



*South African Auditing Practice Statement (SAAPS) 5*

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## **Reporting on Donor Funding Engagements**

### **Warning to Readers**

Registered auditors are alerted to the fact that the practice statement has not been updated for amendments to legislation that has been referenced, types and categories of donors and for amendments to:

- ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, effective for audits of financial statements for periods beginning on or after 15 December 2009;
- ISA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*, effective for audits of financial statements for periods beginning on or after 15 December 2009;
- ISRE 2400 (Revised), *Engagements to Review Historical Financial Statements*, effective for reviews of financial statements for periods ending on or after 31 December 2013;
- ISA 610 (Revised 2013), *Using the Work of Internal Auditors*; effective for audits of financial statements for periods ending on or after 15 December 2014;
- ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, effective for audits of financial statements for periods ending on or after 15 December 2016; and
- ISA 800, *Special Considerations – Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks*.

Registered Auditors should ensure that any report issued is in compliance with the Standards.

**REPORTING ON DONOR FUNDING ENGAGEMENTS**

**SOUTH AFRICAN AUDITING**

**PRACTICE STATEMENT 5**

**Reporting on Donor Funding Engagements**

**March 2007**

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**Appendix: Types and categories of donors, types and forms of entities that receive donor funding and issuing the appropriate report**

This South African Practice Statement (SAAPS) on *Reporting on Donor Funding Engagements* should be read in the context of the *Preface to the Standards on Quality Control, Auditing, Assurance and Related Services Adopted for Issue by the Auditing and Assurance Standards Board* (the predecessor body to the Committee for Auditing Standards), which sets out the application and authority of SAAPSs.

# REPORTING ON DONOR FUNDING ENGAGEMENTS

## Introduction

1. Donor funding is significant and important to South Africa's economy. The characteristics associated with donor funding results in specific considerations for the auditor when engaged to report on an entity that:
  - (a) provides donor funding (donor); or
  - (b) receives and distributes donor funding (intermediary); or
  - (c) receives donor funding (recipient).

## Scope of this SAAPS

2. This South African Auditing Practice Statement (SAAPS) provides guidance to auditors on the application of the International Auditing and Assurance Standards Board's (IAASB) Engagement Standards when engaged to report on an entity that is a donor, an intermediary or a recipient.
3. This SAAPS also provides guidance to an auditor of an entity that is a donor, an intermediary or a recipient, in respect of the auditor's considerations when engaged to report in terms of an assurance framework other than the IAASB Engagement Standards.
4. The following matters fall outside the scope of this practice statement:
  - The establishment of a financial reporting framework or a separate financial reporting standard according to which the financial statements or other historical financial information of an entity that is a donor, an intermediary or a recipient is prepared;
  - The establishment of an internal control framework for an entity that is a donor, an intermediary or a recipient;
  - Reporting on performance information against the achievement of objectives of the programmes for which the donor funding was provided; and
  - Conducting any other engagements that fall outside the IAASB Engagement Standards, such as an engagement to conduct forensic investigations.
5. The guidance contained in this SAAPS is not limited to the reporting considerations of the auditor of a not-for-profit organisation receiving donor funding, but applies to the reporting considerations of the auditor reporting on any entity that is a donor, an intermediary or a recipient.

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### Effective date

6. This SAAPS is effective.

### Objective to be achieved

7. In relation to this SAAPS, the objective of the auditor is to evaluate the nature of engagement to be performed at an entity that is a donor, an intermediary or a recipient so as to issue an appropriate report in the circumstances.
8. The guidance contained in this SAAPS does not establish new requirements for, or exemptions from, the requirements of the International Standards on Auditing (ISA), International Standards on Assurance Engagements (ISAE), International Standards on Review Engagements (ISRE) and International Standards on Related Services (ISRS), and should be read in conjunction with the applicable IAASB Engagement Standards. The auditor exercises professional judgment to determine the extent to which any of the guidance provided in this SAAPS may be appropriate in the light of the requirements of the international standards and the auditor's particular circumstances.

### Considerations in planning and performing the engagement

9. While this SAAPS does not seek to provide guidance on the considerations when planning and performing the engagement, other than those considerations relating to issuing an appropriate report in the circumstances, the auditor's attention is drawn to the requirements of ISA 240<sup>1</sup>, and ISA 250<sup>2</sup>. The auditor considers the guidance in the relevant ISAs, on the aspects of donor funding engagements performed in accordance with ISAs, ISAEs, ISREs and ISRSs. The auditor also considers the application of other standards and guidance required by donors in other jurisdictions to donor funding engagements where the IAASB's engagement standards do not apply.
10. The auditor's attention is drawn to the requirements of the Auditing Profession Act, 2005 (Act 26 of 2005), in particular to Section 45, *Duty to report on irregularities*.
11. In donor funding engagements, the auditor gives special consideration to sources of donor funding and permissible expenditures in accordance with donor contracts, as well as fraud and laws and regulations, in order to provide the required level of assurance or findings thereon.

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1 ISA 240, "The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements"

2 ISA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements"

## REPORTING ON DONOR FUNDING ENGAGEMENTS

### Glossary of terms

12. For purposes of this SAAPS, the following terms or phrases apply:
- *Donor funding* – includes monetary amounts, assets or services donated by one party and received by another, usually subject to certain conditions or terms, for which no consideration was paid by the entity receiving those monetary amounts, assets or services.
  - *Donor* – an individual or an entity that provides donor funding to another entity for the purpose of meeting the objectives of the entity receiving the donor funding or for a purpose determined in terms of a contractual agreement between the parties.
  - *Intermediary* – any entity that receives and distributes donor funding whether in terms of a contractual agreement with a donor or its own criteria or objectives.
  - *Recipient* – the entity receiving donor funding from a donor or from an intermediary for the purpose of meeting its objectives or for a purpose determined in terms of a contractual agreement between the parties.

### Terms of Engagements

13. Based on the expectations of donors and the fact that the auditor is usually required to report not only in terms of a financial reporting framework (financial statement audit), but also in accordance with other stipulated conditions of the donor contract, the auditor is cautioned to ensure that the terms of the engagement are clearly understood by management of the intermediary, the recipient, and where necessary, the donor(s).
14. Where the donor is not an intermediary or a recipient it is unlikely that the special contract considerations, as described in paragraphs 15 to 17, will apply. In such circumstances the auditor follows the guidance contained in the IAASB Engagement Standards.

### Nature of contracts between donors, intermediaries and recipients (Donor contracts)

15. The utilisation of donor funding received by an intermediary and/or a recipient is usually subject to certain conditions as set out in a written contract with the donor. In addition to the financial reporting requirements, donors may seek assurance that the donor funding is utilised by the intermediary and/or recipient in accordance with the stipulated conditions of the donor contract. Accordingly, the intermediary and/or the recipient are

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required to generate general purpose or special purpose financial statements as well as specific reports to the donor in respect of the utilisation of the donor funding received and on the design, implementation, and in some instances the operating effectiveness, of relevant internal controls.

16. The donor contract often contains specific requirements for the auditor of the intermediary and/or the recipient, of which the auditor of the intermediary and/or the recipient may not be aware unless the auditor has inspected the donor contract. In most instances the auditor is required to issue a report dealing with one or more of the following:

- Reasonable assurance that the preparation of the financial statements achieves fair presentation (ISA 700<sup>3</sup>), or is prepared in all material respects (ISA 800<sup>4</sup>), or limited assurance (ISRE 2400<sup>5</sup>). In relation to this requirement, donors may require the intermediary and/or the recipient to report in terms of:
  - An applicable financial reporting framework; or
  - A financial reporting framework determined by the donor or a financial reporting framework which is not designed to meet the requirements of an applicable financial reporting framework that is a comprehensive basis of accounting; or
  - An unspecified financial reporting framework. The entity, unless required by law to report in terms of an applicable financial reporting framework, normally applies an entity specific basis of accounting.
- Factual findings arising from agreed-upon procedures performed so that the donor can form an opinion on whether the donor funding was utilised in accordance with the stipulated conditions of the donor contract (ISRS 4400<sup>6</sup>).
- Assurance that the intermediary and/or recipient has implemented internal controls that are suitably designed and implemented and which operate effectively to ensure compliance with requirements stipulated in the donor contract and which reduce the

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3 ISA 700, "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements"

4 ISA 800, "The Independent Auditor's Report on Special Purpose Audit Engagements"

5 ISRE 2400, "Engagements to Review Financial Statements"

6 ISRE 4400, "Engagements to Perform Agreed-upon Procedures Regarding Financial Information"

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risk that the donor funding is misappropriated and the financial statements are materially misstated (ISAE 3000<sup>7</sup>).

17. In addition to obtaining an understanding of those requirements identified in the previous paragraph, the auditor obtains a clear understanding of other terms and conditions in the donor contract that may impact on the scope of the engagement and the appropriateness of the auditor's report. These include:
- Identification of the party to whom the audit report is addressed (paragraphs 34 to 38 provide additional guidance on the restriction on distribution and/or use of the auditor's report).
  - The performance of specific procedures designed to meet specific objectives.
  - The expected timing of the report to be issued by the auditor.
  - Predetermined wording of the report of the auditor, taking into consideration the types of professional services performed. Such wording may not be consistent with terminology used in the IAASB Engagement Standards.
  - The right of access to the auditor's working papers by the donor.
18. An intermediary and/or recipient may receive donor funding from more than one donor and the conditions for utilising the donor funding received, as stipulated by the various donors, may differ. Accordingly the auditor obtains an understanding of the stipulated conditions of each donor contract when determining the scope of the engagement.

### Engagement letter

19. An engagement at an intermediary and/or a recipient may include one or more of the types of engagements identified in paragraph 16. The auditor and the intermediary and/or the recipient agree on the terms and conditions of the engagement. To avoid any misunderstanding, the auditor documents the agreed terms of the engagement in an engagement letter<sup>8</sup> or other suitable form of contract. The engagement letter documents and confirms the auditor's acceptance of the appointment; the objective and scope of the work to be performed; the extent of the auditor's responsibilities to the intermediary and/or recipient, the donor and any other third party(ies); as well as the

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7 ISAE 3000, "Assurance Engagements Other than Audits or Reviews of Historical Financial Information"

8 Standards and guidance on the terms of the engagement is provided in ISA 210, "Terms of Audit Engagements, ISRE 2400 and ISAE 3000"

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form and content of any report. Where the appropriate, the auditor discusses the stipulated conditions of the donor contract and the resulting terms of engagement with the intermediary and/or the recipient as well as the donor(s).

20. The nature and content of the engagement letter will vary depending on the nature and type of the engagement as well as the nature and type of report expected by the intermediary, the recipient and the donor(s) (refer to paragraph 16). Where the auditor is engaged to perform more than one type of engagement identified in paragraph 16, the auditor applies professional judgement in determining whether or not to issue one engagement letter dealing with each type of engagement, or to issue a separate engagement letter for each type of engagement. In many instances, the stipulated conditions of the donor contract may require the auditor to issue one engagement letter dealing with each type of engagement. The auditor may also be requested to perform additional work within the ambit of the larger engagement and in such circumstances the auditor considers establishing the objective and scope of the work to be performed by issuing a separate engagement letter.
21. The decision to send either a single engagement letter or a separate engagement letter for each type of engagement will depend on the following factors:
  - The donor's requirements, usually stipulated in the donor contract;
  - The expectation that the auditor issue a single auditor's report or whether a separate auditor's report is issued for each type of engagement;
  - The expected timing of the report by the auditor – for example, the expected timing of a factual findings report in an agreed-upon procedures engagement may be three months after the required timing for the opinion to be expressed on the financial statements;
  - The number of donors and the individual requirements of each donor, which may differ in terms of each donor's contract with the intermediary and/or recipient; and
  - The expected users of the report – for example, the distribution of a factual findings report or an assurance report is usually limited to specifically identified parties (often consulted with when determining the objective and scope of the engagement) while the opinion on the fair presentation of the financial statements may be distributed to a wide range of users.



## **REPORTING ON DONOR FUNDING ENGAGEMENTS**

### *Matters that the auditor considers when determining the terms of the engagement*

22. The auditor considers including the following matters in the engagement letter with the intermediary and/or recipient:
- Reference to any stipulated conditions contained in the donor contract, especially conditions affecting the responsibilities of the auditor.
  - Reference to the assurance framework according to which the auditor performs the engagement(s).
  - Reference to regulatory and legal requirements complied with, including those regulatory and legal requirements relating to jurisdictions outside South Africa.
  - The form and content of the report or reports to be issued by the auditor, taking into consideration the matters discussed in paragraph 21.
  - An appropriate statement as to any expected restriction on the distribution and/or use of the auditor's report (paragraphs 34 to 38 provide additional guidance on the restriction on distribution and/or use of the auditor's report).

### **Engagements not conducted in terms of the IAASB's Engagement Standards**

23. Where the donor contract requires that the auditor perform an engagement in accordance with an identified assurance framework other than the IAASB's Engagement Standards, the auditor considers whether the firm and the engagement team have the necessary knowledge and expertise to comply with the professional standards and regulatory and legal requirements applicable to such an engagement. Where the auditor determines that the firm and the engagement team are unable to comply with the applicable professional standards and regulatory and legal requirements, the auditor declines the engagement.
24. The auditor complies with the IAASB's Engagement Standards where such engagement standards apply. Where IAASB Engagement Standards do not apply and/or where the assurance framework is not identified, the auditor exercises professional judgement in conducting the engagement and specifies in the auditor's report that there are no applicable standards to an engagement of this nature. The auditor is cautioned to consider the risks in accepting such an engagement.

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### Reporting

25. An auditor of an intermediary or a recipient ordinarily reports in terms of one or more of the following types of engagements:
- (a) An audit or review of financial statements (historical financial information).
  - (b) An agreed-upon procedures engagement.
  - (c) An assurance engagement other than an audit or review of historical financial information.

#### *An audit or review of financial statements of an intermediary or a recipient;*

26. The auditor, when engaged by an intermediary or a recipient to issue an auditor's report on:
- A complete set of general purpose financial statements, where the financial statements have been prepared in accordance with an applicable financial reporting framework, reports in terms of ISA 700;
  - A review of financial statements, reports in terms of ISRE 2400; and
  - Other historical financial information, such as a report on an audit of a project income statement and balance sheet, reports in terms of ISA 800.
27. SAAPS 2<sup>9</sup> provides auditors with guidance concerning the effect that the financial reporting framework or basis of accounting has on the auditor's report in South Africa where an audit opinion is expressed. Appendix A of this SAAPS (SAAPS 5) contains a table which provides a summary of the categories of intermediaries and recipients and the applicable financial reporting frameworks and audit opinions as well as other types of engagements where auditors are engaged and has been based on the table contained in Appendix 2 of SAAPS 2.

#### *Assurance engagement other than audits or reviews of historical financial information*

28. An assurance engagement other than an audit or review of historical financial information is conducted in accordance with the guidance provided in the ISAE 3000 (Also refer to Appendix A of this SAAPS). An assurance engagement is appropriate where the donor seeks to obtain assurance that specified internal controls at the

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<sup>9</sup> SAAPS 2, "Financial Reporting Frameworks and Audit Opinions"

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intermediary and/or recipient are adequately designed, have been implemented, and in some instances are also operating effectively, to ensure that the donor funding has not been misappropriated.

29. The expectation, usually by the donor(s) (and in some instances other interested stakeholders), is that the auditor, as part of the engagement, provides assurance that the internal controls are well designed and implemented and in some instances operating effectively. It is appreciated that the auditor, as part of the audit of the financial statements, focuses only on those internal controls that impact on the financial reporting process, but the expectation of the donor may be that assurance is provided in respect of controls that are both part of the financial reporting process as well as those that do not form part of the financial reporting process (hereinafter referred to as business controls).
30. The donor contract often requires the auditor to report on the internal controls of the intermediary and/or the recipient in accordance with specific requirements stipulated in the donor contract. The donor contract may specify the control framework or the internal controls that should be implemented by management at the intermediary and/or the recipient. The donor contract may, however, provide a general requirement that internal controls should be implemented without specifying the control framework or the internal controls that should be implemented by the intermediary or recipient.
31. The auditor ordinarily reports on noncompliance with internal controls arising from the audit of financial statements. However, where the auditor is required to report on the financial reporting controls and/or the business controls beyond those that, in the auditor's professional judgement, are applicable to the audit of financial statements, the auditor:
  - Where the internal control framework or internal controls are specified in the donor contract, inspects the donor contract to:
    - Obtain an understanding of the internal control framework or internal controls that should be implemented by the management of the intermediary or the recipient;
    - Obtain an understanding as to whether reasonable or limited assurance is to be provided; and

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- Obtain an understanding as to which internal controls the donor(s) is seeking assurance on and whether this relates only to the design and implementation of the internal controls or whether the donor(s) also seeks assurance as to the operating effectiveness of those internal controls.
- Where the internal control framework or internal controls are not specified in the donor contract or the specified requirements are unclear, obtains an understanding of the same matters referred to above, through discussions with management and the donor(s).

### *Agreed-upon procedures engagement*

32. An agreed-upon procedures engagement is conducted in accordance with the guidance provided in the ISRS 4400. An agreed-upon procedures engagement may be appropriate where the donor seeks to determine whether the donor funding was applied or used by the intermediary and/or the recipient in accordance with the terms of the donor contract, for example reporting on project expenditure allocated to budgeted categories of expenses or acquired assets utilised for the purposes of the programme (the donor's contract in many instances will determine the procedures to be performed by the auditor). In such circumstances the auditor performs the agreed-upon procedures and presents a factual findings report. The donor, intermediary and/or recipient and any identified third party is then able to draw a conclusion from the procedures performed and findings reported by the auditor.

### **Other reporting considerations**

#### *Issuing a combined report*

33. Where the donor stipulates that a single report should be issued and the auditor deems that this is possible, based on the auditor's consideration of the factors in paragraph 21, the auditor ensures that the report clearly distinguishes between:
- The audit opinion expressed on the financial statements or review opinion expressed on the financial information; and
  - The assurance conclusion expressed that the internal controls at the intermediary and/or the recipient are adequately designed and implemented, and where applicable operating effectively; and

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- Factual findings of procedures performed as agreed-upon between the donor, the intermediary and/or recipient and the auditor.

### *Restriction on distribution and/or use of the auditor's report*

34. The auditor considers the users of the auditor's report, as well as any statutory requirements, in determining whether to restrict the distribution and/or use of the auditor's report.
35. When an audit opinion is expressed on a complete set of general purpose financial statements of an intermediary or a recipient, prepared in accordance with a financial reporting framework that is designed to meet the needs of a wide range of users (ISA 700), the auditor may not restrict the distribution and use of the auditor's report, for example the financial statements of a company, including a company formed in terms of section 21 of the Companies Act, 1973 (Act 61 of 1973).
36. When an audit opinion is expressed on special purpose financial statements of an intermediary or a recipient, prepared in accordance with a financial reporting framework that is not designed to meet the needs of a wide range of users (ISA 800) and is intended to be distributed to:
  - A wide range of users, the auditor may not restrict the distribution of the auditor's report, but considers restricting the use of auditor's report; or
  - A limited range of users, the auditor considers restricting both the distribution and use of the auditor's report.

This guidance applies to assurance reports issued in accordance with ISAE 3000.

37. When reporting factual findings in respect of an agreed-upon procedures engagement the auditor restricts both the distribution and use of the report.
38. When a combined report is issued, as contemplated in paragraph 33, the auditor considers whether to restrict the distribution and/or use of the report in the circumstances.

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### **Other matters**

#### **Communication with those charged with governance and donors**

39. The auditor considers whether any identified material weaknesses in the design or implementation of internal control at the intermediary and/or recipient are to be reported to the donor(s) in terms of the donor contract. Where management of the intermediary and/or the recipient is responsible for communicating such material weaknesses to the donor(s) in terms of the donor contract and management fails to, or is unwilling to, the auditor informs management or those charged with governance of the intermediary and/or the recipient of their duty. When management or those charged with governance of the intermediary and/or recipient do not respond appropriately to the auditor's communication, the auditor's report states this and contains sufficient appropriate detail to provide the donor(s) with an appropriate understanding of any identified material weaknesses which have come to the auditor's attention.

# REPORTING ON DONOR FUNDING ENGAGEMENTS

## Appendix

### **Types and categories of donors, types and forms of entities that receive donor funding and issuing the appropriate report**

#### **Types and categories of donors**

1. There are various types and categories of donors. Examples include:
  - Donors that are governments or represent governments, such as local government departments, the United States Agency for International Development (USAID); the Department for International Development (DFID) of the United Kingdom; the Norwegian Agency for Development (NORAD); the Swedish International Development Cooperation Agency (Sida); as well as quasi-government agencies, such as the European Commission (EU).
  - Private foundations that are usually trusts, created by individuals, such as the Mott Foundation, the Bill and Melinda Gates Foundation, the Ford Foundation and the Rockefeller Foundation.
  - Overseas Funding Agencies, such as Oxfam and ActionAID.
  - Local non-government organisations, such as Section 21 companies and trusts.

#### **Types and forms of entities that receive donor funding**

2. There are generally two types of entities that receive donor funding, being intermediaries and recipients. These entities can also take various legal forms.
3. The sole purpose for the existence of some intermediaries and recipients is to conduct their activities on a not-for-profit basis (generally referred to as not-for-profit organisations (NPOs)), for example schools and universities, child welfare organisations and professional bodies. Such intermediaries or recipients may take the form of a section 21 company, a legal entity other than a section 21 company, a government department or a regulated entity. NPOs ordinarily receive donor funding from donors for the purposes of funding their main activities, for example donor funding donated to a child welfare organisation would be utilised to provide for the cost of housing and the day-to-day needs of the children, cared for by the organisation, as well as for the day-to-day administrative functions, such as the salaries of staff.

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4. Other entities, such as public companies (both listed and unlisted), private companies, close corporations, partnerships and farming operations conduct their activities for the purpose of generating profits. Such entities may also be the recipient of donor funding, for example a newly formed company operating in the industrial sector may receive a government grant for the purpose of research and development associated with its main operations.
5. Donors may provide donor funding to intermediaries and recipients for one of the following reasons:
  - Achieving the objectives of a specific project, for example the sponsorship of a specific learnership program at a community centre focused on providing basic life-skills training.
  - Disbursing the day-to-day administrative costs of the entity.
  - Achieving the objectives of projects managed by the entity, as well as for the purpose of disbursing the day-to-day administrative costs of the entity.
  - To promote the development of small to medium sized business.

### **Issuing the appropriate report for the type of engagement**

6. The table (on the following page) provides a summary of the guidance provided in the SAAPS concerning the types of engagements, categories of intermediaries and recipients, the applicable financial reporting frameworks and the applicable reporting standard or SAAPS.



## REPORTING ON DONOR FUNDING ENGAGEMENTS

Type of engagement	Categories of intermediaries and recipients	Applicable legislation and/or constitution and/or contract	What is required by the constitution of the entity regarding the preparation of financial statements?	Applicable financial reporting framework	Applicable reporting standard or SAAPS
An engagement to express an opinion on the financial statements	Nonprofit organisations (formed as section 21 companies)	Companies Act Nonprofit Organisations Act		South African Statements of GAAP and/or IFRS	ISA 700 <sup>10</sup> : Opinion – present fairly
	Nonprofit organisations (other than section 21 companies) “For profit” entities	Nonprofit Organisations Act and/or Other Legislation and/or Founding document and/or Contract and/or Entity choice	Financial reporting framework	For example: South African Statements of GAAP; IFRS; GAMAP; GRAP; etc	ISA 700 <sup>11</sup> : Opinion – present fairly
			Comprehensive basis of accounting	For example: Basis established by a regulator or professional body for a specific industry/type of entity, for example retirement funds	ISA 800 <sup>11</sup> : Opinion – present fairly
			Not specified or gaap, therefore: Entity specific basis of accounting	Suitable criteria established specifically for the entity and adequately disclosed in the financial statements	The International Framework for Assurance Engagements, and SAAPS 2  Opinion - prepared in accordance with ...
Assurance engagement	Nonprofit organisations and “for profit” entities (above)	Legislation and/or contract	Assurance framework	Suitable criteria to evaluate or measure the subject matter	ISAE 3000: Assurance conclusion
Agreed-upon procedures	Nonprofit organisations and “for profit” entities (above)	Legislation and/or contract	Procedures agreed-upon by parties		ISRS 4400: Factual findings

<sup>10</sup> Or ISRE 2400 review opinion, as appropriate