

Auditing Standard

**AUS 810**  
(July 2002)

# Special Purpose Reports on the Effectiveness of Control Procedures

Prepared by the **Auditing & Assurance Standards Board** of the  
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**AUDITING STANDARD**  
**AUS 810 “SPECIAL PURPOSE REPORTS ON THE**  
**EFFECTIVENESS OF CONTROL PROCEDURES”**

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**MAIN FEATURES OF THE STANDARD**

**The Standard:**

- (a) establishes standards and provides guidance on engagements to report in relation to special purpose reports about the effectiveness of control procedures;
- (b) differentiates the different types of engagements that an auditor can be engaged to undertake;
- (c) provides guidance on the audit process and procedures to be applied to engagements to report on control procedures;
- (d) provides guidance on the process for identifying suitable criteria against which to report; and
- (e) identifies the basic elements for reporting on control procedures and the circumstances that result in a modified opinion.

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### Introduction

- .01 The purpose of this Auditing Standard is to establish standards and provide guidance to auditors engaged to report to either:
- (a) an entity’s management either at the governing body or operational level; or
  - (b) a specified third party, for example a regulator or another auditor,
- on whether control procedures for a specified area of activity are effective. It is recognised that an auditor may be engaged to report on design effectiveness, for example if evaluating a proposed system, or operating effectiveness, and not necessarily both. However, unless otherwise stated this Standard applies to engagements to report on both the design and operation of control procedures. This Standard does not deal with engagements to:
- (i) report publicly (ie. where the report is intended to meet the information needs common to users who are unable to command the preparation of reports tailored so as to satisfy specifically all of their information needs regarding control procedures for the area of activity); or
  - (ii) report on an entity’s entire internal control structure, control environment and/or information system.
- .02 ***The objective of an engagement to report on control procedures for a specific area of activity is for the auditor to provide:***
- (a) ***a level of assurance (in the case of an audit or review); or***
  - (b) ***a report of factual findings (in the case of agreed-upon procedures);***
- about the design and operating effectiveness of those procedures based on identified suitable criteria.***
- .03 This Standard is to be read in conjunction with Australian Auditing Standards applicable to performance audits, and other AUSs as indicated.

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### *Definitions*

- .04 “Area of activity” is the specific aspect(s) of the subject matter (internal control) relating to the entity’s activities that is being reported upon by the auditor, for example, compliance with specified laws, the preparation of annual financial reports, the management of risks in trading in financial derivatives or the effectiveness of motor vehicle fleet management.
- .05 “Attest reporting engagement” means an engagement where management makes a written assertion about the effectiveness of their control procedures, and the auditor provides an opinion to enhance the credibility of management’s assertion. The auditor’s report can either be in the form of an opinion:
- (a) about the effectiveness of the control procedures themselves. In this case, by expressing an opinion on the same subject matter as the written assertion by management, the auditor enhances the credibility of that assertion; or
  - (b) about management’s assertion about the effectiveness of the control procedures.
- The standards and guidance in this Standard are directed towards the former type of opinion. If the terms of the engagement require the latter type of opinion, the reporting requirements may need to be adapted.
- .06 “Control procedures” means those policies and procedures in addition to the control environment that management has established to ensure, as far as possible, that specific entity objectives will be achieved.
- .07 “Control weakness” means a deficiency in the design of control procedures or a deficiency in operation of a control procedure that could potentially result in risks relevant to the area of activity not being reduced to an acceptable level. Relevant risks are those that threaten achievement of the objectives relevant to the area of activity being examined.
- .08 “Criteria” means reasonable and attainable standards against which the effectiveness of the control procedures in relation to the area of activity can be assessed.

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- .09 “Direct reporting engagement” means an engagement where management does not make a written assertion about the effectiveness of their control procedures, and the auditor:
- (a) provides an opinion about the effectiveness of the control procedures; and
  - (b) when appropriate, provides relevant and reliable information about the procedures in the form of facts and findings.

- .10 “Internal control structure” (internal control) means the dynamic, integrated processes, effected by the governing body, management and all other staff, that are designed to provide reasonable assurance regarding the achievement of the following general objectives:
- (a) effectiveness, efficiency and economy of operations;
  - (b) reliability of management and financial reporting; and
  - (c) compliance with applicable laws and regulations and internal policies.

Management’s strategies for achieving these general objectives are affected by the design and operation of the following components:

- (i) the control environment;
- (ii) the information system; and
- (iii) control procedures.

Each of these components is discussed further in AUS 402 “Risk Assessments and Internal Controls”. The relationship between the general objectives and the components of internal control can be depicted as shown below<sup>1</sup>:

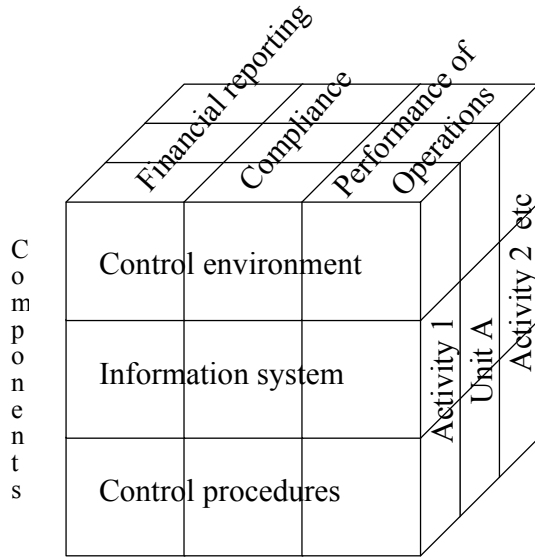
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<sup>1</sup> This diagram has been adapted from “Internal Control – Integrated Framework” the Committee of Sponsoring Organizations of the Treadway Commission (COSO), 1992.



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- .11 “Materiality” refers to the potential for knowledge of a control weakness to affect the decisions of the addressee of the auditor’s report.

**Assurance**

*Types of Engagement*

- .12 An auditor may be engaged to perform any of the following types of engagement:
- (a) audit (direct or attest);
  - (b) review (direct or attest); or
  - (c) agreed-upon procedures.

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*Audit and Review*

- .13 An audit provides a high but not absolute level of assurance about the effectiveness of control procedures. This is expressed as reasonable assurance in recognition of the fact that absolute assurance is rarely attainable due to such factors as the need for judgement, the use of testing, the inherent limitations of internal control and because much of the evidence available to the auditor is persuasive rather than conclusive in nature.
- .14 A review provides a moderate level of assurance about the effectiveness of control procedures. The level of assurance provided is less than that provided in an audit because the scope of the auditor’s work is less extensive than that of an audit, and the nature, timing and extent of the procedures performed do not provide sufficient appropriate audit evidence to enable the auditor to express a positive opinion. The objective of a review is to enable the auditor to state whether, on the basis of procedures which do not provide all the evidence that would be required in an audit, anything has come to the auditor’s attention that causes the auditor to believe that the control procedures were not effective based on identified criteria (expression of negative assurance). AUS 902 “Review of Financial Reports” is to be applied to the extent practicable in an engagement to review the effectiveness of control procedures.
- .15 Both audits and reviews of control procedures involve:
- (a) planning the engagement;
  - (b) evaluating the design effectiveness of control procedures;
  - (c) testing the operating effectiveness of the control procedures (the nature, timing and extent of testing will vary as between an audit and a review); and
  - (d) forming a conclusion about, and reporting on, the design and operating effectiveness of the control procedures based on the identified criteria. The conclusion for:
    - (i) an audit is expressed as a positive expression of opinion and provides a high level of assurance; or
    - (ii) a review is expressed as a statement of negative assurance and provides a moderate level of assurance only.

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- .16 To undertake either an audit or review, the auditor will need to be satisfied that sufficient knowledge can be obtained to meet the requirements of AUS 304 “Knowledge of the Business”.
- .17 The lower level of assurance provided by a review engagement is a reflection of the nature, timing and extent of tests of operating effectiveness, which will ordinarily be limited to discussion with entity personnel and inspection of the system in operation for deviations from the specified design. This may involve observation of, and enquiring about the operation of the internal controls for a small number of transactions or events. An audit however will, in addition, ordinarily involve reperformance of control procedures on a test basis to provide more evidence on which to base an opinion.
- .18 The auditor applies professional judgement in determining the specific nature, timing and extent of procedures to be conducted in either an audit or review. This will depend on the individual circumstances faced by the auditor. For example in a review engagement, the auditor may decide that additional examination procedures are required to dispel or confirm a suspicion that a significant control weakness exists. The performance of such additional examination procedures does not convert the engagement to an audit. These procedures relate to the resolution of a specific matter and do not necessarily provide all the evidence needed to raise the overall assurance capable of being provided from moderate to high.
- .19 Audits and reviews can result in either a direct report or an attest report, depending on whether management have made a written assertion about the effectiveness of their control procedures.

*Agreed-Upon Procedures*

- .20 An agreed-upon procedures engagement does not result in the expression of any assurance by the auditor. The auditor is engaged to carry out specific procedures to meet the information needs of those parties who have agreed to the procedures to be performed. The auditor issues a report of factual findings to those parties that have agreed to the procedures. The recipients must form their own conclusions from this report because the auditor has not determined the nature, timing and extent of procedures to be able to express any assurance. The report is restricted to those parties (for example, a regulatory body) that have agreed to the procedures to be performed, since others are not aware of the reasons for the procedures and may misinterpret the results.

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### *Engagement Mandate*

- .21 Where an engagement is to be undertaken to meet a regulatory or similarly imposed requirement, it is important that the auditor be satisfied that the type of engagement is clear from the relevant legislation or other source of the engagement mandate. If there is any uncertainty, it is recommended that the auditor and/or appointing party communicate with the relevant regulator or other party responsible for establishing or regulating the requirement and agree the engagement type and the assurance to be provided.
- .22 An auditor, who before the completion of an engagement, is requested to change the engagement from an audit to a review or agreed-upon procedures engagement, needs to consider the appropriateness of doing so, and cannot agree to a change where there is no reasonable justification for the change. For example, a change is not appropriate in order to avoid a modified report.

### *Scope of Standard*

- .23 Except as otherwise stated, the remainder of this AUS is directed towards audit engagements. For review engagements the auditor would apply this AUS in the context of AUS 902. For agreed-upon procedures engagements the auditor would apply this AUS in the context of AUS 904 “Engagements to Perform Agreed-upon Procedures”.

### *Limitations*

- .24 The auditor’s opinion is based on the procedures determined to be necessary for the collection of sufficient appropriate evidence, that evidence being persuasive rather than conclusive in nature. The assurance provided by an auditor on the effectiveness of internal controls is however restricted because of the nature of internal controls and the inherent limitations of any set of internal controls and their operations. These limitations include:
- (a) management’s usual requirement that the cost of an internal control does not exceed the expected benefits to be derived;
  - (b) most internal controls tend to be directed at routine rather than non-routine transactions/events;
  - (c) the potential for human error due to carelessness, distraction or fatigue, misunderstanding of instructions and mistakes in judgement;

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- (d) the possibility of circumvention of internal controls through the collusion of employees with one another or with parties outside the entity;
- (e) the possibility that a person responsible for exercising an internal control could abuse that responsibility, for example, a member of management overriding a control procedure;
- (f) the possibility that management may not be subject to the same internal controls applicable to other personnel; and
- (g) the possibility that internal controls may become inadequate due to changes in conditions, and compliance with procedures may deteriorate.

.25 Custom, culture, and the corporate governance system may inhibit fraud, error, or non-compliance with laws and regulations by management, but they are not infallible deterrents. An effective control environment, may help mitigate the probability of such fraud, error, or non-compliance with laws and regulations. Control environment factors such as an effective governing body, audit committee, and internal audit function may constrain improper conduct by management. Alternatively, an ineffective control environment may negate the effectiveness of control procedures within the internal control structure. For example, although an entity has good control procedures relating to compliance with environmental regulations, management may have a strong bias to suppress information about any detected breaches that would reflect adversely on the entity’s public image. The effectiveness of internal controls might also be affected by factors such as a change in ownership or control, changes in management or other personnel, or developments in the entity’s market or industry.

### Terms of Engagement

.26 ***The auditor and the appointing party should agree on the terms of the engagement.*** Particular attention needs to be paid to defining the area of activity to be examined and the criteria against which the effectiveness of control procedures are to be assessed. The agreed terms would ordinarily be included in legislation or a contract, or recorded in an engagement letter or other suitable form. It is important that the terms are clear as to whether the engagement is an audit, review or agreed-upon procedures engagement, and whether it is an attest or direct reporting engagement. The auditor would include in the engagement letter a reference to management’s responsibility for establishing and maintaining an effective internal

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control structure, including control procedures in relation to the area of activity.

**Planning**

- .27 ***The auditor should plan the work so that the engagement will be performed in an effective manner.*** This will affect the auditor’s judgement about what comprises sufficient appropriate audit evidence, and will also assist in determining the nature, timing and extent of audit procedures, to achieve the engagement objective.
- .28 ***In planning the engagement, the auditor should obtain a general understanding of the internal control structure and a more detailed understanding of the control procedures in relation to the area of activity to be examined.*** This may be done by making inquiries of appropriate personnel, inspecting documents, and observing activities and operations. The nature and extent of these procedures will vary from engagement to engagement, due to factors such as:
- (a) the entity’s size and complexity;
  - (b) the nature of the area of activity to be examined, including the objective(s) to which the control procedures are directed and the risk that those objectives will not be achieved;
  - (c) the extent to which information technology is used; and
  - (d) the documentation available.
- .29 The extent to which an understanding of the information technology controls is required, and the level of specialist skills necessary, will be affected by the complexity of the computer system, extent of computer use and importance to the entity, and the extent to which significant control procedures are incorporated into computer programs.
- .30 Where specialist skills are required the auditor would apply the guidance in AUS 206 “Quality Control for Audit Work” for experts employed by the auditor and AUS 606 “Using the Work of an Expert” for experts engaged by the entity or auditor.
- .31 ***The auditor should develop and document an engagement plan describing the expected scope and conduct of the engagement. The auditor should develop and document an audit program setting out the nature, timing and extent of procedures required to***

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*implement the plan. The plan and program should be revised as necessary during the course of the audit.* When developing the audit plan and program, the auditor would consider factors such as:

- (a) matters affecting the industry in which the entity operates, for example economic conditions, laws and regulations, and technology;
- (b) risks to which the business is exposed that are relevant to the area of activity being examined;
- (c) the quality of the control environment within the entity and the role of the governing body, audit committee and internal auditing;
- (d) knowledge of the entity’s internal control structure obtained during other engagements;
- (e) the extent of recent changes if any, in the entity, its operations or its internal control structure;
- (f) methods adopted by management to evaluate the effectiveness of the internal control structure;
- (g) preliminary judgements about significant risk;
- (h) the nature and extent of evidence likely to be available;
- (i) the nature of control procedures relevant to the subject matter and their relationship to the internal control structure taken as a whole; and
- (j) the auditor’s preliminary judgement about the effectiveness of the internal control structure taken as a whole and of the control procedures for the area of activity.

**Materiality**

.32 *The auditor should consider materiality when:*

- (a) *determining the nature, timing and extent of audit procedures; and*
- (b) *evaluating the effect of identified control weaknesses on the auditor’s conclusion.*

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The auditor applies the same considerations in a review as in an audit to judgements as to what is material, since such judgements are not affected by the level of assurance being provided.

- .33 Materiality is addressed in the context of the entity’s objectives relevant to the area of activity being examined, and whether the internal controls will reduce to an acceptably low level the risks that threaten achievement of those objectives.
- .34 When assessing materiality, the auditor would consider qualitative factors as well as quantitative factors. The following are examples of qualitative factors that may be relevant:
- (a) the purpose of the engagement and any specific requirements of the terms of the engagement;
  - (b) the economic, social, political and environmental impact of a control weakness;
  - (c) the importance of an identified control weakness in relation to the area of activity and the entity’s overall objectives;
  - (d) the impact of a centralised function (for example computer security, central budgeting or human resource management) on other parts of the entity;
  - (e) public perceptions and/or interest in the area of activity;
  - (f) the cost of alternative controls relative to their likely benefit; and
  - (g) the length of time an identified control weakness was in existence.

The auditor would also consider those factors affecting materiality and risk that are identified in AUS 808 “Planning Performance Audits”, paragraph .17.

### **The Link between Objectives, Risks, Control Procedures and Criteria**

- .35 Internal controls exist to reduce to an acceptably low level the risks that threaten achievement of the entity’s objectives. To implement effective internal controls, the entity needs to:
- (a) establish objectives;



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- (b) identify the significant risks that threaten achievement of those objectives; and
- (c) have in place control procedures that reduce those risks to an acceptable level.

Examples of each of these are attached as Appendix 2.

- .36 Objectives are set at various levels. At the highest level they may be represented by the entity’s mission or vision statement. These would be complemented at lower levels by specific objectives for each activity, for example the reliability of financial reporting and the efficient use of motor vehicles. Objectives need to be consistent throughout the entity because an internal control structure cannot provide reasonable assurance about the achievement of conflicting objectives, and therefore suitable criteria could not be established to assess the effectiveness of control procedures.
- .37 It is recognised that there are, legitimately, different approaches to establishing criteria. The basis for determining the criteria needs to be relevant to the engagement circumstances, and the level of detail at which criteria are set will also vary with the circumstances of each engagement. Criteria can be established by reference to the specific objectives for an area of activity, and expressed as the outcomes of the control process. For example, if the objective is to comply with applicable laws and regulations, the criteria expressed in terms of outcomes may be that all applicable laws and regulations are identified, communicated to all relevant staff and any instances of non-compliance detected are notified to the governing body on a timely basis. They can also be expressed in terms of relevant risks, or some combination of objectives and risks. Alternatively, criteria may be expressed in terms of the control policy or methodology establishing what should be in place to reduce the risks that threaten the achievement of the objective(s) to an acceptable level. When the criteria are related to residual risk, that is the risk left after the operation of control procedures, they will need to be expressed in such a way that it is clear the auditor is not responsible for forming an opinion about what level of risk is, or should be, acceptable to users.
- .38 Control procedures, for example segregation of duties, custodial controls, logic checks etc., are the mechanism by which entities seek to reduce the risks that threaten achievement of objectives. The internal control procedures are not therefore the criteria in their own right, but are assessed as to their effectiveness to determine whether the criteria have been achieved, for example that the objective(s) has

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been met and/or the risks that threaten the achievement of those objectives reduced to an acceptable level.

### *Suitable Criteria*

- .39 Suitable criteria need to be identified by the parties to the engagement and agreed by the appointing party and the auditor. The auditor may need to discuss the criteria to be used with management and the intended user of the report. Criteria can be either established or specifically developed. The auditor normally concludes that established criteria embodied in laws or regulations or issued by professions, associations or other recognised authorities that follow due process are suitable when the criteria are consistent with the objective. Other criteria may be agreed to by the addressee of the auditor’s report, or a party entitled to act on their behalf, and may also be specifically developed for the engagement.
- .40 In situations where the criteria have been specifically developed for the engagement, including where the auditor assists in developing suitable criteria, the auditor would obtain from the addressee or a party entitled to act on their behalf, acknowledgment that the specifically developed criteria are sufficient for the addressee’s purpose.

### *Assessing the Suitability of Criteria*

- .41 ***The auditor should determine that there are suitable criteria to enable the assessment of the effectiveness of the control procedures.*** Suitable criteria are those that are relevant to the matters being examined, are appropriate to the circumstances and are in a form that will allow for the expression of a meaningful opinion. At the initial planning stage, criteria may be identified at a relatively general level, however, more specific criteria will need to be identified for use during the engagement process. The auditor needs to be satisfied that specifically developed criteria do not result in a report that would be misleading to intended users.
- .42 Characteristics of suitable criteria include:
- (a) *Relevance:* Relevant criteria contribute to a conclusion to meet the engagement objective and assist decision-making by the intended user.
  - (b) *Reliability:* Reliable criteria result in consistent conclusions when used by other auditors in the same circumstances;

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- (c) *Neutrality*: Neutral criteria are free from any bias of the auditor or management and do not cause the auditor’s opinion to mislead the intended users;
- (d) *Understandability*: Understandable criteria are clearly stated and are not subject to significantly different interpretations;
- (e) *Completeness*: Complete criteria include all significant criteria necessary to assess internal controls in the circumstances.

These characteristics would be considered together in identifying and assessing the suitability of criteria. The relative importance of the characteristics in different circumstances is a matter of professional judgement and would, depending on the engagement mandate, be discussed with the user of the auditor’s report.

- .43 Criteria may need to be amended as the engagement proceeds. For example, more information may become available or the circumstances of the entity may change. This would ordinarily be discussed with the user of the auditor’s report.
- .44 AUS 808 deals further with criteria and factors to consider in assessing the suitability of criteria.

### *The Consequence of Unsuitable Criteria*

- .45 The auditor needs to consider whether the identified criteria are in a suitable form to allow for the expression of a meaningful opinion. ***If the auditor believes the identified criteria are unsuitable, the auditor should either:***
  - (a) ***agree on suitable criteria with the addressee of the auditor’s report, or a party entitled to act on their behalf, prior to continuing with the engagement. If unable to agree on suitable criteria, the auditor would not continue with the engagement; or***
  - (b) ***issue a qualified report where the auditor is required to perform the engagement under a legislative mandate.***

### **Internal Auditing**

- .46 ***During the planning phase, the auditor should determine whether the entity has an internal auditing function and its effect on the internal control structure.*** Internal auditing is an appraisal activity

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established within an entity as a service to the entity. Its functions include, among other things, examining, evaluating and monitoring the adequacy and effectiveness of other components of the internal control structure.

- .47 An effective internal auditing function will often allow a modification in the nature and/or timing, and/or a reduction in the extent, of procedures performed by the external auditor, but cannot eliminate them entirely. Where the entity has an internal auditing function, the external auditor would obtain an understanding and perform a preliminary assessment of internal auditing regarding:
- (a) its impact on the effectiveness of the control structure and, in particular, control procedures in relation to the subject matter; and
  - (b) its effect on procedures to be performed by the external auditor.

### Evaluating Design Effectiveness

- .48 ***The auditor should obtain a general understanding of the control environment and information system to identify matters that are likely to have a significant impact on the effectiveness of particular control procedures.*** Evaluating design effectiveness is done in the context of the auditor’s general understanding of the control environment and information system as gained for the purpose of planning the engagement. A weakness in the control environment could undermine the effectiveness of control procedures, and this would be taken into account in determining the nature, timing and extent of procedures to test operating effectiveness. However, unless specifically required by the terms of the engagement, the auditor is not expressing an opinion on the control environment and information system. This is recognised in the auditor’s report.
- .49 ***The auditor should evaluate the design effectiveness of the control procedures based on the identified criteria.*** This evaluation would be based on whether the control procedures have been suitably designed to reduce to an acceptably low level, the risks that threaten achievement of the objectives relevant to the area of activity. Where the auditor is unable to identify control procedures designed to provide reasonable assurance about the reduction of risk, this would constitute a weakness in relation to design effectiveness.
- .50 Where, in the auditor’s opinion, a material weakness exists which has extreme implications in relation to design effectiveness, the

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auditor would consider issuing a modified report without performing any tests of operating effectiveness. In such situations, an adverse opinion would ordinarily be appropriate.

- .51 Control consists of a number of integrated processes directed at the achievement of objectives. Some controls may have a pervasive effect on achieving many overall objectives, whereas others are designed with a particular objective in mind. Because of the pervasive nature of some controls, the auditor may often find several control procedures that affect the risks relevant to a particular objective. Consequently, where the auditor evaluates a control procedure as being ineffective for a particular objective the auditor would not, on this basis alone, conclude that a material weakness exists. Where a control procedure has been evaluated as ineffective however, the auditor will need to consider the effect of this evaluation on other control procedures.

### Testing Operating Effectiveness

- .52 ***The auditor should perform tests to obtain sufficient appropriate evidence about whether the control procedures are operating as contemplated in the evaluation of design effectiveness.*** Tests of operating effectiveness are concerned with how the control procedures were applied, the consistency with which they were applied, and by whom they were applied. The auditor would also need to consider the period of time over which the control procedures were applied. These tests ordinarily include procedures such as inquiry of appropriate personnel, inspection of relevant documentation, observation of the entity’s operations, and:
- (a) for an audit, detailed procedures to substantiate the effective operation of control procedures. Detailed procedures will include reperformance or other examination and follow-up of the application of significant control procedures; or
  - (b) for a review, inspection of the control procedures in operation for deviations from the specified design. This may involve observation of, and enquiring about the operation of the control procedures for a small number of transactions or events.
- .53 The auditor’s evaluation of the design effectiveness of control procedures often influences the nature, timing and extent of tests of operating effectiveness.

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- .54 The nature of a control procedure often influences the nature of tests of operating effectiveness that can be performed. For example, the auditor may examine evidence regarding control where such evidence exists, however documentary evidence regarding some control procedures often does not exist. In these circumstances, the tests of operating effectiveness may consist of inquiry and observation only. As such controls may operate only because of inquiry and observation and may not operate at other times during the period, the auditor would, in conjunction with those procedures, seek to obtain other supporting evidence by looking to the outcomes from the system, for example substantive testing of the accuracy of the information over which the controls operate.
- .55 The decision about what comprises sufficient appropriate audit evidence is a matter of professional judgement. The auditor would consider for example:
- (a) the nature of the area of activity;
  - (b) the significance of the control procedure in achieving the relevant objective(s);
  - (c) the nature and extent of any tests of operating effectiveness performed by the entity (management, internal auditing or other personnel); and
  - (d) the likelihood that the control procedure will not reduce to an acceptably low level the risks relevant to the objective(s). This may involve consideration of:
    - (i) the design effectiveness of the internal control;
    - (ii) changes in the volume or nature of transactions that might affect design or operating effectiveness (for example, an increase in the volume of transactions may make it tedious to identify and correct errors thus creating a disincentive to perform the control among entity personnel);
    - (iii) whether there have been any changes in the control procedure (personnel may not be aware of the change or may not understand the way it operates thus inhibiting effective implementation);
    - (iv) the interdependence of the control procedure upon other controls (for example the design of control procedures associated with the cash receipts

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function may be assessed as effective however their operating effectiveness may be poor due to a lack of segregation of duties);

- (v) changes in key personnel who perform the control procedure or monitor its performance (this may result in insufficient knowledge about how the control should operate);
- (vi) whether the control procedure is manual or computerised and the significance of the information system’s general controls (manual controls may allow a greater degree of override in a weak control environment, whereas adequately tested computer controls will consistently perform a function based on agreed specifications);
- (vii) the complexity of the control procedure (a complex procedure may promote non compliance if personnel are not adequately trained in the operation of the procedure);
- (viii) whether more than one control procedure achieves the same objective (the assessment of a procedure as ineffective would not necessarily preclude its objective from being achieved as other procedures that are pervasive in nature may address this objective); and
- (ix) whether there have been any changes in the processes adopted by an entity (for example, a change in a process may render a particular control procedure ineffective).

.56 Management, internal auditing or other entity personnel may provide the auditor with the results of their tests of the operating effectiveness of certain aspects of internal control. Although the auditor would consider the results of such tests when evaluating operating effectiveness, it is the auditor’s responsibility to obtain sufficient appropriate evidence to support the auditor’s opinion and, if appropriate, corroborate the results of such tests. When evaluating whether sufficient appropriate evidence has been obtained, the auditor would consider that evidence obtained through direct personal knowledge, observation, reperformance, and inspection is more persuasive than information obtained indirectly, such as from management, internal auditing or other entity personnel. Further, judgements about the sufficiency and appropriateness of evidence

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obtained and other factors affecting the auditor’s opinion, such as the significance of identified control weaknesses, should be those of the auditor.

### Period of Testing

#### *Current System*

- .57 Where the terms of the engagement require an opinion on the current control procedures only, that is the system in place at reporting date, the period of time over which the auditor would perform tests of operating effectiveness is a matter of judgement. This may vary with the nature of the control being tested and also with the frequency with which the procedures operate. Some procedures operate continuously, for example, in relation to sales, while others operate only at particular times, for example, procedure in relation to physical inventory counts. ***The tests of operating effectiveness should be performed over a period of time that is adequate to determine that the control procedures are operating effectively.***
- .58 Where control procedures have changed during the period subject to examination, the auditor would need to consider whether the new control procedures have been in place for a sufficient period to assess their effectiveness.

#### *Extended Period*

- .59 When the auditor is reporting in relation to an extended period of time, for example a full year, the auditor will need to consider whether the control procedures currently in use were in use throughout the period. If substantially different control procedures were used at different times during the period, the auditor would consider each separately.

### Management’s Representations

- .60 ***The auditor should obtain evidence that management acknowledges its responsibility for establishing and maintaining the entity’s internal control structure.*** This may be in the form of a published assertion or obtained from relevant minutes of meetings or by obtaining a written representation from management.

### Subsequent Events

- .61 ***The auditor should perform procedures designed to provide sufficient appropriate evidence that all matters up to the date of***



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*the auditor’s report that may impact upon the conclusion about the effectiveness of the internal control procedures have been identified.* This does not require an extension of the detailed audit procedures on which the initial conclusion was based at the specified date or period end. The procedures are limited to review of relevant reports, for example reports on control procedures, minutes of relevant committees and inquiry of management or other personnel as to significant non-compliance with control procedures.

- .62 The matters identified may:
- (a) provide additional evidence or reveal for the first time conditions that existed during the period on which the auditor is reporting; or
  - (b) provide evidence about conditions that existed subsequent to the period on which the auditor is reporting that may significantly affect the operation of the control procedures.
- .63 In the circumstances described in paragraph .62(a), the auditor would reassess any conclusions previously formed that are likely to be affected by the additional evidence obtained.
- .64 In the circumstances described in paragraph .62(b) when the auditor’s report has not already been issued:
- (a) in an attest engagement, the auditor would:
    - (i) include an emphasis of matter where the report by management adequately discloses the subsequent event; or
    - (ii) issue a qualified opinion if the report by management does not adequately disclose the subsequent event; and
  - (b) in a direct reporting engagement, the auditor would include as part of the description of facts and findings a section headed “Subsequent Events” describing the events and indicating they may affect the future effectiveness of the control procedures.
- .65 The auditor does not have any responsibility to perform procedures or make any inquiry after the date of the report. If however, after the date of the report, the auditor becomes aware of a matter identified in paragraph .62(a), the auditor would consider re-issuing the report. In an attest engagement where the report has already been issued,

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the new report would include an emphasis of matter discussing the reason for the new report. In a direct reporting engagement, the new report would discuss the reason for the new report in the description of facts and findings section under a heading “Subsequent Events”.

### Conclusions and Reporting

- .66 *The auditor should review and assess the conclusions drawn from the evidence obtained as the basis for forming an opinion on the effectiveness of the control procedures based on the identified criteria.*
- .67 *An auditor’s report about the effectiveness of control procedures should include the following:*
- (a) the title;*
  - (b) the addressee;*
  - (c) a description of the scope of the audit, including:*
    - (i) an identification or description of the area of activity;*
    - (ii) the criteria used as a basis for the auditor’s conclusion; and*
    - (iii) a statement that the maintenance of an effective internal control structure, including control procedures for the area of activity, is the responsibility of management;*
  - (d) where the engagement is an attest engagement, a statement identifying the source of managements representation about the effectiveness of control procedures;*
  - (e) a statement that the auditor has conducted the engagement in order to express an opinion on the effectiveness of control procedures;*
  - (f) an identification of the purpose for which the auditor’s report has been prepared and of those entitled to rely on it, and a disclaimer of liability for its use for any other purpose or by any other person;*

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- (g) a description of the criteria or disclosure of the source of the criteria;*
- (h) a statement that the audit has been conducted in accordance with Australian Auditing Standards;*
- (i) in rare and exceptional circumstances, when a departure from a basic principle or essential procedure may be necessary, as indicated in Miscellaneous Professional Statements APS 1.1 “Conformity with Auditing Standards”, the statement required under paragraph (h) should provide details of the particular basic principle(s) or essential procedure(s) that has been departed from together with the justification for the departure;*
- (j) further explanatory details about the variables that affect the assurance provided and other information as appropriate;*
- (k) a paragraph section headed “Inherent Limitations” stating that:*

  - (i) because of inherent limitations in any internal control structure, it is possible that fraud, error, or non-compliance with laws and regulations may occur and not be detected. Further, the internal control structure, within which the control procedures that have been audited operate, has not been audited and no opinion is expressed as to its effectiveness;*
  - (ii) an audit is not designed to detect all weaknesses in control procedures as it is not performed continuously throughout the period and the tests performed on the control procedures are on a sample basis; and*
  - (iii) any projection of the evaluation of the control procedures to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions, or that the degree of compliance with them may deteriorate;*
- (l) when the auditor’s opinion is qualified, a section headed “Qualification” which clearly describes the qualification;*

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- (m) an expression of opinion about whether, in all material respects and based on the identified criteria, the design and operation of control procedures in relation to the area of activity were effective;*
- (n) the auditor’s signature;*
- (o) the auditor’s address; and*
- (p) the date of the auditor’s report.*

- .68 Where the auditor undertakes a review engagement, the reporting principles in AUS 902.33 are to be adopted and applied. The report indicates that the auditor’s conclusion relates to design and operating effectiveness, and that the auditor’s work in relation to operating effectiveness was limited primarily to inquiries, inspection and minimal testing of the operation of the internal controls. The report includes a statement that an audit has not been performed, that the procedures undertaken provide less assurance than an audit and that an audit opinion is not expressed. The expression of negative assurance states that nothing has come to the auditor’s attention that cause the auditor to believe the entity’s control procedures were, in any material respect, ineffective in relation to the area of activity, based on the identified criteria.
- .69 In addition, the auditor may expand the report to include other information not intended as a qualification of the auditor’s opinion or statement. For example, a description of the facts and findings relating to particular aspects of the engagement recommendations about identified control weaknesses and control weaknesses not considered significant because the cost of control exceeds the benefit. When considering whether to include any such information the auditor assesses the materiality of that information in the context of the objectives of the engagement. Additional information is not to be worded in such a manner that it may be regarded as a qualification of the auditor’s opinion or statement.
- .70 If the criteria are adequately described in a source that is readily accessible to the addressee of the auditor’s report, the auditor may identify those criteria by reference, rather than by repetition of the description in the auditor’s report or an appendix to the report. For example, if the criteria are published and generally available, or if they are detailed in an engagement letter.

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**Modifications to the Auditor’s Report**

.71 *The auditor’s report should be modified as indicated in the following table.* This table lists the circumstances in which a modified report would be issued and the type of opinion appropriate in the circumstances:

	Material but not extreme	Extreme
Scope limitation	“except for”	inability to form an opinion
Control weakness	“except for” <sup>2</sup>	adverse
Unsuitable criteria <ul style="list-style-type: none"> <li>• Contractual mandate</li> <li>• Legislative mandate</li> </ul>	No report (withdraw from engagement)  “except for”	No report (withdraw from engagement)  adverse
Subsequent Events <ul style="list-style-type: none"> <li>• Inadequate Disclosure</li> </ul>	“except for”	“adverse”

[An emphasis of matter would be used in the circumstances described in paragraph .64(a)(i).]

.72 In a modified auditor’s report, reference would be made to all relevant matters. For example, a qualification on one matter would not be regarded as a reason for omitting other, perhaps unrelated, qualifications which otherwise would have been reported.

*Scope Limitation*

<sup>2</sup> In an attest reporting engagement where the auditor’s opinion is to be expressed in terms of an opinion about management’s assertion, and management adequately identify the weakness in their assertion, an unqualified opinion with an emphasis of matter would be appropriate.

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- .73 A limitation on the scope of the auditor’s work may be imposed by the terms of the engagement or by the circumstances of the particular engagement. *When the limitation is imposed by the terms of the engagement, and the auditor believes that an inability to form an opinion would need to be expressed, the engagement should not be accepted or continued past the current period.*
- .74 *When a scope limitation is imposed by the circumstances of the particular engagement, the auditor should attempt to perform reasonable alternative procedures to overcome the limitation. When a scope limitation exists, the wording of the auditor’s opinion should indicate that it is qualified as to the effects of any significant weakness that might have been identified had the limitation not existed.*
- .75 Where a material weakness exists, the auditor will not be able to conclude that control procedures are effective. The type of report to be issued by the auditor will be determined by the significance of the weakness.
- .76 The duty of the auditor is to convey information, not merely arouse inquiry. *Whenever the auditor expresses a qualified opinion, the auditor’s report should include a clear description of all the substantive reasons therefor, and:*
- (a) *a description of the effect of all identified matters on the residual risk of not achieving relevant objectives; or*
  - (b) *if the auditor is unable to reliably determine the effect of a matter, a statement to that effect and the reasons therefor.*

### *Unsuitable Criteria – Legislative Mandate*

- .77 *When the auditor’s report is qualified as required by paragraph .45(b), it should:*
- (a) *state that in the auditor’s opinion the criteria are unsuitable;*
  - (b) *explain the reasons why the auditor believes the criteria are unsuitable.*

### **Reporting to Management**

- .78 During the course of the engagement the auditor may become aware of control weaknesses. *The auditor should report to an appropriate*

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*level of management on a timely basis any identified control weaknesses.* The engagement procedures are designed to gather sufficient appropriate evidence to form a conclusion in accordance with the terms of the engagement. In the absence of a specific requirement in the terms of engagement the auditor does not have a responsibility to design procedures to identify matters that may be appropriate to report to management.

- .79 Certain matters may be of such importance that they would be reported to the audit committee or the governing body of the entity. Unless stated otherwise in the terms of engagement, less important matters would be reported to a level of management that has the authority to take appropriate action.

### **Operative Date**

- .80 This AUS, which incorporates amendments made by AUS/AGS Omnibus 3 “Miscellaneous Amendments to AUSs and AGSs”, is operative from July 2002. This version of AUS 810 supersedes AUS 810 “Special Purpose Reports on the Effectiveness of Control Procedures”, as revised in May 1999.

### **Compatibility with International Standards on Auditing**

- .81 There is no corresponding International Auditing Standard.

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*APPENDIX 1*

Examples of Audit Reports

**Example 1: Unqualified Attest Report [In the form of an opinion about the effectiveness of the control procedures themselves – refer paragraph .05]**

**INDEPENDENT AUDIT REPORT**

To *addressee*

Scope

We have audited [name of entity] control procedures in relation to [area of activity] [as at/for the period] ended [date] in order to express an opinion about their effectiveness based on [describe or identify criteria].

[The area of activity and the criteria would be identified either:

- (a) by cross-reference to an accessible source, for example an engagement letter; or
- (b) described in full here or in another place in the report. If a detailed description is appropriate to the circumstances of the engagement, it may be appropriate to include details under separate headings or as attachments.]

The [members of the governing body] are responsible for maintaining an effective internal control structure including control procedures in relation to [area of activity]. Management's assertion about the effectiveness of these control procedures is included in the accompanying report [title of report]. We have conducted an independent audit of the control procedures in order to express an opinion on them to [addressee].

Our audit has been conducted in accordance with Australian Auditing Standard AUS 810 “Special Purpose Reports on the Effectiveness of Control Procedures” and accordingly included such tests and procedures as we considered necessary in the circumstances. These procedures have been undertaken to form an opinion whether in all material respects, the control procedures in relation to [area of activity] were adequately designed and operated effectively based on the criteria referred to above.

This report has been prepared for distribution to [addressee] for the purpose of [explain purpose]. We disclaim any assumption of responsibility for any reliance on this report to any person other than [addressee], or for any purpose other than that for which it was prepared.



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**Inherent Limitations**

Because of the inherent limitations of any internal control structure it is possible that fraud, error, or non-compliance with laws and regulations may occur and not be detected. Further, the internal control structure, within which the control procedures that we have audited operate, has not been audited and no opinion is expressed as to its effectiveness.

An audit is not designed to detect all weaknesses in control procedures as it is not performed continuously throughout the period and the tests performed are on a sample basis.

Any projection of the evaluation of control procedures to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions, or that the degree of compliance with them may deteriorate.

The audit opinion expressed in this report has been formed on the above basis.

**Findings** [or other appropriate heading or headings]

[Additional details per paragraphs .67(j) and .69 as appropriate]

**Audit Opinion**

In our opinion, [name of entity] maintained, in all material respects, effective control procedures in relation to [area of activity] [as at/for the period] ended [date] based on the criteria referred to above.

Date	Firm
Address	Partner

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**Example 2: Unqualified Attest Report [In the form of an opinion on managements assertion about the effectiveness of the control procedures – refer paragraph .05]**

**INDEPENDENT AUDIT REPORT**

To *addressee*

Scope

We have audited the assertions made by [governing body of other appropriate party] which are contained in [identify report and report date] that the [name of entity] control procedures in relation to [area of activity] [as at/for the period] ended [date] are effective based on [describe or identify criteria].

[The area of activity and the criteria would be identified either:

- (a) by cross-reference to an accessible source, for example an engagement letter; or
- (b) described in full here or in another place in the report. If a detailed description is appropriate to include details under separate headings or as attachments.]

The [members of the governing body] are responsible for maintaining an effective internal control structure including control procedures in relation to [area of activity]. We have conducted an independent audit in order to express an opinion on the assertions by [governing body or other appropriate party] to [addressee].

Our audit has been conducted in accordance with Australian Auditing Standard AUS 810 “Special Purpose Reports on the Effectiveness of Control Procedures” and accordingly included such tests and procedures as we considered necessary in the circumstances. These procedures have been undertaken to form an opinion whether in all material respects, the control procedures in relation to [area of activity] were adequately designed and operated effectively based on the criteria referred to above in order to support our opinion on the assertions contained in the [report of the governing body or other appropriate party] [date].

This report has been prepared for distribution to [addressee] for the purpose of [explain purpose]. We disclaim any assumption of responsibility for any reliance on this report to any person other than [addressee], or for any purpose other than that for which it was prepared.

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**Inherent Limitations**

Because of the inherent limitations of any internal control structure it is possible that fraud, error, or non-compliance with laws and regulations may occur and not be detected. Further, the internal control structure, within which the control procedures that we have audited operate, has not been audited and no opinion is expressed as to its effectiveness.

An audit is not designed to detect all weaknesses in control procedures as it is not performed continuously throughout the period and the tests performed are on a sample basis.

Any projection of the evaluation of control procedures to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions, or that the degree of compliance with them may deteriorate.

The audit opinion expressed in this report has been formed on the above basis.

**Findings** [or other appropriate heading or headings]

[Additional details per paragraphs .67(j) and .69 as appropriate]

**Audit Opinion**

In our opinion, the assertion by the [governing body] that [name of entity] [has/has not] maintained, in all material respects, effective control procedures in relation to the [area of activity] [as at/for the period] ended [date] based on the criteria referred to above, is fairly stated.

Date	Firm
Address	Partner

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### **Example 3: Unqualified Direct Report**

A direct report would be the same as the attest report except that the following sentence would be deleted from the first paragraph of the “Scope” section in Example 1:

“Management's assertion about the effectiveness of the internal controls in relation to [area of activity] is included in the accompanying report [title of report]”.

### **Example 4: Modified Audit Report – Material, but not extreme, control weakness identified**

The following qualification section and opinion section would be used in Example 1:

#### **Qualification**

Our evaluation of the design of the internal controls identified a material weakness in relation to control procedures in the [area of activity]. [Give details.] The effect of this design weakness is that the entity did not have reasonable assurance that the [specific objective] was being consistently achieved.

Further, our tests of operating effectiveness identified that the control procedures designed to ensure achievement of [specific objective] were not operating effectively. [Give details.] The entity could not therefore have had reasonable assurance that the [specific objective] was consistently achieved. (While management has taken steps to overcome this weakness [give details], the revised procedures have not been in place for a sufficient period for us to evaluate their effectiveness.)

#### **Qualified Audit Opinion**

In our opinion, except for the matters referred to in the qualification section, [name of entity] maintained, in all material respects, effective control procedures in relation to [area of activity] [as at/for the period] ended [date] based on the criteria referred to above.

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**Example 5: Modified Audit Report – Material, but not extreme, control weakness identified that was corrected during the period (extended period reporting only)**

The following qualification section and opinion section would be used in Example 1:

**Qualification**

Our tests of operating effectiveness identified that the control procedures designed to ensure achievement of [specific objective] were not operating effectively during the period [... to ...]. [Give details]. The entity could not therefore have had reasonable assurance that this objective was consistently achieved. Action taken by management rectified this situation as of [date].

**Qualified Audit Opinion**

In our opinion, except for the matter referred to in the qualification section, [name of entity] maintained, in all material respects, effective control procedures in relation to [area of activity] for the [period] ended [date] based on the criteria referred to above.

**Example 6: Unqualified Direct Review Report**

INDEPENDENT REVIEW REPORT

To *addressee*

**Scope**

We have reviewed [name of entity] control procedures in relation to [area of activity] [as at/for the period] ended [date]. The [members of the governing body] are responsible for maintaining an effective internal control structure including control procedures in relation to [area of activity]. We have conducted an independent review of the control procedures in order to state whether, on the basis of our examination as described, anything has come to our attention that would indicate that they are not adequately designed and effectively operated, in order to, based on [identify criteria].

[The area of activity and the criteria would be identified either:

- (a) by cross-reference to an accessible source, for example an engagement letter; or

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- (b) described in full here or in another place in the report. If a detailed description is appropriate to the circumstances to the engagement, it may be appropriate to include details under separate headings or as attachments.]

Our review has been conducted in accordance with Australian Auditing Standards AUS 902 “Review of Financial Reports” and AUS 810 “Special Purpose Reports on the Effectiveness of Control Procedures. A review is limited primarily to inquiries of entity personnel, inspection of evidence and observation of, and enquiry about, the operation of the control procedures for a small number of transactions or events.

**Inherent Limitations**

Because of the inherent limitations of any internal control structure it is possible that fraud, error, or non-compliance with laws and regulations may occur and not be detected. Further, the internal control structure, within which the control procedures that we have reviewed operate, has not been reviewed and no view is expressed as to its effectiveness.

A review is not designed to detect all weaknesses in control procedures as it is not performed continuously throughout the period and the tests performed are on a sample basis. Also, a review does not provide all the evidence that would be required in an audit, thus the level of assurance provided is less than given in an audit. We have not performed an audit and, accordingly, we do not express an audit opinion.

Any projection of the evaluation of control procedures to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions, or that the degree of compliance with them may deteriorate.

**Findings** (or other appropriate heading or headings)

[Additional details per paragraphs .67(j) and .69 as appropriate.]

**Statement**

Based on our review, which is not an audit, nothing has come to our attention that causes us to believe that [name of entity] did not maintain, in all significant respects, effective control procedures in relation to [area of activity] [as at/for the period] ended [date] based on the criteria referred to above.

Date	Firm
Address	Partner

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### APPENDIX 2

#### Examples of significant objectives, risks control elements and levels of remaining risks<sup>1</sup>

Objective 1	Objective 2	Objective 3
To comply with applicable laws and regulations	To secure ongoing funding for program delivery	To provide services to all eligible citizens

#### Significant risks related to these objectives

- |   |   |   |
|---|---|---|
| <ul style="list-style-type: none"> <li>• failure to identify applicable laws and regulations</li> <li>• failure to communicate applicable laws and regulations to staff</li> <li>• failure to promptly act on any instances of non-compliance of applicable laws and regulations</li> </ul> | <ul style="list-style-type: none"> <li>• failure to identify and cultivate new sources and means of funding</li> <li>• failure to manage the relations (communications, recognition, participation) with existing funders</li> <li>• increased competition for funding dollars</li> </ul> | <ul style="list-style-type: none"> <li>• the consequences of incorrectly refusing services to eligible citizens such as erosion of staff morale, loss of reputation with the community and funders, legal liability</li> <li>• the consequences of incorrectly providing services to ineligible citizens such as inefficient and ineffective use of limited resources, loss of reputation of the organisation with the community and funders, erosion of staff morale, loss of not-for-profit status</li> </ul> |
|---|---|---|

#### Key elements of control to manage these risks

- |   |  |   |
|---|--|---|
| <ul style="list-style-type: none"> <li>• ongoing monthly review of industry publications to identify applicable laws and regulations</li> <li>• yearly discussion with the organisation’s legal counsel</li> <li>• weekly staff meetings which provide an opportunity to discuss applicable laws and regulations, compliance with laws and regulations and to deal with the consequences of non-compliance</li> <li>• requirements in code of conduct to comply with applicable laws and regulations and to report any instances of non-compliance to the chief executive officers</li> <li>• organisational culture that encourages and rewards timely communication about “bad news”</li> </ul> | <ul style="list-style-type: none"> <li>• employment of a fundraising professional</li> <li>• development and approval by the board of directors of a three year fundraising plan</li> <li>• monthly reviews of fundraising results to date and projections for the next twelve months</li> <li>• semi-annual meetings with major funders</li> <li>• diversification of fundraising sources</li> <li>• a funders recognition program</li> </ul> | <ul style="list-style-type: none"> <li>• development of eligibility criteria for providing services which were approved by the board of directors</li> <li>• shared values within the organisation about mission of the organisation and the need to serve the community</li> <li>• training for staff to learn how to apply the criteria and approve eligibility</li> <li>• weekly reporting and analysis of the number of citizens receiving service and refused service</li> <li>• monitoring of a “complaints” program for people who were refused service</li> </ul> |
|---|--|---|

<sup>1</sup> Example based on material relating to a not-for-profit organisation adapted from the Canadian Institute of Chartered Accountants Criteria of Control Board “Guidance on Assessing Control – The CoCo Principles”, June 1997.

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