

CHAPTER 1

Special purpose framework

This article aims to:

Summarise the key considerations for financial statements prepared for a specific set of users.



Introduction

An entity usually prepares general purpose financial statements as per the general-purpose framework. A general-purpose framework is designed to meet the common financial information needs of a wide range of users, e.g.:

- a. Financials prepared as per applicable Generally Accepted Accounting Principles (GAAP) for tax filing purposes
- b. Financials of a foreign subsidiary prepared as per Indian Accounting Standards (Ind AS)/ Accounting Standards (AS) for inclusion in the annual report.

The general-purpose framework i.e. Ind AS and AS are used for preparation and presentation of the financial statements. The Standards on Auditing (SA) issued by the Institute of Chartered Accountants of India (ICAI) apply to an audit of general-purpose financial statements.

However, under certain circumstances, an entity would be required to submit financial statements as per a special purpose framework or an audited single financial statement, specific elements, accounts, or items of a financial statement to a specific category of stakeholders. A special-purpose financial statement is a financial report that is intended for presentation to specific users, and it may accompany a complete set of financial

statements that is intended for general use, or it may be presented separately. The audits of such statements are conducted in accordance with all the SAs. The ICAI has also formulated special consideration standards which are also required to be followed by an auditor when undertaking such engagements.

Therefore, in addition to the application of all the SAs (in the 100-700 series), an auditor is also required to comply with:

- SA 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks* which deals with the audit of financial statements prepared in accordance with a special purpose framework, and
- SA 805, *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement* which deals with an audit of a single financial statement, a specific element, account or item of a financial statement to be prepared in accordance with a general or special purpose framework.

However, SA 805 does not apply to the report of a component auditor which is issued as a result of the work performed on the financial

information of a component at the request of a group engagement team for purposes of an audit of group financial statements.

As per SA 800, a special purpose framework is designed to meet the financial information needs of specific users, example:

- i. Financial statements prepared on cash receipts and disbursements basis of accounting for cash flow information that may be requested by the key supplier
- ii. Financial statements prepared as per the financial reporting provisions established by a regulator to meet the requirements of that regulator
- iii. Financial statements prepared as per the financial reporting provisions of a contract, such as a bond indenture, a loan agreement, or a project grant.

It is pertinent to note that, when financial statements are prepared based on the needs of a regulator, it should not be construed that such financial statements are special purpose financial statements. Special purpose financial statements are financial statements with a special purpose framework i.e. a financial reporting framework designed to meet the financial information needs of specific users. Special purpose financial

statements are not intended to meet the common information needs of a wide range of users.

Examples of single financial statement or the specific element, account or item of a financial statement are:

- i. An audited cashflow statement to be submitted to potential investors.
- ii. Accounts receivable, allowance for doubtful accounts receivable, inventory, the liability for accrued benefits of a private pension plan, the recorded value of identified intangible assets, or the liability for 'incurred but not reported' claims in an insurance portfolio, including related notes.
- iii. A schedule of externally managed assets and income of a private pension plan, including related notes.
- iv. A schedule of net tangible assets, including related notes.
- v. A schedule of disbursements in relation to a lease property, including explanatory notes.
- vi. A schedule of profit participation or employee bonuses, including explanatory notes.

Key considerations for the management while preparing financial statements under special circumstances

The financial statements (both general purpose financial statements and special purpose financial statements) can either be prepared as per the fair presentation framework or as per the compliance framework.

A fair presentation framework is a financial reporting framework that requires compliance with the requirements of the framework and:

- a. Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework, or
- b. Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in extremely rare circumstances.

A compliance framework is a financial reporting framework that requires compliance with the requirements of the framework but does not contain the acknowledgements in (a) or (b) above.

It is the primary responsibility of the management to prepare financial statements. In order to do so

following aspects need to be considered:

Purpose

The management should understand the purpose for which such financial statements are being prepared and its intended users.

Accounting framework

While preparing financial statements under a special purpose framework, it is essential to understand the financial information needs of the intended users in order to determine the acceptability of the appropriate financial reporting framework to be applied in the preparation of the financial statements. If the special purpose financial statements are prepared in accordance with the applicable accounting standards, then a proper explanation should be provided for any material departures from those accounting standards. The management should ensure that the appropriate accounting policies are applied consistently, judgements and estimates are reasonable and prudent so as to give a true and fair view of the state of affairs of the entity.

In case the financial statements are prepared as per the financial reporting provisions laid down by the regulator or as per the terms of a contract,

the same should be specified in the said financial statements.

Where the management intends to publish an audited single financial statement or an audited specific element of a financial statement together with the entity's audited complete set of financial statements, then the management should ensure that the presentation of such a single financial statement or of the specific element of a financial statement is sufficiently differentiated from the complete set of financial statements.

In certain situations, the laws or regulations may prescribe the financial reporting framework to be used by the management in the preparation of special purpose financial statements. In certain cases the financial reporting provisions are prescribed in a contract, then that reporting framework would be considered acceptable if the framework exhibits attributes of a normally acceptable financial reporting framework.

Adequate disclosures

Ensure that the special purpose financial statements contain adequate disclosures to enable the intended users to understand the information contained in the financial statements.



Key considerations for the auditor

Acceptance and planning

When accepting a special purpose audit, an auditor should consider the following:

- Understand the purpose for which the financial statements are prepared
- Understand the intended users
- Obtain an understanding of the steps taken by the management to determine that the applicable financial reporting framework is acceptable in the circumstances and the entity's selection and application of accounting policies
- Planning and performing the audit engagement to obtain sufficient and appropriate audit evidence
- Should ensure compliance with the applicable laws and regulations
- Communication with Those Charged with Governance (TCWG) regarding significant matters.

Compliance with SAs

SA 800 and SA 805 also draw reference to SA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with*

Standards on Auditing thereby requiring an auditor to comply with:

- The relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements, and
- All SAs relevant to the audit unless in certain circumstances of the audit, the auditor is of the view that the entire SA is not relevant, or the requirement is not relevant because it is conditional, and the condition does not exist.

Forming an opinion and reporting

When forming an opinion and reporting on special purpose financial statements or single financial statement or on a specific element of a financial statement, an auditor should comply with the requirements in SA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*¹.

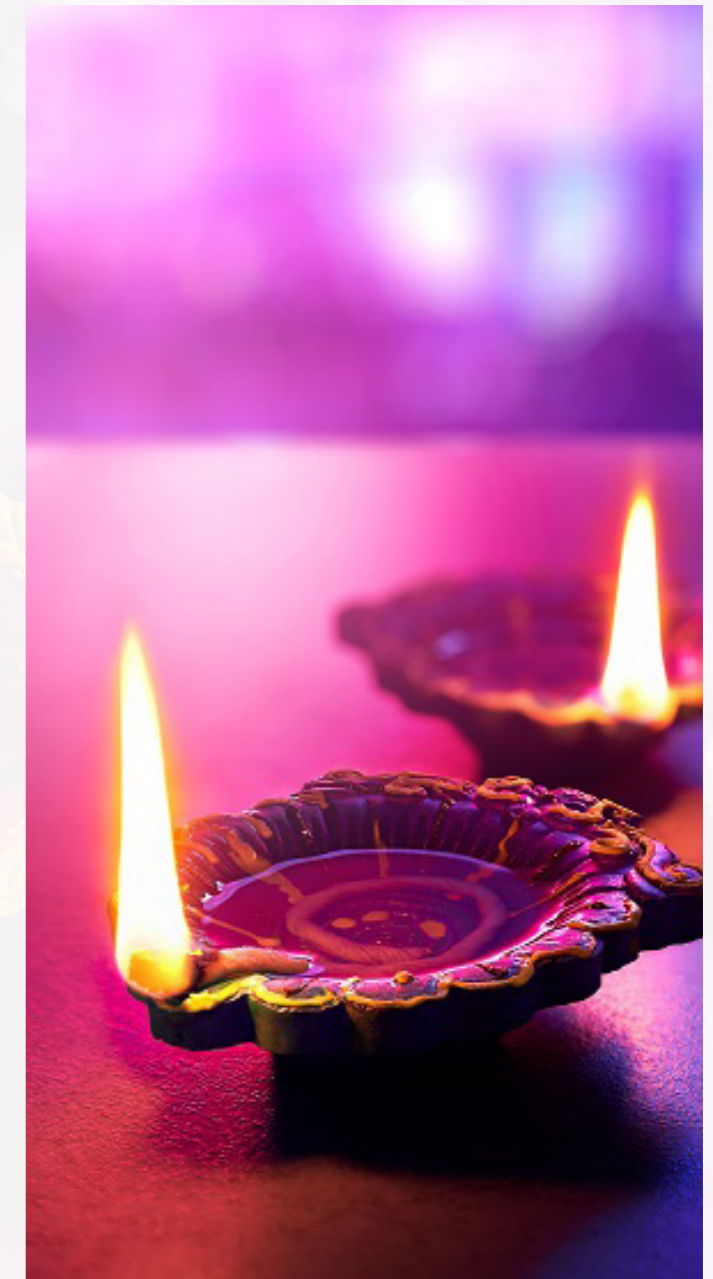
The report should also contain an explanation of the management's responsibility regarding the selection of the financial reporting framework and preparation of such financial statements. While auditing and reporting on special purpose financial statements or single financial statements or on a specific element of a financial statement, an auditor must take into consideration the impact of the following aspects included in the auditor's

report on the complete financial statements:

- Material uncertainty related to going concern as per SA 570 (Revised), *Going Concern*,
- Key audit matters in accordance with SA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*
- Other information as per SA 720, *The Auditor's Responsibilities Relating to Other Information*.

When reporting on special purpose financial statements under SA 800, the auditor's report should describe the purpose for which the financial statements are prepared and the intended users. or refer to the note in the special purpose financial statements that contains information which states that the financial statements are prepared in accordance with a special purpose framework and may not be suitable for another purpose. The auditor is required to do so by including an Emphasis of Matter (EOM) paragraph in the audit report.

¹ SA 700 (Revised) deals with the form and content of the auditor's report. It provides guidance with respect to the auditor's responsibility to form an opinion on the financial statements. SA 700 (Revised) requires an auditor to evaluate whether the financial statements are prepared, in all material respects, in accordance with the requirements of the applicable financial reporting framework. This evaluation should also be based on qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgements. In order to form an opinion about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, the auditor must obtain reasonable assurance



If an auditor undertakes an engagement under SA 805 to report on a single financial statement or on a specific element of a financial statement, then the auditor should not express an opinion on the effectiveness of the entity's internal control. Further, where an auditor has undertaken an engagement to report on the single financial statement or on a specific element of a financial statement in conjunction with an engagement to audit the entity's complete set of financial statements, the auditor should express a separate opinion for each engagement and must ensure that the presentation of a single financial statement or of the specific element of a financial statement sufficiently differentiates from a complete set of financial statements. If not, the auditor shall not issue the auditor's report containing the opinion on the single financial statement or on the specific element of a financial statement until the auditor is satisfied with the differentiation.

An auditor should not express an unmodified opinion on a single financial statement of a complete set of financial statements if the auditor has expressed an adverse opinion or disclaimed an opinion on the complete set of financial statements as a whole, unless the following conditions are satisfied:

- The auditor is not prohibited by law or regulation from doing so
- The opinion is expressed in an auditor's report that is not published together with the auditor's

report containing the adverse opinion or disclaimer of opinion, and

- The specific element does not constitute a major portion of the entity's complete set of financial statements.

Bottom line

Financial statements prepared under a special purpose framework or special circumstance are unique engagements that provide specific and relevant information to a specific group of users. Therefore, due consideration should be given by the management and the auditor to the requirements of such specific users. As the audit reports of general-purpose financial statements and special purpose financial statements are governed by two different auditing standards (SA 700 and SA 800), an auditor is expected to obtain clarity about the difference between the two frameworks. Further, auditors should exercise professional skepticism and should have professional experience for issuing such audit reports as it helps maintain stakeholder confidence in the assurance process.

