstances, for example, reports on financial statements prepared in accordance with a general purpose framework for which a specific layout, form, or wording of the auditor's report is required.

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<sup>18</sup> Paragraph .18 of section 210. [Footnote renumbered by the issuance of SAS No. 127, January 2013.]

.A33

## Appendix A—Overview of Reporting Requirements

The following table provides an overview of the reporting requirements depending on the special purpose framework:

	<i>Cash Basis</i>	<i>Tax Basis</i>	<i>Regulatory Basis</i>	<i>Regulatory Basis (General Use)</i>	<i>Contractual Basis</i>	<i>Other Basis</i>
<i>Opinion(s)</i>	Single opinion on special purpose framework	Single opinion on special purpose framework	Single opinion on special purpose framework	Dual opinion on special purpose framework and generally accepted accounting principles <sup>1</sup>	Single opinion on special purpose framework	Single opinion on special purpose framework
<i>Description of purpose for which special purpose financial statements are prepared<sup>2</sup></i>	No	No	Yes	Yes	Yes	As required by paragraph .18b(ii)
<i>Emphasis-of-matter paragraph alerting readers regarding the preparation in accordance with a special purpose framework<sup>3</sup></i>	Yes	Yes	Yes	No	Yes	Yes
<i>Other-matter paragraph including an alert restricting the use of the auditor's report<sup>4</sup></i>	No	No	Yes	No	Yes	As required by section 905, <i>Alert That Restricts the Use of the Auditor's Written Communication</i> <sup>5</sup>
<i>Exhibit A Illustrations</i>	1	2	3	4	5	

[As amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125. As amended, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

<sup>1</sup> Paragraph .21. [Footnote renumbered by the issuance of SAS No. 127, January 2013.]

<sup>2</sup> Paragraph .18b. [Footnote renumbered by the issuance of SAS No. 127, January 2013.]

<sup>3</sup> Paragraphs .19 and .21. [Footnote renumbered by the issuance of SAS No. 127, January 2013.]

<sup>4</sup> Paragraphs .20–.21. [Footnote renumbered by the issuance of SAS No. 127, January 2013.]

<sup>5</sup> Paragraph .06a–b of section 905. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

.A34

## Appendix B—Fair Presentation and Adequate Disclosures (Ref: par. .A19–.A22)

When special purpose financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with generally accepted accounting principles (GAAP), paragraph .17 requires the auditor to evaluate whether, the financial statements include informative disclosures similar to those required by GAAP. The auditor is also required to evaluate whether additional disclosures, beyond those specifically required by the framework, related to matters that are not specifically identified on the face of the financial statements or other disclosures are necessary for the financial statements to achieve fair presentation. This appendix provides guidance, in addition to paragraphs .A19–.A22, on evaluating the adequacy of disclosures in financial statements prepared in accordance with a special purpose framework, including matters related to the presentation of financial statements.

If special purpose financial statements contain items for which GAAP would require disclosure, the financial statements may either provide the relevant disclosure that would be required for those items in a GAAP presentation or provide information that communicates the substance of that disclosure. Likewise, if GAAP sets forth requirements that apply to the presentation of financial statements, special purpose financial statements may either comply with those requirements or provide information that communicates the substance of those requirements, without modifying the format of the special purpose financial statements. This may result in substituting qualitative information for some of the quantitative information required for GAAP presentations. For example:

- Disclosure of the repayment terms of significant long-term borrowings may sufficiently communicate information about future principal reduction without providing the summary of principal reduction during each of the next five years.
- Information about the effects of accounting changes, discontinued operations, and extraordinary items could be disclosed in a note to the financial statements without following the GAAP presentation requirements in the statement of results of operations, using those terms, or disclosing net-of-tax effects.
- Instead of showing expenses by their functional classifications in certain industries, a statement of activities could present expenses according to their natural classifications, and a note to the statement could use estimated percentages to communicate information about expenses incurred by the major program and supporting services.
- Instead of showing the amounts of, and changes in, the unrestricted and temporarily and permanently restricted classes of net assets in certain industries, a statement of assets and liabilities could report total net assets or fund balances, a related statement of activities could report changes in those totals, and a note to the financial statements could provide information, using estimated or actual amounts or percentages, about the restrictions on those amounts and on any deferred restricted amounts, describe the major restrictions, and provide information about significant changes in restricted amounts.

For special purpose financial statements, GAAP disclosure requirements that are not relevant to the measurement of the item need not be considered. To illustrate:

- Fair value disclosures for debt and equity securities would not be relevant when the basis of presentation does not adjust the cost of such securities to their fair value.
- Disclosures related to actuarial calculations for contributions to defined benefit plans would not be relevant in financial statements prepared in accordance with the cash or tax basis of accounting.
- Disclosures related to the use of estimates would not be relevant in a presentation that has no estimates, such as the cash basis of accounting.

Special purpose financial statements may not include a statement of cash flows. If a presentation of cash receipts and disbursements is presented in a format similar to a statement of cash flows or if the entity chooses to present such a statement, the statement would either conform to the requirements for a GAAP presentation or communicate their substance. As an example, the statement of cash flows might disclose noncash acquisitions through captions on its face.

.A35

**Exhibit—Illustrations of Auditor's Reports on Special Purpose Financial Statements (Ref: par. .A16)**

Illustration 1—An Auditor's Report on a Complete Set of Financial Statements Prepared in Accordance With the Cash Basis of Accounting

Illustration 2—An Auditor's Report on a Complete Set of Financial Statements Prepared in Accordance With the Tax Basis of Accounting

Illustration 3—An Auditor's Report on a Complete Set of Financial Statements Prepared in Accordance With a Regulatory Basis of Accounting (the Financial Statements Together With the Auditor's Report Are Not Intended for General Use)

Illustration 4—An Auditor's Report on a Complete Set of Financial Statements Prepared in Accordance With a Regulatory Basis of Accounting (the Financial Statements Together With the Auditor's Report Are Intended for General Use)

Illustration 5—An Auditor's Report on a Complete Set of Financial Statements Prepared in Accordance With a Contractual Basis of Accounting

## Illustration 1—An Auditor's Report on a Complete Set of Financial Statements Prepared in Accordance With the Cash Basis of Accounting

Circumstances include the following:

- The financial statements have been prepared by management of the entity in accordance with the cash basis of accounting (that is, a special purpose framework).
- Management has a choice of financial reporting frameworks.<sup>1</sup>

### **Independent Auditor's Report**

[Appropriate Addressee]

#### ***Report on the Financial Statements***<sup>2</sup>

We have audited the accompanying financial statements of ABC Partnership, which comprise the statement of assets and liabilities arising from cash transactions as of December 31, 20X1, and the related statement of revenue collected and expenses paid for the year then ended, and the related notes to the financial statements.

#### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the cash basis of accounting described in Note X; this includes determining that the cash basis of accounting is an acceptable basis for the preparation of the financial statements in the circumstances. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

#### ***Auditor's Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the partnership's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the

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<sup>1</sup> If management does not have a choice of financial reporting frameworks, the auditor is not required by paragraph .18a to make reference to management's responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances.

<sup>2</sup> The subtitle "Report on the Financial Statements" is unnecessary in circumstances when the second subtitle "Report on Other Legal and Regulatory Requirements" is not applicable.

effectiveness of the partnership's internal control.<sup>3</sup> Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the assets and liabilities arising from cash transactions of ABC Partnership as of December 31, 20X1, and its revenue collected and expenses paid during the year then ended in accordance with the cash basis of accounting described in Note X.

***Basis of Accounting***<sup>4</sup>

We draw attention to Note X of the financial statements, which describes the basis of accounting. The financial statements are prepared on the cash basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

***Report on Other Legal and Regulatory Requirements***

*[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]*

*[Auditor's signature]*

*[Auditor's city and state]*

*[Date of the auditor's report]*

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<sup>3</sup> In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances." In addition, the next sentence, "Accordingly, we express no such opinion." would not be included.

<sup>4</sup> Another appropriate heading may be used.

## Illustration 2—An Auditor’s Report on a Complete Set of Financial Statements Prepared in Accordance With the Tax Basis of Accounting

Circumstances include the following:

- The financial statements have been prepared by management of a partnership in accordance with the basis of accounting the partnership uses for income tax purposes (that is, a special purpose framework).
- Based on the partnership agreement, management does not have a choice of financial reporting frameworks.<sup>1</sup>

### **Independent Auditor’s Report**

*[Appropriate Addressee]*

#### ***Report on the Financial Statements***<sup>2</sup>

We have audited the accompanying financial statements of ABC Partnership, which comprise the statements of assets, liabilities, and capital-income tax basis as of December 31, 20X1, and the related statements of revenue and expenses—income tax basis and of changes in partners’ capital accounts—income tax basis for the year then ended, and the related notes to the financial statements.

#### ***Management’s Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the basis of accounting the Partnership uses for income tax purposes; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

#### ***Auditor’s Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the partnership’s preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the

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<sup>1</sup> If management has a choice of financial reporting frameworks, paragraph .18a requires that the explanation of management’s responsibility for the financial statements also make reference to its responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances.

<sup>2</sup> The subtitle “Report on the Financial Statements” is unnecessary in circumstances when the second subtitle “Report on Other Legal and Regulatory Requirements” is not applicable.

effectiveness of the partnership's internal control.<sup>3</sup> Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### ***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the assets, liabilities, and capital of ABC Partnership as of December 31, 20X1, and its revenue and expenses and changes in partners' capital accounts for the year then ended in accordance with the basis of accounting the Partnership uses for income tax purposes described in Note X.

### ***Basis of Accounting***<sup>4</sup>

We draw attention to Note X of the financial statements, which describes the basis of accounting. The financial statements are prepared on the basis of accounting the Partnership uses for income tax purposes, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

### ***Report on Other Legal and Regulatory Requirements***

*[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]*

*[Auditor's signature]*

*[Auditor's city and state]*

*[Date of the auditor's report]*

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<sup>3</sup> In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances." In addition, the next sentence, "Accordingly, we express no such opinion." would not be included.

<sup>4</sup> Another appropriate heading may be used.

### **Illustration 3—An Auditor’s Report on a Complete Set of Financial Statements Prepared in Accordance With a Regulatory Basis of Accounting (the Financial Statements Together With the Auditor’s Report Are Not Intended for General Use)**

Circumstances include the following:

- The financial statements have been prepared by management of the entity in accordance with the financial reporting provisions established by a regulatory agency (that is, a special purpose framework).
- The financial statements together with the auditor's report are not intended for general use.
- Based on the regulatory requirements, management does not have a choice of financial reporting frameworks.<sup>1</sup>

#### **Independent Auditor's Report**

[Appropriate Addressee]

#### ***Report on the Financial Statements***<sup>2</sup>

We have audited the accompanying financial statements of ABC City, Any State, which comprise cash and unencumbered cash for each fund as of December 31, 20X1, and the related statements of cash receipts and disbursements and disbursements—budget and actual for the year then ended, and the related notes to the financial statements.

#### ***Management’s Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the financial reporting provisions of Section Y of Regulation Z of Any State. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

#### ***Auditor’s Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the

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<sup>1</sup> If management has a choice of financial reporting frameworks, paragraph .18a requires that the explanation of management's responsibility for the financial statements also make reference to its responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances.

<sup>2</sup> The subtitle "Report on the Financial Statements" is unnecessary in circumstances when the second subtitle "Report on Other Legal and Regulatory Requirements" is not applicable.

entity's internal control.<sup>3</sup> Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### ***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the cash and unencumbered cash of each fund of ABC City as of December 31, 20X1, and their respective cash receipts and disbursements, and budgetary results for the year then ended in accordance with the financial reporting provisions of Section Y of Regulation Z of Any State described in Note X.

### ***Basis of Accounting***<sup>4</sup>

We draw attention to Note X of the financial statements, which describes the basis of accounting. As described in Note X to the financial statements, the financial statements are prepared by ABC City on the basis of the financial reporting provisions of Section Y of Regulation Z of Any State, which is a basis of accounting other than accounting principles generally accepted in the United States of America, to meet the requirements of Any State. Our opinion is not modified with respect to this matter.

### ***Restriction on Use***<sup>5</sup>

Our report is intended solely for the information and use of ABC City and Any State and is not intended to be and should not be used by anyone other than these specified parties.

### ***Report on Other Legal and Regulatory Requirements***

*[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]*

*[Auditor's signature]*

*[Auditor's city and state]*

*[Date of the auditor's report]*

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<sup>3</sup> In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances." In addition, the next sentence, "Accordingly, we express no such opinion." would not be included.

<sup>4</sup> Another appropriate heading may be used.

<sup>5</sup> Another appropriate heading may be used.

## **Illustration 4—An Auditor’s Report on a Complete Set of Financial Statements Prepared in Accordance With a Regulatory Basis of Accounting (the Financial Statements Together With the Auditor’s Report Are Intended for General Use)**

Circumstances include the following:

- The financial statements have been prepared by management of the entity in accordance with the financial reporting provisions established by a regulatory agency (that is, a special purpose framework).
- The financial statements together with the auditor's report are intended for general use.
- Based on the regulatory requirements, management does not have a choice of financial reporting frameworks.<sup>1</sup>
- The variances between the regulatory basis of accounting and accounting principles generally accepted in the United States of America (U.S. GAAP) are not reasonably determinable and are presumed to be material.

### **Independent Auditor's Report**

[Appropriate Addressee]

#### ***Report on the Financial Statements***<sup>2</sup>

We have audited the accompanying financial statements of XYZ City, Any State, which comprise cash and unencumbered cash for each fund as of December 31, 20X1, and the related statements of cash receipts and disbursements and disbursements—budget and actual for the year then ended, and the related notes to the financial statements.

#### ***Management’s Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the financial reporting provisions of Section Y of Regulation Z of Any State. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

#### ***Auditor’s Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error.

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<sup>1</sup> If management has a choice of financial reporting frameworks, paragraph .18a requires that the explanation of management's responsibility for the financial statements also make reference to its responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances.

<sup>2</sup> The subtitle "Report on the Financial Statements" is unnecessary in circumstances when the second subtitle "Report on Other Legal and Regulatory Requirements" is not applicable.

In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.<sup>3</sup> Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

***Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles***

As described in Note X of the financial statements, the financial statements are prepared by XYZ City on the basis of the financial reporting provisions of Section Y of Regulation Z of Any State, which is a basis of accounting other than accounting principles generally accepted in the United States of America, to meet the requirements of Any State.

The effects on the financial statements of the variances between the regulatory basis of accounting described in Note X and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

***Adverse Opinion on U.S. Generally Accepted Accounting Principles***

In our opinion, because of the significance of the matter discussed in the "Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles" paragraph, the financial statements referred to above do not present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position of each fund of XYZ City as of December 31, 20X1, or changes in financial position or cash flows thereof for the year then ended.

***Opinion on Regulatory Basis of Accounting***

In our opinion, the financial statements referred to above present fairly, in all material respects, the cash and unencumbered cash of each fund of XYZ City as of December 31, 20X1, and their respective cash receipts and disbursements, and budgetary results for the year then ended in accordance with the financial reporting provisions of Section Y of Regulation Z of Any State described in Note X.

***Report on Other Legal and Regulatory Requirements***

*[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]*

*[Auditor's signature]*

*[Auditor's city and state]*

*[Date of the auditor's report]*

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<sup>3</sup> In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances." In addition, the next sentence, "Accordingly, we express no such opinion." would not be included.

## Illustration 5—An Auditor’s Report on a Complete Set of Financial Statements Prepared in Accordance With a Contractual Basis of Accounting

Circumstances include the following:

- The financial statements have been prepared by management of the entity in accordance with a contractual basis of accounting (that is, a special purpose framework) to comply with the provisions of that contract.
- Based on the provisions of the contract, management does not have a choice of financial reporting frameworks.<sup>1</sup>

### **Independent Auditor’s Report**

[Appropriate Addressee]

#### ***Report on the Financial Statements***<sup>2</sup>

We have audited the accompanying financial statements of ABC Company, which comprise the assets and liabilities—contractual basis as of December 31, 20X1, and the revenues and expenses—contractual basis, changes in equity—contractual basis, and cash flows—contractual basis for the year then ended, and the related notes to the financial statements.

#### ***Management’s Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the financial reporting provisions of Section Z of the contract between ABC Company and DEF Company dated January 1, 20X1 (the contract). Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

#### ***Auditor’s Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the

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<sup>1</sup> If management has a choice of financial reporting frameworks, paragraph .18a requires that the explanation of management’s responsibility for the financial statements also make reference to its responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances.

<sup>2</sup> The subtitle "Report on the Financial Statements" is unnecessary in circumstances when the second subtitle "Report on Other Legal and Regulatory Requirements" is not applicable.

entity's internal control.<sup>3</sup> Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### ***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the assets and liabilities of ABC Company as of December 31, 20X1, and revenues, expenses, changes in equity, and cash flows for the year then ended in accordance with the financial reporting provisions of Section Z of the contract.

### ***Basis of Accounting***<sup>4</sup>

We draw attention to Note X of the financial statements, which describes the basis of accounting. The financial statements are prepared by ABC Company on the basis of the financial reporting provisions of Section Z of the contract, which is a basis of accounting other than accounting principles generally accepted in the United States of America, to comply with the financial reporting provisions of the contract referred to above. Our opinion is not modified with respect to this matter.

### ***Restriction on Use***<sup>5</sup>

Our report is intended solely for the information and use of ABC Company and DEF Company and is not intended to be and should not be used by anyone other than these specified parties.

### ***Report on Other Legal and Regulatory Requirements***

*[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]*

*[Auditor's signature]*

*[Auditor's city and state]*

*[Date of the auditor's report]*

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<sup>3</sup> In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances." In addition, the next sentence, "Accordingly, we express no such opinion." would not be included.

<sup>4</sup> Another appropriate heading may be used.

<sup>5</sup> Another appropriate heading may be used.