Audits of specialised areas

MODULE 5 | 5.1 | STUDENT COMPANION

When users need assurance on something narrower or more tailored than complete general purpose financial statements, three standards apply: **ASA 800** (special purpose frameworks), **ASA 805** (a single statement, or a specific element, account or item) and **ASA 810** (summary financial statements). For the first two, every relevant auditing standard applies, adapted to the narrower subject; for a summary, the auditor reports under ASA 810's own requirements, which build on its audit of the full statements.

Three engagements, three standards

Assurance on something narrower or more tailored than a full set of general purpose statements

ASA 800 (ISA 800)	ASA 805 (ISA 805)	ASA 810 (ISA 810)
Special purpose framework	**One statement, or one element**	**Summary financial statements**
Financial statements prepared under a framework built for particular users, such as the reporting rules in a contract or a regulator's requirements. Met in Module Four.	A single statement, such as cash receipts and payments; or one element, account or item, such as a schedule of royalties, a list of receivables, or grant income and spending for a funding body	Drawn from audited financial statements, but with less detail, for readers such as members or customers

ASA 800 and ASA 805: every auditing standard relevant to the audit applies, adapted to the narrower subject. **ASA 810:** the auditor reports under its own standard, which builds on its audit of the full statements

Special purpose frameworks (ASA 800) are built for particular users: the reporting rules in a loan agreement or joint venture contract, a regulator's requirements, or a cash basis. Before accepting, the auditor asks why the statements are prepared, who will rely on them and how management judged the framework acceptable; Module Four covered the report and its warning that the statements may not suit other purposes. An element prepared under such a framework, such as a lease's definition of gross sales, brings ASA 805 and ASA 800 together.

Auditing a single element

Ferngrove (imagined cafe chain)

Its lease: base rent plus 6% of gross sales above $1 million a year, and an audited statement of gross sales prepared under the lease's definition

1. **Materiality set for the element**
   Judged against gross sales and the rent they drive: $50,000 might not matter to a large group's statements, but it matters here
2. **Attention to related accounts**
   Refunds, discounts and cash takings all feed into the gross sales figure
3. **The framework that defines it**
   The lease's own definition: are gift cards counted when sold or when used? Are delivery-app sales in or out?
4. **An opinion on that element alone**
   Is the statement of gross sales prepared, in all material respects, in line with the lease's definition?

The main planning risk: gross sales understated to cut the rent

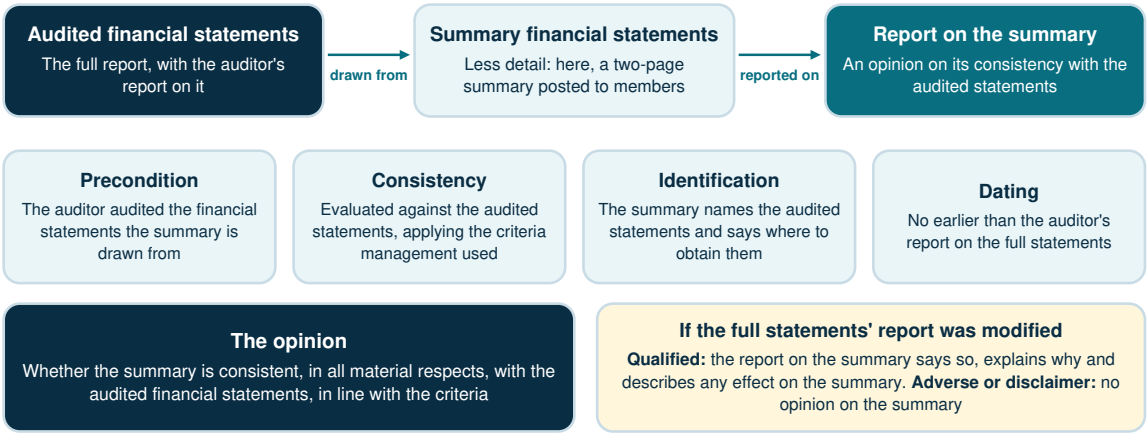
Before accepting an element audit, the auditor checks that the definition can actually be applied the same way every time; at Ferngrove, that means knowing when gift card sales count and whether delivery-app sales are in. **Materiality** is then judged against the element and the people who use it, not the whole entity. A $50,000 misstatement is probably too small to change how investors see a large group, but above Ferngrove's $1 million threshold it changes the extra rent by $3,000 (6% of $50,000), so the landlord and the tenant both care.

If the same auditor also audits the full financial statements

Each engagement gets its own report and opinion; an element published with the full statements must be clearly set apart from them, so readers don't confuse the two opinions.

Report on the complete set	What it means for the element
Modified opinion, or an Emphasis of Matter or Other Matter paragraph	Decide what effect it has on the element; where relevant, modify the element's opinion or add a similar paragraph
Adverse opinion or disclaimer	No unmodified opinion on an element that forms a major part of the complete set, or on any single statement in it (a single statement always counts as a major part), because it would contradict the overall conclusion
Adverse or disclaimer, and the element is only a minor part	An unmodified opinion on the element is possible only if law allows it and its report is not published with the report on the complete set

Reporting on summary financial statements



Before accepting, the auditor confirms that it audited, or will audit, the statements the summary comes from; that management's criteria for the summary are acceptable; and that management will prepare the summary on those criteria, make the audited statements easy to obtain, and put the auditor's report alongside the summary in any document that says the auditor has reported on it. **The work** asks: do the figures agree with, or recalculate from, the audited statements? Does the summary say it is a summary and where the full statements are? Does it leave out anything that would make it misleading?

When the report on the full statements is modified

For the imagined building society, whose members get a two-page summary with the full report online, the report on the summary follows whatever happened to the full statements.

Report on the full statements	Report on the summary
Qualified opinion	The opinion on the summary can still be given if the summary is consistent. The report adds that the full statements received a qualified opinion, describes the basis for it and the opinion itself, and explains the effect, if any, on the summary
Adverse opinion or disclaimer	No opinion on the summary: the report says so, describes the basis, and states that it is therefore inappropriate to give an opinion on the summary
The summary itself isn't consistent, and management won't fix it	An adverse opinion on the summary

Practice questions

MODULE 5 | 5.1 | TRY THESE BEFORE THE WORKED ANSWERS

Question 1 - Which kind of specialised audit?

Is each engagement an audit of special purpose statements, of a single statement or element, or of summary statements? Name the Australian standard that applies.

Engagement (all imagined)	Special purpose, single element or summary?	Standard(s)
(a) Pinkwater Salt, a joint venture between two companies, prepares a full set of financial statements using the reporting rules in its joint venture agreement, for the two venturers		
(b) Parkhaven Pty Ltd runs a council's multi-storey car park and pays the council 40% of the fees it collects. The contract requires an audited schedule of fees collected, using the contract's definitions		
(c) Mulga Infrastructure Fund, a listed fund, posts its unit holders a four-page summary drawn from its audited annual financial statements, saying where the full report can be found		
(d) The buyer of Trevally Seafoods Pty Ltd wants an audited statement of financial position, on its own, at the date the sale is completed		
(e) Lantern Bridge Foundation, a charity, prepares financial statements for an overseas donor using the donor's own reporting guidelines		

Question 2 - Plan the audit of a franchisee's gross sales

Juniper Bay Washes Pty Ltd (imagined) runs three car-wash sites in the Sparkway Car Wash franchise network (also imagined). The franchise agreement charges a royalty of 7% of gross sales and requires an audited statement of gross sales each year, using the agreement's definition: all amounts received or receivable for washes and wash products, excluding GST and refunds. Customers pay by card at the automatic bays, with coins and notes at the self-serve bays, through monthly memberships billed in an app, or on monthly invoices for fleet customers. Juniper Bay also sells prepaid wash cards through a nearby fuel station. Gross sales are about $2.6 million a year. Plan the audit of the statement of gross sales, including materiality and the key risks.

Question 3 - A summary after a qualified opinion

Milkwood Valley Co-operative (imagined), owned by its dairy-farmer members, sends each member a two-page summary drawn from its audited financial statements. This year the auditor's report on the full statements contains a qualified opinion: the board refused to recognise a $2.4 million impairment of a cheese factory that has stood idle since March, which the auditor judges material but not pervasive. The summary is drawn accurately from the full statements. Explain how the auditor's report on the summary should differ from last year's report, which accompanied an unmodified opinion.

Worked answers

MODULE 5 | 5.1 | WORKED ANSWERS - ATTEMPT THE QUESTIONS FIRST

Question 1 - Kinds of specialised audit

Engagement	Kind	Standard(s) and why
(a) Pinkwater Salt	Special purpose statements	ASA 800: a full set, but prepared under the agreement's reporting rules for two specific users
(b) Parkhaven	Specific element	ASA 805 with ASA 800: one item (fees collected), measured under the contract's definitions; materiality set for the schedule
(c) Mulga Infrastructure Fund	Summary	ASA 810: drawn from audited statements. The auditor can report on it only if it audited the full statements
(d) Trevally Seafoods	Single statement	ASA 805: one statement on its own. If it follows the accounting standards' rules for that statement, ASA 805 alone; if the sale contract sets the rules, ASA 800 as well
(e) Lantern Bridge Foundation	Special purpose statements	ASA 800: the donor's guidelines are a framework built for one user's needs

Question 2 - Juniper Bay Washes (sample plan)

Area	Plan
Acceptance and the framework	Read the agreement's definition and check it can be applied consistently: are prepaid wash cards counted when sold or when used, and at the price paid? Are memberships counted when billed? Are free washes for staff or complaints excluded? Settle unclear points in writing with both parties, and confirm that management accepts responsibility for the statement
Materiality	Set for the statement and its users, not for Juniper Bay as a whole. The franchisor uses every dollar to calculate the royalty, so materiality is low: for example, about 0.5% of expected gross sales (around $13,000, which would move the royalty by about $900), with lower performance materiality. Nature matters too: a deliberate understatement of any size would matter
Key risks	**Understatement** to cut the royalty: cash from the self-serve bays not banked or not recorded; fleet invoices or memberships left out; sales recorded net of discounts the agreement doesn't allow. **Misapplying the definition:** wash cards, memberships, refunds and GST. **Cut-off** at year end. **Completeness:** every site and every payment channel included
Related items	Refunds, discounts and promotional free washes; the liability for wash cards sold but not yet used; cash takings and bank deposits
Procedures	Reconcile card sales to the payment provider's settlement reports and bank statements; compare cash banked with each machine's coin and note counters; agree membership income to the app provider's reports and fleet sales to contracts and receipts; recalculate wash-card income on the agreed basis; compare each bay's wash counter, multiplied by average prices, with recorded sales by site and month, and check water and power use against wash numbers; test refunds, discounts and cut-off; obtain written representations
Reporting	An opinion on whether, in all material respects, the statement follows the agreement's definition, describing that framework and alerting readers that the statement may not suit other purposes

Question 3 - Milkwood Valley Co-operative (sample answer)

- **The opinion on the summary can still be given.** It states whether the summary is consistent, in all material respects, with the audited financial statements, in line with the criteria. Because the summary is drawn accurately from the full statements, it is consistent with them.
- **A new section on the full statements' report.** The report must state that the auditor's report on the full statements contains a qualified opinion, and describe both the basis for the qualification (the $2.4 million impairment of the idle cheese factory that the board refused to recognise) and the qualified opinion itself.
- **The effect on the summary.** Because the summary comes from those statements, the same misstatement is in it: property, plant and equipment, profit and equity are each overstated by about $2.4 million (before any tax effect). Members reading only the summary must be told this.
- **Dating.** The report on the summary can't be dated earlier than the report on the full statements.
- **Compare:** if the full statements had received an adverse opinion or a disclaimer, the report would say so, describe the basis, and state that it is therefore inappropriate to give an opinion on the summary.