SECTION 500

Reporting Phase

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510 – Overview of the Reporting Phase

Based on the work in the preceding phases, the auditor decides how to report on, as applicable, the entity’s

* financial statements, required supplementary information (RSI) (including management’s discussion and analysis (MD&A)), and other information included in the annual report;
* internal control over financial reporting;
* financial management systems’ substantial compliance with the three FFMIA requirements (for CFO Act agencies); and
* compliance with significant provisions of applicable laws, regulations, contracts, and grant agreements.

The following sections provide guidance for making these determinations and formulating the report type and form. Guidance is also provided on other activities that the auditor should perform during the reporting phase (see Contents).

520 – Perform Overall Analytical Procedures

Purposes of Overall Analytical Procedures

1. As the audit nears completion, the auditor should design and perform overall analytical procedures, as discussed in AU-C 520. The purposes of these procedures are

* to determine if an adequate understanding of all fluctuations from expectations and relationships in the financial statements has been obtained; or if not, to identify and resolve significant or unusual fluctuations from expectations that have not been identified and resolved in other audit procedures;
* to determine if other audit evidence is consistent with explanations for fluctuations from expectations documented during overall analytical procedures; and
* to assist the auditor when forming an overall conclusion about whether the financial statements are consistent with the auditor’s understanding of the entity (AU-C 520.06).

If overall analytical procedures indicate that an adequate understanding of relationships and fluctuations has not been obtained or if there are inconsistencies in audit evidence gathered from other audit procedures, the auditor should make further inquiries and perform sufficient testing to obtain an adequate understanding or to resolve the inconsistencies.

The auditor may perform overall analytical procedures in more detail than the financial statement level (supplemental analytical procedures, as discussed in FAM 475) and then use the results of these procedures to “roll up” into and support the overall analytical procedures at the financial statement level. For example, the auditor may perform overall analytical procedures at the account level and roll them up to the financial statement line item to which they belong.

The auditor may use analytical procedures to obtain complete or partial substantive assurance for certain accounts or to perform supplemental analytical procedures when detail tests are used exclusively to obtain substantive assurance. The auditor may use information obtained during these procedures as the basis for explanations of fluctuations for overall analytical procedures.

Audit efficiency and effectiveness may be gained if the same audit staff that conducted the detail tests on an account also conduct the supplemental analytical procedures by building on the knowledge obtained during detail testing.

The auditor generally should coordinate overall analytical procedures with the evaluation of the MD&A, including forming conclusions about the information in it. See FAM 280.08 for guidance on performing procedures over RSI.

### Performance of Overall Analytical Procedures

The auditor should achieve the purposes of overall analytical procedures described above by taking the following actions:

1. Assessing expectations. The auditor should determine if expectations previously developed during preliminary analytical procedures in FAM 225 are still appropriate or should be revised.
2. Comparing current-year amounts with expectations. This information may be on a summarized level, such as the level of financial statements, or a more detailed level, as discussed in FAM 520.03.
3. Identifying significant or unusual fluctuations from expectations that have not already been identified and resolved. The auditor should determine whether previously established parameters for determining whether a fluctuation is significant are still appropriate. Parameters are usually based on performance materiality. Unusual fluctuations include inappropriate accounting balances (such as debit balances in liability accounts), balances with either no current-year or no prior-year comparison, and decreases in property accounts that would normally occur only by disposition (instead of by misstatements) or inconsistencies with other relevant information obtained during the audit (AU-C 520.08c). Fluctuations identified are a matter of the auditor’s professional judgment. The auditor should also evaluate the absence of expected fluctuations when identifying significant fluctuations (such as lower foreclosure rates on home loans despite higher default rates).
4. Understanding identified fluctuations from expectations. The auditor should understand all significant fluctuations identified, obtain audit evidence corroborating the causes, and document the causes. The documentation may be a brief description with a reference to corroborating audit evidence. If the auditor does not understand the cause of a fluctuation or if the understanding is not consistent with the audit evidence, the auditor should perform procedures to obtain an understanding or to resolve any inconsistencies.
5. Evaluating the results of overall analytical procedures. The auditor should evaluate these results to determine if the auditor obtained an adequate understanding of significant fluctuations from expectations and if the financial statements are consistent with the auditor’s understanding of the entity. If the auditor identifies a previously unrecognized risk of material misstatement, the auditor should revise the auditor’s assessment of the risks of material misstatement and modify the audit procedures accordingly (AU-C 520.A26).

530 – Reassess Materiality and Risks of Material Misstatement

1. In the planning phase, the auditor determined materiality for the financial statements as a whole based on preliminary information. Based on this materiality, the auditor determined performance materiality and tolerable misstatement, which affected the extent of audit testing. Based on AU-C 450.10, before the end of the audit, prior to evaluating the effect of uncorrected misstatements, the auditor should reassess materiality to confirm whether it remains appropriate in the context of the entity’s final financial statements. If the reassessment of materiality results in a lower amount (or amounts), then the auditor should reconsider performance materiality and the appropriateness of the nature, timing, and extent of the further audit procedures in order to obtain sufficient appropriate audit evidence on which to base the audit opinion.

In the planning and internal control phases, the auditor identified and assessed the risks of material misstatement at the financial statement and assertion levels. Before the conclusion of the audit, the auditor should evaluate, based on the audit procedures performed and the audit evidence obtained, whether the assessments of the risks of material misstatement at the financial statement and assertion levels remain appropriate (AU-C 315.41 and 330.27). If necessary, the auditor should revise the identification or assessment of these risks. The auditor should determine whether the overall audit strategy and audit plan need to be revised

* if the aggregate of misstatements accumulated during the audit approaches materiality (AU-C 450.06b) (see FAM 540) or
* if the nature of the identified misstatements and the circumstances of their occurrence indicate that other misstatements may exist that when aggregated with misstatements accumulated during the audit, could be material (AU-C 450.06a).

In addition, if material weaknesses or other significant deficiencies are identified, the auditor should consider their implications on this risk assessment.

The auditor should update the fraud risk evaluation throughout the audit because evidence gathered later in the audit could change or support an earlier judgment about fraud risks. For example, the auditor may identify discrepancies in the accounting records or conflicting or missing evidence.

The auditor should evaluate, at or near the end of the audit, whether the accumulated results of auditing procedures affect the assessment of the risks of material misstatement due to fraud made earlier in the audit or indicate a previously unrecognized risk of material misstatement due to fraud. In this case, the auditor should evaluate the need for additional or different audit procedures. If not already performed when forming an overall conclusion, the analytical procedures relating to revenue should be performed through the end of the reporting period (AU-C 240.34). The auditor should

* perform overall analytical procedures related to revenue, if revenue is (or is expected to be) material;
* evaluate whether overall analytical or other substantive procedures indicate a previously unrecognized fraud risk;
* evaluate whether responses to inquiries during the audit have been vague, implausible, or inconsistent with other evidence; and
* evaluate other evidence gathered during the audit.

Based on these reassessments, the auditor should determine whether the nature, extent, and timing of substantive audit procedures were sufficient and appropriate, such as the sample sizes used in detail tests and the limit used for investigating differences identified in substantive analytical procedures. The auditor should document the determination and identify any additional procedures that should be performed. This documentation must be provided to the reviewer in a timely manner to allow any issues to be promptly identified and resolved.

When the auditor determines whether an opinion can be expressed on the financial statements, the auditor should evaluate any limitations on the nature, extent, or timing of work performed. Additional guidance on scope limitations and their impact is provided in FAM 580.03 through .08. Also see FAM 545 for further evaluation of audit risk.

540 – Evaluate Effects of Misstatements on Financial Statements and Auditor’s Reports

1. The auditor might detect misstatements during substantive tests or other procedures. The auditor should communicate misstatements to management on a timely basis; accumulate misstatements identified during the audit, other than those that are clearly trivial (AU-C 450.05); and evaluate misstatements individually and in the aggregate in both quantitative and qualitative terms.
2. Based on AU-C 450.A6, to assist in evaluating the effects of misstatements accumulated during the audit and in communicating misstatements to management, the auditor generally should use the following categories to classify each misstatement:

* Factual misstatements. Misstatements about which there is no doubt. These include identified factual misstatements arising from nonstatistical selections or other nonstatistical tests.
* **Judgmental misstatements.** Differences arising from the judgments of management, including those concerning recognition, measurement, presentation, and disclosure in the financial statements (including the selection or application of accounting policies), that the auditor considers unreasonable or inappropriate. These include identified judgmental misstatements arising from nonstatistical selections or other nonstatistical tests.
* **Projected misstatements.** The auditor’s best estimate of the amount of the misstatements in populations, involving the projection of misstatements identified in statistical audit samples to the entire population from which the samples were drawn.

1. For accounting estimates, based on AU-C 540.A139, if the audit evidence supports an auditor’s point estimate that differs from management’s point estimate, the difference between the auditor’s point estimate and management’s point estimate constitutes a misstatement. If the audit evidence supports a range that does not include management’s point estimate, the auditor generally should include the difference between management’s point estimate and the nearest point of the auditor’s range as a judgmental misstatement. See FAM 905 for additional guidance on accounting estimates.
2. FAM 475 (substantive analytical procedures) and FAM 480 (substantive detail tests) discuss the evaluation of individual misstatements from a quantitative standpoint.

If the auditor judges an individual misstatement to be material, the auditor generally should not offset other misstatements against it.[[1]](#footnote-2) Following that guidance, the auditor should quantify the effects of the misstatement.

### Communicate Misstatements to Management

Based on AU-C 450.07, when the auditor detects misstatements during the audit, the auditor should, on a timely basis, take the following actions:

1. Communicate the misstatements, other than those that are clearly trivial, with the appropriate level of management.
2. Request that management adjust the entity’s financial statements and underlying records to correct the misstatements.
3. Management is responsible for determining whether the misstatements the auditor communicated are material to the entity’s financial statements and determining whether to adjust the entity’s financial statements and underlying records to correct the misstatements. If management does not correct the misstatements, the auditor should obtain an understanding of management’s reasons for not making the corrections and whether the uncorrected misstatements are considered material. The auditor should take that understanding into account when evaluating whether the financial statements as a whole are free from material misstatement (AU-C 450.09).
4. The auditor may request that management examine a line item, account, note disclosure, or class of transactions in order for management to understand the cause of a misstatement identified by the auditor; perform procedures to determine the amount of the actual misstatement in the line item, account, note disclosure, or class of transactions; and make appropriate adjustments to the financial statements (AU-C 450.A12).[[2]](#footnote-3) The auditor should then test management’s procedures and the amount of the proposed adjustment to determine the reasonableness of the amount. The auditor should perform additional audit procedures, if needed, to determine whether misstatements remain (AU-C 450.08).

When the auditor has identified a judgmental misstatement involving differences in estimates, such as a difference in a fair value estimate, the auditor may request management to review the assumptions and methods used in developing management’s estimate (AU-C 450.A14).

1. If management disagrees with the auditor’s judgmental and projected misstatements, and if the disagreement involves amounts that are material, the auditor should again request that management perform procedures, such as reviewing all or substantially all of the items in the relevant population, to determine its own estimated amount of the misstatement and provide more assurance as to the auditor’s estimate, if the entity has not yet done so. If the entity determines its own estimate of the misstatement, the auditor should test management’s procedures and conclusions and determine whether additional audit procedures are necessary.

If management refuses to perform the necessary investigation, the audit director may decide not to expend additional time and audit resources to resolve the disagreement because, for example, additional testing is unlikely to provide different conclusions.

If the auditor believes that the auditor’s estimate is sufficiently accurate, the auditor should express a qualified or adverse opinion, depending on the materiality and pervasiveness of the item to the financial statements as a whole (see FAM 580.43). If the auditor believes that the auditor’s estimate is not sufficiently accurate, the auditor should express a qualified or disclaimer of opinion for a scope limitation, depending on the materiality and pervasiveness of the item to the financial statements as a whole.

The auditor should document an overall evaluation, including decisions reached, of any management disagreement with the misstatements.

### Accumulate Misstatements

1. To evaluate the aggregate effects of misstatements on the financial statements, the auditor should accumulate misstatements identified during the audit, other than those that are clearly trivial (AU-C 450.05) (see FAM 595 C for details and examples on accumulating misstatements).
2. The auditor should accumulate individual misstatements that management chose not to correct, including any nontrivial misstatements that management brings to the auditor’s attention that management has not corrected. The auditor should quantify and evaluate uncorrected misstatements on the financial statement line items under both the balance sheet and net cost approaches.[[3]](#footnote-4)

* The **balance sheet** approach quantifies a misstatement with the objective of making the balance sheet correct as of the end of the current year.
* The **net cost approach** quantifies a misstatement with the objective of making the current year statement of net cost correct.

The auditor should prepare the list of adjusting entries needed to correct the uncorrected misstatements and accumulate the entries on the summary of uncorrected misstatements (SUM). See FAM 595 C for details on accumulating misstatements, including examples for each approach, and an example SUM and corresponding list of adjusting entries needed to correct the uncorrected misstatements.

The auditor should also accumulate misstatements that the auditor has identified and management has corrected on the summary of corrected misstatements. (See FAM 595 C, example 2 for an example of the summary of corrected misstatements.)

1. If the entity presents comparative financial statements, the auditor should also update, as appropriate, the list of adjusting entries needed to correct the uncorrected misstatements and SUM corresponding to the prior period. If, during the current period audit, the auditor detects a misstatement, other than clearly trivial, affecting the prior period financial statements that was not previously detected, the auditor should bring it to management’s attention and update the list of adjusting entries needed to correct the uncorrected misstatements and SUM for the prior period to incorporate those misstatements. The auditor should also update, as appropriate, the prior year list of adjusting entries needed to correct the uncorrected misstatements and SUM for any other changes based on updated information. The auditor should determine if the misstatement, together with other uncorrected misstatements, is material to the prior-period and current-period financial statements. Also see FAM 580.110 regarding financial statement restatements.
2. The auditor should also accumulate uncorrected misstatements (including omissions), other than those that are clearly trivial, on the notes to the entity’s financial statements on a quantitative and qualitative basis.

Quantitative misstatements, including omissions, in note disclosures include (1) a material misstatement of an amount in the note disclosure and (2) the misclassification of a material amount between subcategories of the line item total.

When determining whether qualitative note disclosures may be material, each individual misstatement, including omissions, is considered (based on size, nature, or circumstances) to evaluate its effect on the relevant note disclosures, as well as its overall effect on the financial statements as a whole. The determination of whether a misstatement in a qualitative note disclosure is material, in the context of the applicable financial reporting framework (generally U.S. GAAP) and the specific circumstances of the entity, is a matter that involves the exercise of professional judgment. Examples of misstatements that may be material include

* inaccurate or incomplete descriptions of information about the objectives, policies, and processes for managing budgetary resources;
* the omission of information about the events or circumstances that have led to an impairment loss;
* incorrect description of an accounting policy relating to a significant item in any of the statements that the financial statements comprise; and
* an inadequate description of the sensitivity of an exchange rate. (AU-C 450.A23)

1. The auditor should communicate the uncorrected misstatements accumulated on the SUM with management. Providing the SUM to management can assist management in understanding the potential aggregate effect of misstatements on the financial statements. Management is responsible for determining whether the uncorrected misstatements on the SUM are material, individually or in the aggregate, to the entity’s financial statements under either the net cost or balance sheet approaches and whether to make any further adjustments to the financial statements. If management makes any further adjustments to correct the misstatements accumulated on the SUM, the auditor should update the (1) list of adjusting entries needed to correct the uncorrected misstatements, (2) SUM, and (3) summary of corrected misstatements.
2. In presenting the misstatements to management, the auditor generally should remind management that AU-C 580, *Written Representations*, requires the entity to provide written representations in the management representation letter about whether it believes the effect of uncorrected misstatements aggregated by the auditor, both individually and in the aggregate, are immaterial to the financial statements as a whole. AU-C 580 also requires that a summary of the uncorrected misstatements be attached to the representation letter. Attaching this summary is further discussed in FAM 1001.

### Evaluate Misstatements

The auditor should evaluate the effects of both uncorrected and corrected misstatements on the financial statements and notes.

When determining whether uncorrected misstatements are material, either individually or in the aggregate, to the financial statements and notes, the auditor should consider the

* size and nature of the misstatements, both in relation to particular line items, accounts, note disclosures, or classes of transactions in the financial statements and in relation to the financial statements as a whole, and the particular circumstances of their occurrence, and
* effect of uncorrected misstatements related to prior periods on line items, accounts, note disclosures, or classes of transactions and the financial statements as a whole (AU-C 450.11).

If the auditor provides assurance on any combining statements and supplemental schedules in relation to the financial statements as a whole, the auditor should determine whether these statements and schedules are materially misstated due to uncorrected misstatements. See AU-C 725 for guidance on reporting on supplementary information.

If the total of uncorrected misstatements is material, the auditor should modify the opinion on the financial statements (see FAM 580.09). Deciding how to modify the opinion, based on the materiality and pervasiveness of the uncorrected misstatements, involves significant auditor judgment. The decision and its basis should be documented. The audit director should be involved in the decision and review the documentation related to it. Also, the related documentation must be provided to the reviewer in a timely manner to allow any issues to be promptly identified and resolved.

Misstatements, either individually or in the aggregate, are material if, in light of surrounding circumstances, it is probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the correction of the items. The concept of materiality includes both quantitative and qualitative considerations, as further discussed in FAM 230 and FAM 545.

Although there is a point at which total uncorrected misstatements would generally be considered material, there is no single amount that can be used for the auditor’s decision to modify the opinion. The auditor should follow a process that considers various factors in reaching this decision. See FAM 545, if applicable.

The auditor should also conclude on the adequacy of the scope of procedures performed in light of the total corrected and uncorrected misstatements identified (see FAM 530 and 545). The auditor’s conclusion must be provided to the reviewer in a timely manner to allow any issues to be promptly identified and resolved.

1. The auditor should determine whether the overall audit strategy and audit plan need to be revised if

* the nature of all identified misstatements (corrected and uncorrected) and the circumstances of their occurrence indicate possible undetected misstatements that, when aggregated with misstatements accumulated during the audit, could be material or
* the aggregate of all misstatements accumulated during the audit approaches materiality as discussed in FAM 530 (AU-C 450.06).

In addition to evaluating the effects of all misstatements (corrected and uncorrected) on the financial statements and notes, the auditor should evaluate the effects of misstatements on the following:

1. The auditor’s conclusions on internal control (see FAM 580.56–.85).

The auditor should determine whether the misstatements indicate control deficiencies that had not been previously identified, whether the assessment of control risk at the assertion level remains appropriate, whether audit procedures are appropriate in light of any revisions to this assessment, and whether the categorization of control deficiencies for reporting purposes is appropriate (whether they are material weaknesses or other significant deficiencies).

1. The consideration of the risks of material misstatement (see FAM 530).

The auditor should determine whether the misstatements indicate the assessment of risk of material misstatement (combined inherent risk and control risk) remains appropriate and whether audit procedures are appropriate in light of any revisions to this assessment.

1. The auditor’s evaluation of the financial management systems’ substantial compliance with the three FFMIA requirements, if applicable (see FAM 580.86–.90).

The auditor should evaluate the effects of misstatements on the auditor’s conclusions with respect to the financial management systems’ substantial compliance with the three FFMIA requirements.

1. The entity’s compliance with significant provisions of applicable laws, regulations, contracts, and grant agreements (see FAM 580.91–.99).

The auditor should evaluate the effects of misstatements on the auditor’s conclusions with respect to the entity’s compliance with significant provisions of applicable laws, regulations, contracts, and grant agreements.

1. Budget formulation and execution.

The auditor should evaluate the effects the misstatements have on budget-related matters for purposes of reporting budget control deficiencies, reporting on the statement of budgetary resources and reconciliation of net cost to net outlays,[[4]](#footnote-5) and reporting on compliance with applicable budget-related provisions of laws and regulations.

1. Other reports.

The auditor should consider whether to report the potential effects of the misstatements and any related control deficiencies on other reports prepared by the entity that are (1) used for management decision-making or (2) distributed outside the entity.

Qualitative Considerations

The auditor should also evaluate appropriate qualitative aspects when determining the effect of uncorrected misstatements on the auditor’s report. The circumstances related to some misstatements may cause the auditor to evaluate them as material, individually or when considered together with other misstatements accumulated during the audit, even if they are quantitatively lower than materiality for the financial statements as a whole. Circumstances that may affect the evaluation include the extent to which a misstatement has the following attributes:

1. Is considered sensitive to financial statement users, that is, the Congress, the public, influential special interest groups, and interested foreign governments.
2. Offsets other misstatements in the aggregate but is individually significant.
3. Has a significant effect on the RSI (including the MD&A presented by management) and other information.
4. Affects compliance with laws and regulations.
5. Affects compliance with contracts or grant agreements.
6. Relates to the incorrect selection or application of an accounting policy that has an immaterial effect on the current period’s financial statements but is likely to have a material effect on future periods’ financial statements.
7. Affects segment information presented in the financial statements (for example, the significance of the matter to a segment or other portion of the entity’s business that has been identified as playing a significant role in the entity’s operations or profitability).
8. Represents an omission of information not specifically required by the applicable financial reporting framework (generally U.S. GAAP) but that in the professional judgment of the auditor is important to the users’ understanding of the financial position, financial performance, or cash flows of the entity.
9. Affects other information that will be communicated in the annual report (for example, information to be included in an MD&A) when there is a substantial likelihood that the other information would influence the judgment made by a reasonable user based on the financial statements.
10. Is currently immaterial but is likely to have a material effect in future periods because of a cumulative effect, for example, that builds over several periods.
11. Is too costly to correct. It may not be cost beneficial for the entity to develop a system to calculate a basis to record the effect of an immaterial misstatement. On the other hand, if management appears to have developed a system to calculate an amount that represents an immaterial misstatement, it may reflect a motivation of management.
12. Represents a risk that possible additional undetected misstatements would affect the auditor’s evaluation.
13. Changes a loss into income or vice versa.
14. Heightens the sensitivity of the circumstances surrounding the misstatement (for example, the implications of misstatements involving fraud, conflicts of interest, or noncompliance with laws, regulations, contracts, or grant agreements).
15. Relates to the definitive character of the misstatement (for example, the precision of an error that is objectively determinable as contrasted with a misstatement that unavoidably involves a degree of subjectivity through estimation, allocation, or uncertainty).
16. Indicates the motivation of management (for example, (1) an indication of a possible pattern of bias by management when developing and accumulating accounting estimates, (2) a misstatement precipitated by management’s continued unwillingness to correct weaknesses in the financial reporting process, or (3) an intentional decision not to follow the applicable financial reporting framework (generally U.S. GAAP)).
17. Involves proprietary or sensitive information, such as protected health information, federal taxpayer information, or classified national security information.
18. Affects financial markets, the U.S. economy, or political decisions, such as controversial pending legislation or an upcoming election.
19. Indicates selective correction by management of certain misstatements brought to its attention during the audit (for example, correcting misstatements with the effect of increasing reported earnings but not correcting misstatements that have the effect of decreasing reported earnings).

These circumstances are only examples—not all are likely to be present in all audits nor is the list necessarily complete. The existence of any circumstances such as these does not necessarily lead to a conclusion that a misstatement is material. See AU-C 450.A28 for further examples.

Evaluate Whether Identified Misstatements Indicate Fraud

The auditor should evaluate whether identified misstatements might indicate fraud. If such an indication exists, the auditor should evaluate the implications of the misstatement with regard to other aspects of the audit, particularly the auditor’s evaluation of materiality, management and employee integrity, and the reliability of management representations, recognizing that an instance of fraud is unlikely to be an isolated occurrence (AU-C 240.35). If, preliminarily, the auditor believes that a misstatement is or might be the result of fraud, the auditor should discuss this with the audit director, who should determine whether to seek assistance from the Special Investigator Unit or the Office of the General Counsel (OGC). If performing the audit under contract, the auditor should consult with the Assistant Inspector General for Audit or the GAO managing director who has responsibility for the audit.

If, on the basis of evidence obtained, the auditor believes that an instance of fraud (or significant abuse) has occurred or is likely to have occurred, the auditor should

* consult with the Special Investigator Unit and OGC (or if performing the audit under contract, consult with the Assistant Inspector General for Audit or the GAO managing director),
* include relevant information in the audit report unless the instance is clearly inconsequential, and
* determine that those charged with governance are adequately informed.

If the auditor has identified or suspects fraud, the auditor should determine whether the auditor has a responsibility to report the occurrence or suspicion to a party outside the entity. Although the auditor’s professional duty to maintain the confidentiality of client information may preclude such reporting, the auditor’s legal responsibilities may override the duty of confidentiality in some circumstances (AU-C 240.42 and GAGAS (2018) 6.53–6.56). In some circumstances, the auditor may be required by law or regulation to report directly to outside parties about fraud (or significant abuse). The auditor may limit public reporting to matters that would not compromise any related investigative or legal proceedings (GAGAS(2018) 6.49).

If a misstatement is or might be the result of fraud and the effect is not material to the financial statements, the auditor should evaluate the implications, especially those regarding the organizational position and responsibilities of the individual involved. If the matter involves a relatively low-level employee who is not responsible for significant activities (for example, a misappropriation from a small petty cash fund by a nonmanagement employee), the auditor may conclude that the matter has little significance to the audit. However, if the auditor identifies a misstatement, whether material or not, and the auditor has reason to believe that it is, or may be, the result of fraud and that management (in particular, senior management) is involved, the auditor should reevaluate the assessment of the risks of material misstatement due to fraud and its resulting effect on the nature, timing, and extent of audit procedures (AU-C 240.36). The auditor should evaluate whether the misstatement is qualitatively material or might indicate a more pervasive problem.

The auditor should also consider whether circumstances or conditions indicate possible collusion involving employees, management, or third parties when reconsidering the reliability of evidence previously obtained (AU-C 240.36). Regardless of the level of the employee involved, the auditor should report the potential fraud to at least the next level of management. In addition, the auditor should reach an understanding with those charged with governance regarding the nature and extent of communications with them about fraud perpetrated by lower-level employees.

If a misstatement is or might be the result of fraud and either the effect could be material or the auditor is unable to determine whether the effect is material, the auditor should

* attempt to obtain additional evidential matter to determine whether material fraud has occurred or is likely to have occurred and its effect on the financial statements and the related audit report;
* evaluate the implications for other aspects of the audit, including reevaluating the assessment of risks and the resulting effects on testing, as described in the preceding paragraph (AU-C 240.35 and .36);
* discuss the matter and the approach for further investigation with at least the next higher level of management and with senior management and those charged with governance; and
* determine whether to advise management to consult with its legal counsel.

As discussed in AU-C 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, the auditor should not assume that an instance of fraud or error is an isolated occurrence and therefore should evaluate how the detection of the misstatement affects the risks of material misstatement, including (1) the related nature, extent, and timing of substantive audit procedures and (2) the audit evidence of the operating effectiveness of relevant controls, including the entity’s risk assessment and monitoring process.

Depending on the circumstances, fraud (material or immaterial) could affect the quality of management’s representations and the auditor’s reports on the financial statements; internal control over financial reporting; and compliance with significant provisions of applicable laws, regulations, contracts, and grant agreements. The auditor must discuss with the reviewer the significant judgments and conclusions made by the engagement team with respect to fraud in a timely manner to allow any issues to be promptly identified and resolved.

545 – Audit Exposure (Further Evaluation of Audit Risk)

1. At the beginning of the audit, performance materiality(which, as defined, is one or more amounts) was set to reduce to an appropriately low level the probability that the aggregate of uncorrected and potential undetected misstatements in the financial statements exceeds materiality for the financial statements as a whole (AU-C 320.09). Before the conclusion of the audit, the auditor should consider any potential further misstatement to the financial statements as a whole by accumulating the total of uncorrected misstatements plus an overall allowance for undetected misstatements.

If the aggregate of misstatements accumulated during the audit approaches materiality, a greater than acceptably low level of risk may exist that possible undetected misstatements, when taken with the aggregate of uncorrected misstatements accumulated during the audit, could exceed materiality (AU-C 450.A8). It is important to evaluate the potential further misstatement amount in relation to materiality for the financial statements as a whole (see FAM 230.06) and the relative importance of the misstated items to readers of the financial statements (qualitative and mitigating aspects). Therefore, the auditor should determine whether its audit exposure (i.e., combination of detected misstatements, possible undetected misstatements, and qualitative aspects) is material to the financial statements.

Evaluation

The auditor may or may not detect misstatements during substantive tests or other procedures performed during the audit (see FAM 540). However, the auditor should evaluate the risk of potential undetected misstatement, which is due to the imprecision of audit procedures. This risk includes such things as the following:

1. Unaudited amounts/accounts that were considered to be individually immaterial and were not tested on that basis (untested amounts). The auditor should include all untested amounts/accounts, including those that are clearly trivial. All untested amounts are considered to be 100 percent overstated for this evaluation. Further, if the auditor believes there is a risk of material understatement, the auditor should include the amount of potential understatement (if the amount is not quantifiable, see FAM 545 A.20).
2. The sampling precision associated with statistical samples selected for substantive tests of financial statement balances.[[5]](#footnote-6)
3. If no statistical samples are selected, an allowance for possible undetected misstatements equal to performance materiality.
4. An allowance for the imprecision of substantive analytical procedures on which the auditor placed complete reliance.

Totaling the amounts from these aspects with any uncorrected misstatements (see FAM 540) provides a conservative quantitative estimate of the potential amount of misstatement to the financial statements as a whole, which affects audit exposure. For example, if the aggregate uncorrected misstatement is $10 million and the allowance for imprecision of audit procedures is probably no more than $5 million, the auditor should determine whether the total of $15 million could materially misstate the financial statements as a whole.

For any notes to the financial statements containing misstatements (other than those that are clearly trivial quantitatively or qualitatively) or for which there is a risk of significant potential undetected misstatements, the auditor should assess the significance of and document any such misstatements and potential undetected misstatements.

1. The auditor may also consider any other aspects that may increase the risk of potential undetected misstatements and also consider any mitigating factors that may lower the risk of misstatement.
2. The auditor’s evaluation of audit exposure must be provided to the reviewer in a timely manner to allow any issues to be promptly identified and resolved. See FAM 545 A for a template that the auditor can use to perform this evaluation.

545 A – Further Evaluation of Audit Risk Template

1. This template is a tool that the auditor can use to conduct the analysis described in FAM 545. The template consists of four sections: (I) Conclusions, (II) Consideration of Quantitative Factors, (III) Consideration of Notes to the Financial Statements, and (IV) Consideration of Other Factors. In each section, blank rows may be used, and if needed, more rows added for additional factors specific to any given audit.

Consideration of Quantitative Factors

Overall

1. Amounts that do not affect the materiality (benchmark) will be entered to column C for each financial statement in the tables below.
2. Untested amounts and allowance for the imprecision of analytical procedures on which complete substantive reliance was placed (see FAM 470.09) will be entered at absolute value (simple addition with no +/- signs).
3. Uncorrected misstatements that do not affect the benchmark will first be netted for each line item, and then the amount for all the line items will be accumulated at absolute value and the total entered to column C.
4. Sampling precision associated with statistical samples selected to test balances that do not affect the benchmark will be statistically combined, as appropriate, with the assistance of the audit sampling specialist, and the result entered to column C. For any financial statement on which the benchmark does not appear, all amounts will be entered to column C. Hence, in such cases, column D will not be needed, and “N/A” can be entered in each row. Amounts related to balances that do affect the benchmark will be entered in column D. In these cases, untested amounts, limits related to analytical tests upon which we placed 100 percent substantive reliance, and uncorrected misstatements will all be added or netted, as appropriate, to determine their actual effect on the benchmark and the results entered in column D.

Combined sampling precision calculations related to balances that do affect the benchmark will be done the same way as for those balances that do not affect the benchmark (above), except that they will be entered in column D. So, on any financial statement that includes the benchmark and also reports a mixture of balances that do, and do not, affect the benchmark (and were subject to statistical sampling), two separate sample combination calculations will be needed—one for column C and one for column D. To illustrate some of these principles:

* If the designated materiality benchmark is total assets, only the balance sheet will use column D at all because total assets does not appear on any other financial statement. On the balance sheet itself, the net exposure amount (debits less credits) to assets will appear in column D because it affects total assets. However, the amount of exposure to liabilities will be calculated separately at absolute value (rather than net value) and entered in column C because it does not affect total assets.
* If the designated materiality benchmark is net position, the balance sheet and the statement of changes in net position will both only use column D because both statements include net position, and all of their line items affect it. Hence, in both cases, column C will not be used, and “N/A” can be entered in each row. On all other financial statements, net position does not appear, and hence, the reverse will be true: Column D will be N/A, and only column C will be used. Because both assets and liabilities affect net position, the amount of exposure to each will be netted as described above and entered in column D for untested amounts, analytical limits, and uncorrected misstatements to arrive at the amount to the benchmark.

1. **Use of column C.** Calculate the net uncorrected misstatements for each individual line item, as indicated above, and enter the result where directed. For all other amount elements, calculate the absolute value (eliminate +/- signs and add them up) of all individual amounts, and enter the result where directed. For example, if you have a $50 untested liability, and a $20 untested asset, you enter $70 on the untested amounts line. Similarly, if you have a total reliance analytical procedures limit of $30 related to one liability line item, and a $60 total reliance on analytical procedures limit related to another liability line item, you enter $90 as the related amount. Because it is absolute value, debit/credit, asset/liability, and cost/revenue distinctions are irrelevant; remove the +/- signs and add them up. Combined sampling precision calculations generally should be performed by the audit sampling specialist. Auditors will need to identify situations where a financial statement includes both balances that do, and do not, affect the materiality benchmark. If both types of line items conditions exist and both were subject to statistical sampling, separate sample combination calculations would become necessary for each, so that the results can be split between columns C and D.
2. **Use of column D.** Calculate the net effect (debits less credits) of each factor on the materiality benchmark, as described above, and enter the result. The question of what affects the benchmark depends on what benchmark is selected. For example, assume that the selected materiality benchmark on the balance sheet is total assets, and you have four untested asset amounts totaling $50, and two allowances (contra-assets) totaling $40—you net the two against each other, and enter $10 on the untested amounts line as the potential undetected misstatement. Combined sampling precision calculations would be done the same way, except that auditors will need to identify whether there are tests of balances that do, and do not, affect the materiality benchmark. If multiple line items were subject to statistical sampling, separate sample combination calculations would become necessary for each, so that the results can be split between columns C and D.
3. Do not separately calculate an exposure amount for financial statement line items, such as subtotals and totals, cumulative results of operations, and net position, as the amount of exposure related to these is shown elsewhere.
4. On the statement of budgetary resources (SBR), audit exposure will be calculated separately for each of its sections. Within each of the three sections, the results of all statistical samples selected will be statistically combined, as appropriate, which generally should be done with the assistance of the audit sampling specialist.

Evaluation of Uncorrected Misstatements

1. For each line item of each financial statement, calculate the net effect (debits less credits) of uncorrected misstatements, if any. Include only the misstatements from nonstatistical selections or other nonstatistical tests (factual and judgmental). The estimated effect of the outcome of statistical tests will be included in the sampling precision calculations below.
2. For uncorrected misstatements that do not affect the materiality benchmark, calculate the absolute value of the amounts calculated above for each financial statement (i.e., once you have calculated the net effect on each line item, remove the +/- signs for the totals and add them up). Enter the result in the appropriate space under column C for each financial statement.
3. For uncorrected misstatements that affect the materiality benchmark, calculate the net effect on the materiality benchmark of all uncorrected misstatements (net the debits and the credits). Enter the result in the appropriate space under column D for each financial statement.

Evaluation of Potential Undetected Misstatements

Untested Amounts

1. For untested amounts that do not affect the materiality benchmark, calculate the absolute value of the untested amounts, and enter the result in the appropriate space under column C, for each financial statement.
2. For untested amounts that affect the materiality benchmark, calculate the net effect on the materiality benchmark of all untested amounts (net the debits and credits). Enter the result in the appropriate space under column D for each financial statement. See FAM 545 A.04 for an example.

Sampling Precision—Monetary Unit Samples (MUS) and Non-MUS Samples

1. For statistical sample(s) selected to test line items that do not affect the materiality benchmark, calculate and enter the combined sampling precision for each financial statement in the appropriate space under column C.
2. For statistical samples selected to test line items that affect the materiality benchmark, calculate and enter the combined sampling precision for each financial statement in the appropriate space under column D. Assess this amount to the financial statement as a whole qualitatively.

If no statistical sampling was performed, enter the performance materiality in column D.

Allowance for Imprecision of Analytical Procedures on Which Complete Substantive Reliance Was Placed

1. For each financial statement, identify analytical procedures upon which complete substantive reliance was placed (see FAM 470.09). Include an allowance for the imprecision of these procedures (i.e., potential undetected misstatement) based on the following scenarios:

* **Scenario (a):** The limit set is not exceeded by the observed difference between the expected and actual outcome. Include the amount of the difference between the expected and actual outcome. If the auditor elects to investigate the difference even though it is not necessary in the circumstances, do not include any portion of the difference for which the auditor has obtained a reasonable and supported explanation.

**Example:** We projected a final balance of $1 million and set a limit of $200,000. The reported balance was actually $900,000. Since the difference between the reported balance and our projected balance ($100,000) is within the limit we set ($200,000), we did not investigate. The amount of potential undetected misstatement in this case would be $100,000, which is the difference we did not investigate between the reported balance ($900,000) and the projected balance ($1 million).

* **Scenario (b):** The limit set is exceeded by the observed difference between the expected and actual outcome. Include the amount of the limit. As in scenario (a), do not include any portion of the limit for which the auditor has obtained a reasonable and supported explanation. The auditor would propose an audit adjustment for the portion of any unexplained difference exceeding the limit, and if management rejects the proposed audit adjustment, the auditor would treat that portion as an uncorrected misstatement (see FAM 545 A.07–A.09 above).

**Example:** We set the limit at $50,000, the projected balance is $900,000, and the reported balance is $1,100,000. The difference between the reported balance ($1,100,000) and our projected balance ($900,000) is $200,000, which exceeds our limit ($50,000), so we investigated but without success. We would propose an audit adjustment $150,000, which is the extent to which the unexplained difference exceeds the limit. If the entity accepts and posts the audit adjustment, the potential undetected misstatement would be $50,000, which is the remaining portion of the unexplained difference that we did not investigate and the entity did not correct. If the entity does not accept the proposed audit adjustment, the audit difference would be $200,000. Of this difference, $50,000 would be treated as a potential undetected misstatement and $150,000 (the rejected adjustment) would be treated as an uncorrected misstatement.

1. For any such analytical procedures affecting line items that do not affect the materiality benchmark, calculate the absolute value of all potential undetected misstatements identified above, and enter the result in the appropriate space under column C, for each financial statement.
2. For any such analytical procedures affecting line items that affect the materiality benchmark, calculate the net effect of all potential undetected misstatements identified above, and enter the result in the appropriate space under column D, for each financial statement.
3. For consideration of the implications of any analytical procedures on which we placed only partial substantive reliance, see section IV, Consideration of Other Factors.

Consideration of Notes to the Financial Statements

1. For any note to the financial statements containing misstatements (other than those that are clearly trivial quantitatively or qualitatively) or for which there is a risk of significant potential undetected misstatements (e.g., untested amounts, imprecision of amounts or audit testing, or note disclosures omitted due to immateriality), assess the significance of and document any such misstatements and potential undetected misstatements (e.g., identifying the note number and name, a description of the misstatement or potential misstatement, and qualitative and quantitative factors considered). Include a misstatement in section III to the extent that the misstatement is not fully considered in section II. For example, include the information in section III if it relates to a disaggregation of a line item (e.g., property, plant, and equipment) in the note. Index to appropriate support.

Consideration of Other Factors

1. Consider the (1) imprecision of analytical procedures on which only partial reliance was placed, (2) audit exposure affecting amounts in the financial statements that do not affect the materiality benchmark when considered in relation to the total of the amounts they directly affect, (3) implications of corrected misstatements (e.g., potential existence of further undetected misstatements), and (4) other factors. Index to appropriate support.

Section I: Conclusions

This section contains example language. The auditor should tailor the language, as appropriate, to the specific circumstances of the audit.

|  |
| --- |
| **Purpose**  To determine if our audit exposure (i.e., combination of detected misstatements, possible undetected misstatements, and qualitative aspects) is material to the financial statements. |
| **Approach**  We analyzed quantitative and qualitative factors potentially affecting our audit risk. The calculated measurable quantitative amounts for each financial statement **(section II)** represents the total value of (1) the net amount of correcting audit adjustments that were not accepted and booked by XYZ entity; (2) amounts that were considered to be individually immaterial and were not tested on that basis (untested amounts); (3) the sampling precision associated with statistical samples selected for the purposes of performing substantive tests of financial statement balances; (4) if no statistical sampling was performed, an allowance equal to performance materiality; and (5) an allowance for the imprecision of substantive analytical procedures on which we placed total reliance. Our analysis was designed to provide a conservative estimate of the risk represented by these conditions and therefore used conservative assumptions. For example, all untested amounts were considered to be 100 percent overstated. All statistical calculations were performed by or in consultation with an audit sampling specialist. We assessed the significance of misstatements and potential undetected misstatements affecting the notes to the financial statements to the extent not fully considered in **section II** and have documented our assessment in **section III**. We also considered whether other factors were relevant or potentially significant to our evaluation of audit risk. This includes factors that may affect risk but whose actual dollar effect cannot be measured with any degree of precision. These are documented in **section IV.** |
| **Materiality Benchmark(s)**  We determined that the materiality benchmark was total gross costs because, based upon our judgment, we concluded that it is the most significant element of XXX’s financial statements to users (FAM 230). During the planning phase of the audit, we used XXX’s reported $300 million in total gross costs for fiscal year 2023 to calculate our performance materiality and tolerable misstatement thresholds. As XXX’s actual total program costs of $315 million for fiscal year 2024 exceeded the prior-year amount used in the planning phase calculations, we believe that the performance materiality and tolerable misstatement thresholds used are adequate. Additionally, we assessed the adequacy of our determination to apply the materiality benchmark to each financial statement given the effect of identified misstatements on the various financial statements and line items; we determined that the application of the benchmark was valid. |
| **Sources**  As indexed in sections II, III, and IV. |
| **Conclusions**  Based on considerations of both the quantitative and qualitative aspects of the audit exposure in this analysis, including the effect of amounts not directly affecting the materiality benchmark, we believe that the audit exposure is immaterial. |

Section II: Consideration of Quantitative Factors

|  |  |  |  |
| --- | --- | --- | --- |
| **BALANCE SHEET** | | | |
| **A** | **B** | **C** | **D** |
| **Audit Exposure (Quantitative)** | **Doc. Ref.** | **Estimated Amounts** | |
| Absolute Value Effect of Factors Not Directly Affecting the Materiality Benchmark | Net Effect of Factors Directly Affecting the Materiality Benchmark, on the Materiality Benchmark |
|
| Factual Uncorrected Misstatements:1 |  | $0 | $0 |
| Judgmental Uncorrected Misstatements: |  | 0 | 0 |
| **Subtotal: Factual and Judgmental Uncorrected Misstatements** | | **$0** | **$0** |
| **Estimate of Potential Undetected Misstatements:** |  |  |  |
| Untested Amounts |  | 0 | 0 |
| Combined Sampling Precision; Non-MUS Sample(s) |  | 0 | 0 |
| Combined Sampling Precision; MUS Sample(s) |  | 0 | 0 |
| **[Include Performance Materiality amount if no statistical sampling was performed (and therefore no global upper error limit amount was included in the two rows above)]** |  | 0 | 0 |
| Allowance for Imprecision of Analytical Procedures on Which Complete Substantive Reliance Was Placed |  | 0 | 0 |
| Other2 |  | 0 | 0 |
| **Subtotal: Estimated Quantitatively Measurable Undetected Misstatements** | | **$0** | **$0** |
| **Total Estimated Quantitatively Measurable Misstatements** | | **$0** | **$0** |
| **Materiality Benchmark ($ amount and benchmark used)** | | **[Add $ amount of benchmark used here]** | **[Describe benchmark used (total assets, total cost, etc.)]** |
| **Total Estimated Quantitatively Measurable Misstatements as a Percentage of Materiality Benchmark** | | **0.0%** | **0.0%** |
| **[Add auditor's note regarding the auditor’s assessment of the percentage.]** | | | |

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **STATEMENT OF NET COST** | | | | | | | | | |
| **A** | | | **B** | | | **C** | | | **D** |
| **Audit Exposure (Quantitative)** | | | **Doc. Ref.** | | | **Estimated Amounts** | | | |
| Absolute Value Effect of Factors Not Directly Affecting the Materiality Benchmark | | | Net Effect of Factors Directly Affecting the Materiality Benchmark, on the Materiality Benchmark |
|
| Factual Uncorrected Misstatements:1 | | |  | | | $0 | | | $0 |
| Judgmental Uncorrected Misstatements: | | |  | | | 0 | | | 0 |
| **Subtotal: Factual and Judgmental Uncorrected Misstatements** | | | | | | **$0** | | | **$0** |
| **Estimate of Potential Undetected Misstatements:** | | |  | | |  | | |  |
| Untested Amounts | | |  | | | 0 | | | 0 |
| Combined Sampling Precision; Non-MUS Sample(s) | | |  | | | 0 | | | 0 |
| Combined Sampling Precision; MUS Sample(s) | | |  | | | 0 | | | 0 |
| **[Include Performance Materiality amount if no statistical sampling was performed (and therefore no global upper error limit amount was included in the two rows above)]** | | |  | | | 0 | | | 0 |
| Allowance for Imprecision of Analytical Procedures on Which Complete Substantive Reliance Was Placed | | |  | | | 0 | | | 0 |
| Other2 | | |  | | | 0 | | | 0 |
| **Subtotal: Estimated Quantitatively Measurable Undetected Misstatements** | | | | | | **$0** | | | **$0** |
| **Total Estimated Quantitatively Measurable Misstatements** | | | | | | **$0** | | | **$0** |
| **Materiality Benchmark ($ amount and benchmark used)** | | | | | | **[Add $ amount of benchmark used here]** | | | **[Describe benchmark used (total assets, total cost, etc.)]** |
| **Total Estimated Quantitatively Measurable Misstatements as a Percentage of Materiality Benchmark** | | | | | | **0.0%** | | | **0.0%** |
| **[Add auditor's note regarding the auditor’s assessment of the percentage.]** | | | | | | | | | |
| **STATEMENT OF CHANGES IN NET POSITION** | | | | | | | | | |
| **A** | | | **B** | | | **C** | | | **D** |
| **Audit Exposure (Quantitative)** | | | **Doc. Ref.** | | | **Estimated Amounts** | | | |
| Absolute Value Effect of Factors Not Directly Affecting the Materiality Benchmark | | | Net Effect of Factors Directly Affecting the Materiality Benchmark, on the Materiality Benchmark |
|
| Factual Uncorrected Misstatements:1 | | |  | | | $0 | | | $0 |
| Judgmental Uncorrected Misstatements: | | |  | | | 0 | | | 0 |
| **Subtotal: Factual and Judgmental Uncorrected Misstatements** | | | | | | **$0** | | | **$0** |
| **Estimate of Potential Undetected Misstatements:** | | |  | | |  | | |  |
| Untested Amounts | | |  | | | 0 | | | 0 |
| Combined Sampling Precision; Non-MUS Sample(s) | | |  | | | 0 | | | 0 |
| Combined Sampling Precision; MUS Sample(s) | | |  | | | 0 | | | 0 |
| **[Include Performance Materiality amount if no statistical sampling was performed (and therefore no global upper error limit amount was included in the two rows above)]** | | |  | | | 0 | | | 0 |
| Allowance for Imprecision of Analytical Procedures on Which Complete Substantive Reliance Was Placed | | |  | | | 0 | | | 0 |
| Other2 | | |  | | | 0 | | | 0 |
| **Subtotal: Estimated Quantitatively Measurable Undetected Misstatements** | | | | | | **$0** | | | **$0** |
| **Total Estimated Quantitatively Measurable Misstatements** | | | | | | **$0** | | | **$0** |
| **Materiality Benchmark ($ amount and benchmark used)** | | | | | | **[Add $ amount of benchmark used here]** | | | **[Describe benchmark used (total assets, total cost, etc.)]** |
| **Total Estimated Quantitatively Measurable Misstatements as a Percentage of Materiality Benchmark** | | | | | | **0.0%** | | | **0.0%** |
| **[Add auditor's note regarding the auditor’s assessment of the percentage.]** | | | | | | | | | |
| **STATEMENT OF BUDGETARY RESOURCES – BUDGETARY RESOURCES** | | | | | | | | | |
| **A** | | | **B** | | | **C** | | | **D** |
| **Audit Exposure (Quantitative)** | | | **Doc. Ref.** | | | **Estimated Amounts** | | | |
| Absolute Value Effect of Factors Not Directly Affecting the Materiality Benchmark | | | Net Effect of Factors Directly Affecting the Materiality Benchmark, on the Materiality Benchmark |
|
| Factual Uncorrected Misstatements:1 | | |  | | | $0 | | | $0 |
| Judgmental Uncorrected Misstatements: | | |  | | | 0 | | | 0 |
| **Subtotal: Factual and Judgmental Uncorrected Misstatements** | | | | | | **$0** | | | **$0** |
| **Estimate of Potential Undetected Misstatements:** | | |  | | |  | | |  |
| Untested Amounts | | |  | | | 0 | | | 0 |
| Combined Sampling Precision; Non-MUS Sample(s) | | |  | | | 0 | | | 0 |
| Combined Sampling Precision; MUS Sample(s) | | |  | | | 0 | | | 0 |
| **[Include Performance Materiality amount if no statistical sampling was performed (and therefore no global upper error limit amount was included in the two rows above)]** | | |  | | | 0 | | | 0 |
| Allowance for Imprecision of Analytical Procedures on Which Complete Substantive Reliance Was Placed | | |  | | | 0 | | | 0 |
| Other2 | | |  | | | 0 | | | 0 |
| **Subtotal: Estimated Quantitatively Measurable Undetected Misstatements** | | | | | | **$0** | | | **$0** |
| **Total Estimated Quantitatively Measurable Misstatements** | | | | | | **$0** | | | **$0** |
| **Materiality Benchmark ($ amount and benchmark used)** | | | | | | **[Add $ amount of benchmark used here]** | | | **[Describe benchmark used (total assets, total cost, etc.)]** |
| **Total Estimated Quantitatively Measurable Misstatements as a Percentage of Materiality Benchmark** | | | | | | **0.0%** | | | **0.0%** |
| **[Add auditor's note regarding the auditor’s assessment of the percentage.]** | | | | | | | | | |
| **STATEMENT OF BUDGETARY RESOURCES – STATUS OF BUDGETARY RESOURCES** | | | | | | | | | |
| **A** | | **B** | | | **C** | | | **D** | |
| **Audit Exposure (Quantitative)** | | **Doc. Ref.** | | | **Estimated Amounts** | | | | |
| Absolute Value Effect of Factors Not Directly Affecting the Materiality Benchmark | | | Net Effect of Factors Directly Affecting the Materiality Benchmark, on the Materiality Benchmark | |
|
| Factual Uncorrected Misstatements:1 | |  | | | $0 | | | $0 | |
| Judgmental Uncorrected Misstatements: | |  | | | 0 | | | 0 | |
| **Subtotal: Factual and Judgmental Uncorrected Misstatements** | | | | | **$0** | | | **$0** | |
| **Estimate of Potential Undetected Misstatements:** | |  | | |  | | |  | |
| Untested Amounts | |  | | | 0 | | | 0 | |
| Combined Sampling Precision; Non-MUS Sample(s) | |  | | | 0 | | | 0 | |
| Combined Sampling Precision; MUS Sample(s) | |  | | | 0 | | | 0 | |
| **[Include Performance Materiality amount if no statistical sampling was performed (and therefore no global upper error limit amount was included in the two rows above)]** | |  | | | 0 | | | 0 | |
| Allowance for Imprecision of Analytical Procedures on which Complete Substantive Reliance Was Placed | |  | | | 0 | | | 0 | |
| Other2 | |  | | | 0 | | | 0 | |
| **Subtotal: Estimated Quantitatively Measurable Undetected Misstatements** | | | | | **$0** | | | **$0** | |
| **Total Estimated Quantitatively Measurable Misstatements** | | | | | **$0** | | | **$0** | |
| **Materiality Benchmark ($ amount and benchmark used)** | | | | | **[Add $ amount of benchmark used here]** | | | **[Describe benchmark used (total assets, total cost, etc.)]** | |
| **Total Estimated Quantitatively Measurable Misstatements as a Percentage of Materiality Benchmark** | | | | | **0.0%** | | | **0.0%** | |
| **[Add auditor's note regarding the auditor’s assessment of the percentage.]** | | | | | | | | | |
| **STATEMENT OF BUDGETARY RESOURCES – OUTLAYS, NET AND DISBURSEMENTS, NET** | | | | | | | | | | |
| **A** | **B** | | | **C** | | | **D** | | | |
| **Audit Exposure (Quantitative)** | **Doc. Ref.** | | | **Estimated Amounts** | | | | | | |
| Absolute Value Effect of Factors Not Directly Affecting the Materiality Benchmark | | | Net Effect of Factors Directly Affecting the Materiality Benchmark, on the Materiality Benchmark | | | |
|
| Factual Uncorrected Misstatements:1 |  | | | $0 | | | $0 | | | |
| Judgmental Uncorrected Misstatements: |  | | | 0 | | | 0 | | | |
| **Subtotal: Factual and Judgmental Uncorrected Misstatements** | | | | **$0** | | | **$0** | | | |
| **Estimate of Potential Undetected Misstatements:** |  | | |  | | |  | | | |
| Untested Amounts |  | | | 0 | | | 0 | | | |
| Combined Sampling Precision; Non-MUS Sample(s) |  | | | 0 | | | 0 | | | |
| Combined Sampling Precision; MUS Sample(s) |  | | | 0 | | | 0 | | | |
| **[Include Performance Materiality amount if no statistical sampling was performed (and therefore no global upper error limit amount was included in the two rows above)]** |  | | | 0 | | | 0 | | | |
| Allowance for Imprecision of Analytical Procedures on Which Complete Substantive Reliance Was Placed |  | | | 0 | | | 0 | | | |
| Other2 |  | | | 0 | | | 0 | | | |
| **Subtotal: Estimated Quantitatively Measurable Undetected Misstatements** | | | | **$0** | | | **$0** | | | |
| **Total Estimated Quantitatively Measurable Misstatements** | | | | **$0** | | | **$0** | | | |
| **Materiality Benchmark ($ amount and benchmark used)** | | | | **[Add $ amount of benchmark used here]** | | | **[Describe benchmark used (total assets, total cost, etc.)]** | | | |
| **Total Estimated Quantitatively Measurable Misstatements as a Percentage of Materiality Benchmark** | | | | **0.0%** | | | **0.0%** | | | |
| **[Add auditor's note regarding the auditor’s assessment of the percentage.]** | | | | | | | | | | |

|  |  |  |  |
| --- | --- | --- | --- |
| **STATEMENT OF {NAME OF STATEMENT}** | | | |
| **A** | **B** | **C** | **D** |
| **Audit Exposure (Quantitative)** | **Doc. Ref.** | **Estimated Amounts** | |
| Absolute Value Effect of Factors Not Directly Affecting the Materiality Benchmark | Net Effect of Factors Directly Affecting the Materiality Benchmark, on the Materiality Benchmark |
|
| Factual Uncorrected Misstatements:1 |  | $0 | $0 |
| Judgmental Uncorrected Misstatements: |  | 0 | 0 |
| **Subtotal: Factual and Judgmental Uncorrected Misstatements** | | **$0** | **$0** |
| **Estimate of Potential Undetected Misstatements:** |  |  |  |
| Untested Amounts |  | 0 | 0 |
| Combined Sampling Precision; Non-MUS Sample(s) |  | 0 | 0 |
| Combined Sampling Precision; MUS Sample(s) |  | 0 | 0 |
| **[Include Performance Materiality amount if no statistical sampling was performed (and therefore no global upper error limit amount was included in the two rows above)]** |  | 0 | 0 |
| Allowance for Imprecision of Analytical Procedures on Which Complete Substantive Reliance Was Placed |  | 0 | 0 |
| Other2 |  | 0 | 0 |
| **Subtotal: Estimated Quantitatively Measurable Undetected Misstatements** | | **$0** | **$0** |
| **Total Estimated Quantitatively Measurable Misstatements** | | **$0** | **$0** |
| **Materiality Benchmark ($ amount and benchmark used)** | | **[Add $ amount of benchmark used here]** | **[Describe benchmark used (total assets, total cost, etc.)]** |
| **Total Estimated Quantitatively Measurable Misstatements as a Percentage of Materiality Benchmark** | | **0.0%** | **0.0%** |
| **[Add auditor's note regarding the auditor’s assessment of the percentage.]** | | | |
| **Explanatory Comments2** | | | |
|  | | | |
|  | | | |
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| 1Include only the identified factual misstatements due to errors arising from nonstatistical selections or other nonstatistical tests. The full estimated effect of the outcome of statistical tests (projected misstatement) will be included in the combined sampling precision calculations, including the related factual amount. | | | |
| 2Describe in “Explanatory Comments” section any factor that does not fall into one of the listed categories. | | | |
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Section III: Consideration of Notes to the Financial Statements

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| --- | --- | --- | --- | --- |
| **Note No.** | **Note Name** | **Description of Misstatement or Potential Undetected Misstatement** | **Auditor’s Assessment** | **Doc. Ref.** |
|  | [Identify any notes to the financial statements containing misstatements or for which there is a risk of significant potential undetected misstatements (other than those that are clearly trivial) to the extent the misstatement is not fully considered in section II.] | [Describe the misstatement or potential undetected misstatement. Include a reference to any related misstatement in section II.] | [Assess the significance of the misstatement or potential undetected misstatement, including quantitative and qualitative factors considered.] |  |
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Section IV: Consideration of Other Factors

|  | **Description** | **Explanatory Comments** | **Doc. Ref.** |
| --- | --- | --- | --- |
| **1** | Imprecision of analytical procedures on which only partial reliance was placed |  |  |
| **2** | Audit exposure affecting amounts on the financial statements that do not affect the materiality benchmark (section II, column C), when considered in relation to the total of the amounts they directly affect1 |  |  |
| **3** | Consideration of all corrected misstatements identified |  |  |
| **4** | *{insert other factors—consider factors noted in FAM 540.23}* |  |  |
| 1For example, if the materiality benchmark is total assets, exposure affecting liability amounts on the balance sheet would not directly affect the benchmark and would therefore be entered to column C in section II. As a qualitative factor, the auditor should assess whether the quantifiably measurable exposure affecting liability amounts, when considered in relation to total liabilities, was relevant and potentially significant. | | | |
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550 – Perform Other Reporting Phase Audit Procedures

1. The auditor should

* perform procedures regarding litigation, claims, and assessments involving the entity that may give rise to a risk of material misstatement (see FAM 550.02–.03);
* identify material subsequent events and subsequently discovered facts (see FAM 550.04–.08);
* obtain management representations (see FAM 550.09–.16);
* assess relationships and transactions with disclosure entities, related parties, and public-private partnerships (see FAM 550.17);
* communicate with those charged with governance (see FAM 550.18–.22);
* assess RSI and other information (see FAM 550.23–.29); and
* consider the entity’s ability to continue as a going concern (see FAM 550.31–.32).

Litigation, Claims, and Assessments

As discussed in FAM 280.02 through .05, the auditor should make inquiries of the entity’s legal counsel and perform other procedures regarding litigation, claims, and assessments involving the entity that may give rise to a risk of material misstatement. In considering any liabilities, contingencies, or uncertainties that may affect the entity or its financial statements, the auditor shouldseek direct communication with the entity’s in-house and, if appropriate, external legal counsel regarding these matters. The auditor should do so through a legal counsel request prepared by management and sent by the auditor requesting the entity’s legal counsel to communicate directly with the auditor.

Further guidance on audit procedures related to litigation, claims, and assessments, including the evaluation of legal counsel responses, is provided in AU-C 501, *Audit Evidence—Specific Considerations for Selected Items*; Office of Management and Budget (OMB) audit guidance; FAM 280; and FAM 1002.

Identify Material Subsequent Events and Subsequently Discovered Facts

Subsequent events are events occurring between the date of the financial statements and the date of the auditor’s report. The auditor should perform audit procedures to obtain sufficient appropriate audit evidence that all subsequent events that require adjustments of, or disclosure in, the financial statements have been identified (AU-C 560.09). The auditor should perform procedures required by AU-C 560.10, which are included in FAM 1005. See AU-C 560, *Subsequent Events and Subsequently Discovered Facts*, and FAM 1005 for additional guidance. If, as a result of these performed procedures, the auditor identifies subsequent events that require adjustment of, or disclosure in, the financial statements, the auditor should determine whether each such event is appropriately reflected in the financial statements in accordance with U.S. GAAP (AU-C 560.11).

The auditor should perform subsequent event procedures near the completion of the audit and should include any events between the date of the financial statements and the date of the auditor’s report. If a long period elapses from the date of the auditor’s report to report release date, the auditor should update the procedures through the report release date.

The auditor should follow AU-C 560.13 and AU-C 700, *Forming an Opinion and Reporting on Financial Statements*, on dating the auditor’s report if management appropriately revises the financial statements for subsequent events and should obtain updated or additional representations from management, as appropriate. If management does not revise the financial statements in circumstances when the auditor believes they need to be revised, the auditor should modify the opinion (express a qualified or an adverse opinion), as required by AU-C 705, *Modifications to the Opinion in the Independent Auditor’s Report* (AU-C 560.14). See FAM 580 for guidance on drafting the auditor’s report.

The auditor is not required to perform any procedures regarding the financial statements after the date of the auditor’s report (AU-C 560.12). The auditor may inquire of management to determine if it is aware of subsequently discovered facts (defined as facts that become known to the auditor after the date of the auditor’s report that, had they been known to the auditor at that date, may have caused the auditor to revise the auditor’s report—see AU-C 560.07) that could materially affect the financial statements (see FAM 1005.05). If the auditor becomes aware of a subsequently discovered fact before the report release date, the auditor should

* discuss the matter with management and, when appropriate, those charged with governance and
* determine whether financial statements need revision and, if so, inquire how management intends to address the matter in the financial statements (see AU-C 560.12).

If a subsequently discovered fact becomes known to the auditor after the report release date, the auditor should follow AU-C 560.15 through .18.

The auditor should inquire of management and, when appropriate, those charged with governance about whether there were any changes in internal control over financial reporting or conditions that might significantly affect internal control over financial reporting subsequent to the as of date but before the date of the auditor’s report (AU-C 940.48), and perform the procedures in AU-C 940.48, which are also included in FAM 1005.

If the auditor becomes aware of any such changes in internal control, the auditor should determine whether the changes significantly affect the effectiveness of the entity’s internal control and their impact on the auditor’s report, as discussed in FAM 580.

The auditor has no responsibility to keep informed of events subsequent to the date of the report on internal control; however, after the release of the report on internal control, the auditor may become aware of conditions that existed at the report date that might have affected the auditor’s opinion had the auditor been aware of them. The evaluation of such subsequent information is similar to the evaluation of facts discovered subsequent to the date of the report on an audit of financial statements, as discussed above.

Obtain Management Representations

As discussed in FAM 280.06, the auditor should request written representations from management with appropriate responsibilities for the financial statements and knowledge of the matters concerned (AU-C 580.09) (this may include those charged with governance when appropriate). These representations should be in the form of a representation letter addressed to the auditor (AU-C 580.21). These representations supplement the other audit procedures performed by the auditor but are not a substitute for them. Written representations help avoid any misunderstandings that could arise if only oral representations were received from management. In some circumstances, corroborating evidence for representations may not be readily available, such as for those involving management’s intent concerning a future transaction or business decision.

The auditor should request that management provide the representations described in FAM 1001.09 through .28, as applicable, including that management has fulfilled its responsibilities as set out in the terms of the engagement. See FAM 1001 for additional guidance on obtaining management representations and FAM 1001 A for an example representation letter.

If the auditor has concerns about the competence, integrity, ethical values, or diligence of management or about management’s commitment to, or enforcement of, these, the auditor should determine the effect that such concerns may have on the reliability of representations (oral and written) and audit evidence in general (AU-C 580.22). In particular, if written representations are inconsistent with other audit evidence, the auditor should perform audit procedures to attempt to resolve the matter. If the matter remains unresolved, the auditor should reconsider the assessment of the competence, integrity, ethical values, or diligence of management or of management’s commitment to, or enforcement of, these and should determine the effect that this may have on the reliability of representations (oral or written) and audit evidence in general (AU-C 580.23).

In the case of identified inconsistencies between one or more written representations and audit evidence obtained from another source, the auditor may consider whether the risk assessment remains appropriate and, if not, may revise the risk assessment and determine the nature, timing, and extent of further audit procedures to respond to the risks of material misstatement (AU-C 580.A30).

If the auditor concludes that the written representations are not reliable, the auditor should take appropriate action, including determining the possible effect on the opinion in the auditor’s report in accordance with FAM 580.43, considering the requirement discussed in FAM 550.12 (AU-C 580.24). The auditor must provide the auditor’s conclusion to the reviewer in a timely manner to allow any issues to be promptly identified and resolved.

Based on AU-C 580.25, the auditor should disclaim an opinion on the financial statements if

the auditor concludes that sufficient doubt exists about the integrity of management such that the written representations described in FAM 1001.09a, .10, and .11a are not reliable or

management does not provide those representations.

If management does not provide one or more of the requested written representations as described in FAM 1001.09 through .28, the auditor should

discuss the matter with management;

reevaluate the integrity of management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general; and

take appropriate actions, including determining the possible effect on the opinion in the auditor’s report, considering the requirement discussed in FAM 550.12 (AU-C 580.26).

Management’s refusal to furnish written representations constitutes a limitation on the scope of the audit. Such refusal is often sufficient to preclude an unmodified opinion (AU-C 580.A33).

In an audit of internal control over financial reporting performed as part of an integrated audit, the failure to obtain written representations from management, including management’s refusal to furnish them, constitutes a limitation on the scope of the audit. The auditor should evaluate the effects of management’s refusal on the auditor’s ability to rely on other representations, such as those obtained during the audit of the entity’s financial statements. See AU-C 940.73 through .77 for additional guidance and determine the effect on the auditor’s report, as discussed in FAM 580.

The auditor should request that members of management and, when appropriate, those charged with governance, who are responsible for and knowledgeable about, directly or through others in the organization, the matters covered by the representations, including the preparation and fair presentation of the financial statements and the completeness of the information provided to the auditor, sign the letter (AU-C 580.06a, .09, and .A2). As discussed in OMB audit guidance, the signers generally should be officials at the highest levels of the audited entity responsible for overseeing the financial reporting process and generally should be the head of the entity, the chief financial officer (CFO), and any others deemed responsible for matters presented in this letter.

Management should date the representation letter as of the date of the auditor’s report. Typically, senior management will review the final financial statements and note disclosures to take responsibility for them before signing the representation letter. Although the auditor is not required to perform audit procedures regarding the financial statements after the date of the auditor’s report, the auditor may determine that an updated management representation letter is necessary to provide evidence concerning events subsequent to the report date. For example, the auditor may determine that updated management representations are needed to

* + - * + support a determination that subsequent events identified after the report date do not require revisions to the financial statements;
        + support a revised report date because of revisions to the financial statements as a result of a subsequent event; or
        + provide evidence that no subsequent events have occurred, particularly where the financial statements are not issued shortly after the audit report release date.

Assess Relationships and Transactions with Disclosure Entities, Related Parties, and Public-Private Partnerships

The auditor should evaluate whether the identified relationships and transactions with disclosure entities, related parties, and public-private partnerships have been appropriately accounted for and disclosed.[[6]](#footnote-7) The auditor should also evaluate whether the effects of such relationships and transactions prevent the financial statements from achieving fair presentation (AU-C 550.28). See FAM 280.07, FAM 904, and AU-C 550, *Related Parties*, for additional guidance on relationships and transactions with disclosure entities, related parties, and public-private partnerships. Statement of Federal Financial Accounting Standards (SFFAS) 47 provides the definitions of related parties and disclosure entities and related disclosure requirements for federal entities. SFFAS 49 provides the criteria for public-private partnerships and related disclosure requirements for federal entities.

Communicate with Those Charged with Governance

The auditor should communicate with those charged with governance findings and issues from the audit that are, in the auditor’s professional judgment, significant and relevant to their responsibility to oversee the financial reporting process. Those charged with governance are those responsible for overseeing the strategic direction of the entity and obligations related to the accountability of the entity, including overseeing the entity’s financial reporting process. At the start of the audit, as part of gaining an understanding of the entity, the auditor should have identified those charged with governance for the entity (see FAM 215). As discussed in FAM 215, in some instances, those charged with governance may include management. The auditor should communicate the following with those charged with governance:

1. The auditor’s views about **qualitative aspects of significant accounting practices**, including accounting policies, accounting estimates, and note disclosures. When applicable, the auditor should take the following actions:

* Explain to those charged with governance why the auditor considers a significant accounting practice that is acceptable under the applicable financial reporting framework (generally U.S. GAAP) not to be the most appropriate to the particular circumstances (AU-C 260.12a.i).
* Determine that those charged with governance are informed about the process management uses in formulating particularly sensitive accounting estimates, including fair value estimates, and about the basis for the auditor’s conclusion regarding the reasonableness of those estimates (AU-C 260.12a.ii). In doing so, the auditor should consider which matters, if any, to communicate regarding accounting estimates, taking into account whether the risks of material misstatement relate to estimation uncertainty or the effects of complexity, subjectivity, or other inherent risk factors in making accounting estimates and related note disclosures (AU-C 540.37). See FAM 905 for further guidance on accounting estimates.

See AU-C 260.A27 through .A29 for items the auditor may consider communicating related to accounting practices.

1. **Significant unusual transactions**, if any (AU-C 260.12b and .A30). See FAM 265.54c for a discussion of significant unusual transactions.
2. **Significant difficulties**, if any, that the auditor encountered during the audit (AU-C 260.12c). See AU-C 260.A31 and AU-C 730.06 for examples of difficulties, such as significant delays in receiving required information, extensive unexpected effort necessary to obtain sufficient appropriate audit evidence, an unreasonably brief time within which to complete the audit, and inability to complete procedures related to RSI.
3. **Uncorrected misstatements**, other than those the auditor believes are clearly trivial, including the following (AU-C 260.13):

* The effect that the uncorrected misstatements, individually or in the aggregate, may have on the opinion in the auditor’s report. The auditor’s communication should identify material uncorrected misstatements individually (see FAM 595 C, example 1). The auditor should request that uncorrected misstatements be corrected (AU-C 260.13a). When there are a large number of individually immaterial uncorrected misstatements, the auditor may communicate the number and overall monetary effect of the uncorrected misstatements, rather than the details of each uncorrected misstatement (AU-C 260.A38). The auditor may discuss the reasons for, and the implications of, failing to correct misstatements, taking into account the size and nature of the misstatement judged in the surrounding circumstances and possible implications with regard to future financial statements (AU-C 260.A39).
* The effect of uncorrected misstatements related to prior periods on line items, accounts, note disclosures, or classes of transactions and on the financial statements as a whole (AU-C 260.13b).
* That uncorrected misstatements or matters underlying those uncorrected misstatements could potentially cause future-period financial statements to be materially misstated, even if the auditor has concluded that the uncorrected misstatements are immaterial to the financial statements under audit (AU-C 260.13c).

1. Any **disagreements with management**, regardless of whether they were satisfactorily resolved, about matters that individually or in the aggregate could be significant to the entity’s financial statements or the auditor’s report (AU-C 260.12d). Examples of disagreements are included in AU-C 260.A32. For this purpose, disagreements do not include differences of opinion based on incomplete facts or preliminary information that are later resolved.
2. **Circumstances that affect the form and content of the auditor’s report**, if any, such as the auditor’s planned modifications to the audit opinion or inclusion of emphasis-of-matter or other-matter paragraphs in the auditor’s report (AU-C 260.12e and .A34). The auditor should also communicate to those charged with governance the wording of the expected modification to the auditor’s report (AU-C 705.31 and 706.12).
3. **Matters that are difficult or contentious** for which the auditor consulted outside the engagement team and that are, in the auditor’s professional judgment, significant and relevant to those charged with governance regarding their responsibility to oversee the financial reporting process (AU-C 260.12f).
4. **Other findings or issues**, if any, arising during the audit that are, in the auditor’s professional judgment, significant and relevant to those charged with governance regarding their responsibility to oversee the financial reporting process (AU-C 260.12g).
5. Unless all of those charged with governance are involved in managing the entity, the auditor also should communicate the following:

* **Material corrected misstatements** that were brought to the attention of management as a result of audit procedures (see FAM 595 C, example 2) (AU-C 260.14a).
* **Management representations** requested by the auditor (AU-C 260.14d). The auditor may provide those charged with governance a copy of management’s written representations (AU-C 260.A42).
* The auditor’s views about significant matters that were the subject of **management’s consultations with other accountants**, if any, on accounting and auditing matters when the auditor is aware that such consultation has occurred (AU-C 260.14c).
* Any **significant findings or issues** arising during the audit that were discussed with management or that were the subject of correspondence with management (AU-C 260.14b). AU-C 260.A41 includes examples of significant matters that the auditor may communicate.
* Significant findings or issuesin connection with the entity’s relationships and transactions with **disclosure entities, related parties, and public-private partnerships** (AU-C 550.29).

1. **Identified or suspected fraud** involving (1) management, (2) employees who have significant roles in internal control, or (3) others when the fraud results in a material misstatement in the financial statements. If the auditor suspects fraud involving management, the auditor should discuss the nature, timing, and extent of audit procedures necessary to complete the audit. Also, the auditor should discuss any other matters involving fraud that are, in the auditor’s professional judgment, relevant to those charged with governance’s responsibility (AU-C 240.40–.41).
2. **Suspected noncompliance** with laws, regulations, contracts, or grant agreements when the auditor determines that it is appropriate to discuss with those charged with governance (AU-C 250.18).
3. The auditor’s responsibility and procedures performed relating to **other information** included in the annual report and the results of these procedures (AU-C 720.15).
4. Matters involving **identified or suspected noncompliance** with laws, regulations, contracts, or grant agreements that come to the auditor’s attention during the audit, unless clearly inconsequential. If, in the auditor’s professional judgment, the matter is believed to be intentional and material, the auditor should communicate the matter as soon as practicable (AU-C 250.21–.22).
5. **Significant deficiencies and material weaknesses** identified during the audit, including those that were remediated during the audit (AU-C 265.11). For an integrated audit, the auditor should communicate in writing to management and those charged with governance significant deficiencies and material weaknesses identified during the integrated audit, including those that were remediated during the integrated audit and those that were previously communicated but have not yet been remediated (AU-C 940.59).
6. If management has imposed a **limitation on the scope of the audit** and refuses to remove the limitation, the auditor should communicate the matter to those charged with governance, unless all of those charged with governance are involved in managing the entity, and if appropriate, determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence (AU-C 705.11 and .12).
7. A material misstatement of the financial statements that relates to the **omission of information** required to be presented or disclosed (AU-C 705.24a).

AU-C 260.A25 through .A42 provide further guidance on these matters. Matters that arose during the audit that were communicated to those charged with governance and satisfactorily resolved do not need to be included in the communication.

As discussed in FAM 215.33, the auditor should communicate significant findings and issues in writing to those charged with governance if, in the auditor’s professional judgment, oral communication would not be adequate. This communication need not include matters that arose during the course of the audit that were communicated with those charged with governance and satisfactorily resolved. Factors that may affect whether to communicate orally or in writing, the extent of detail or summarization in the communication, and the formality of the communication are discussed in AU-C 260.A48 through .A50. Effective communication may involve formal presentations and written reports as well as less formal communications, including discussions (AU-C 260.A48–.A50).

As discussed in FAM 215.37 and .38, the auditor should communicate with those charged with governance on a timely basis and should document all matters that are required to be communicated, including when and to whom they were communicated.

If, as part of its communication to those charged with governance, management communicated some or all of the matters the auditor is required to communicate, and as a result, the auditor did not communicate these matters at the same level of detail as management, the auditor should communicate any omitted or inadequately described matters to those charged with governance. The auditor does not need to communicate them at the same level of detail as to management, as long as the auditor (a) participated in management’s discussion with those charged with governance and (b) affirmatively confirmed to those charged with governance that management has adequately communicated these matters (AU-C 260.17).

The auditor should evaluate the adequacy of the two-way communication between the auditor and those charged with governance for the purposes of the audit (AU-C 260.20). Inadequate two-way communication may indicate an unsatisfactory control environment, which will influence the auditor’s assessment of the risks of material misstatements. There is also a risk that the auditor may not have obtained sufficient appropriate audit evidence to form an opinion on the financial statements (AU-C 260.A54). The auditor does not need to design specific procedures to evaluate the adequacy of this communication. Rather, the auditor may base the evaluation on observations resulting from audit procedures performed for other purposes. Such observations may include the following (AU-C 260.A53):

* the appropriateness and timeliness of actions taken by those charged with governance in response to matters the auditor communicated;
* the apparent openness of those charged with governance in their communications with the auditor;
* the willingness and capacity of those charged with governance to meet with the auditor without management present;
* the apparent ability of those charged with governance to fully comprehend matters communicated by the auditor, such as the extent to which those charged with governance probe issues and question recommendations made to them;
* difficulty in establishing with those charged with governance a mutual understanding of the form, timing, and expected general content of communications; and
* when all or some of those charged with governance are involved in managing the entity, their apparent awareness of how matters discussed with the auditor affect their broader governance responsibilities, as well as their management responsibilities.

If the two-way communication between the auditor and those charged with governance is not adequate, the auditor should evaluate the effect, if any, on the auditor’s assessment of the risks of material misstatement and ability to obtain sufficient appropriate audit evidence and should take appropriate action. If the situation cannot be resolved, the auditor may take actions as discussed in AU-C 260.A55, including modifying the auditor’s opinion for a limitation on the scope of the audit (AU-C 260.20 and .A55).

Assess RSI and Other Information

The auditor should conclude on procedures performed for RSI and other information. See FAM 580.38 through .39 regarding how the auditor reports on the work performed in these areas.

For RSI, the auditor should determine whether there are any omissions, material departures from Federal Accounting Standards Advisory Board (FASAB) guidance, or material inconsistencies with the financial statements and the auditor’s knowledge, based on procedures performed in FAM 280.08. The auditor should also obtain management representations regarding RSI as specified in FAM 280.08. If the auditor is unable to complete the procedures described in FAM 280.08, the auditor should consider whether management contributed to the auditor’s inability to complete the procedures. If the auditor concludes that the inability to complete the procedures was due to significant difficulties encountered in dealing with management, the auditor should inform those charged with governance (AU-C 730.06).

For other information, the auditor should determine whether there are any material inconsistencies with the audited financial statements or misstatement of fact based on procedures performed in FAM 280.09.

1. If the auditor identifies that a material inconsistency appears to exist between the other information and the audited financial statements or becomes aware that the other information appears to be materially misstated, the auditor should discuss the matter with management and, if necessary, perform other procedures to conclude whether (1) a material misstatement of the other information exists, (2) a material misstatement of the financial statement exists, and (3) the auditor’s understanding of the entity and its environment needs to be updated (AU-C 720.19).
2. If the auditor concludes that a material misstatement of the other information exists, the auditor should request that management correct the other information and, if management agrees to make the correction, determine that the correction has been made. If management refuses to make the correction, the auditor should communicate the matter to those charged with governance and request that the correction be made. If the other information is not corrected after communicating with those charged with governance, the auditor should consider the implications for the auditor’s report and communicate to those charged with governance about how the auditor plans to address the material misstatement in the auditor’s report (AU-C 720.20 and .21a). If the auditor concludes that a material misstatement exists in other information obtained after the date of the auditor’s report, the auditor should follow the requirements in AU-C 720.22.
3. If, as a result of performing procedures on other information, the auditor concludes that a material misstatement in the financial statements exists or the auditor’s understanding of the entity and its environment needs to be updated, the auditor should respond appropriately in accordance with other relevant AU-C sections (AU-C 720.23).
4. In reading the other information, the auditor may become aware of new information that has implications for the following (AU-C 720.A55):

* the auditor’s understanding of the entity and its environment, the financial reporting framework (generally U.S. GAAP), and the entity’s internal control, which may indicate the need to revise the auditor’s risk assessment;
* the auditor’s responsibility to evaluate the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements; and
* the auditor’s responsibilities related to subsequent events.

Supplementary Information

1. If the auditor is engaged to report on whether supplementary information, such as consolidating statements, is fairly stated, in all material respects, in relation to the financial statements as a whole, the auditor should follow the requirements in AU-C 725.

Consider the Entity’s Ability to Continue as a Going Concern

AU-C 570, *The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern*, discusses the implications for the auditor’s report if conditions and events have been identified that raise substantial doubt about an entity’s ability to continue as a going concern for a reasonable period of time. However, according to SFFAS 39, *Subsequent Events: Codification of Accounting and Financial Reporting Standards Contained in the AICPA Statements on Auditing Standards*, appendix A, FASAB considered the nature of the federal government and determined that “going concern” as contemplated in the commercial sense is not applicable to federal government financial reporting.

For entities that conform to Financial Accounting Standards Board (FASB) standards, the auditor should evaluate whether there is substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time based on the results of the audit procedures performed pursuant to AU-C 570.

560 – Determine Whether Financial Statement Presentation Is in Accordance with U.S. Generally Accepted Accounting Principles

1. U.S. GAAP for federal government entities is promulgated by FASAB. As permitted by SFFAS 34, *The* *Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*, some federal entities, including government corporations, prepare financial statements in accordance with standards promulgated by FASB. For further information on the requirements for applying FASB standards, see SFFAS 34.

FASAB established the hierarchy of accounting principles for federal entities in SFFAS 34*.* This hierarchy is presented below, from most authoritative to least authoritative.

1. FASAB Statements and Interpretations and AICPA and FASB pronouncements made applicable to federal governmental entities by a FASAB Statement or Interpretation.
2. FASAB Technical Bulletins and the following pronouncements if the AICPA specifically made them applicable to federal governmental entities and FASAB cleared them: AICPA Industry Audit and Accounting Guides and AICPA Statements of Position.
3. AICPA Accounting Standards Executive Committee Practice Bulletins if specifically made applicable to federal governmental entities and cleared by FASAB and Technical Releases of its Accounting and Auditing Policy Committee.
4. Implementation guides published by FASAB staff and practices that are widely recognized and prevalent in the U.S. government.

In the absence of a pronouncement in the above hierarchy, the auditor may evaluate other accounting literature, including

1. FASAB Concepts Statements;
2. pronouncements in categories a through d in FAM 560.02 when not specifically made applicable to federal governmental entities;
3. FASB and Government Accounting Standards Board (GASB) Concepts Statements;[[7]](#footnote-8)
4. GASB Statements, Interpretations, and Technical Bulletins;
5. AICPA Issue Papers;
6. International Accounting Standards of the International Accounting Standards Committee;
7. pronouncements of other professional associations or regulatory agencies;
8. AICPA Technical Practice Aids; and
9. accounting textbooks, handbooks, and articles.

Entities summarize their significant accounting policies, usually in note 1 to the financial statements.

The auditor should perform audit procedures to evaluate whether the financial statements are prepared and presented, in all material respects, in accordance with U.S. GAAP or other applicable financial reporting framework (AU-C 330.26 and 700.14). See FAM 215.14 for discussion of financial reporting framework. This evaluation should include consideration of the qualitative aspects of the entity’s accounting practices, including indicators of possible bias in management’s judgments (AU-C 700.14). This evaluation should include the following:

1. Whether, in view of the requirements of the applicable financial reporting framework (generally U.S. GAAP):

* The financial statements appropriately disclose the significant accounting policies selected and applied. In making this evaluation, the auditor should consider the relevance of the accounting policies to the entity and whether they have been presented in an understandable manner.
* The accounting policies selected and applied are consistent with the applicable financial reporting framework (generally U.S. GAAP) and are appropriate.
* The accounting estimates and related note disclosures made by management are reasonable.
* The information presented in the financial statements is relevant, reliable, comparable, and understandable. In making this evaluation, the auditor should consider whether all required information has been included, and whether such information is appropriately described, classified, aggregated or disaggregated, and presented.
* The financial statements provide adequate note disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements.
* The terminology used in the financial statements, including the title of each financial statement, is appropriate (AU-C 700.15).

1. Whether the financial statements achieve fair presentation, including consideration of the following:

* the appropriate classification and description of financial information and the underlying transactions, events, and conditions;
* the appropriate presentation, structure, and content of the financial statements (AU-C 330.26); and
* whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation (AU-C 700.16).

1. Whether the financial statements adequately refer to or describe the applicable financial reporting framework (generally U.S. GAAP) (AU-C 700.17).

The auditor can meet the requirement for the above evaluations by completing the Federal Financial Reporting Checklist.[[8]](#footnote-9) This checklist also can assist the entity in preparing financial statements with appropriate and adequate note disclosures in accordance with U.S. GAAP.

For accounting estimates, the auditor’s procedures should address whether management has developed note disclosures about estimation uncertainty related to management’s point estimate (AU-C 540.25b).[[9]](#footnote-10) The greater the degree to which an accounting estimate is subject to estimation uncertainty, the more likely the risks of material misstatement will be assessed as higher and, therefore, the more persuasive the audit evidence needs to be to determine whether management’s point estimate and related note disclosures about estimation uncertainty are reasonable in the context of the applicable financial reporting framework (generally U.S. GAAP) or are misstated (AU-C 540.A113). See FAM 905 for further guidance on auditing accounting estimates.

The auditor should evaluate the impact of any instances where the financial statements are not in accordance with U.S. GAAP and should determine the effects, if any, on the auditor’s report (see FAM 580.09–.10).

570 – Determine Compliance with GAO/CIGIE *Financial Audit Manual*

1. The auditor should determine whether the audit was conducted in accordance with GAGAS and, if applicable, OMB audit guidance. The auditor should also determine whether the FAM methodology was followed. One tool the auditor should use to determine and document FAM compliance and whether there are any exceptions or deviations is the audit completion checklist in FAM 1003. If the auditor is using a different methodology and if required by contract, the auditor should use the audit completion checklist to provide a crosswalk between the audit methodology used and the FAM.

580 – Draft Reports

1. Based on AU-C 700.21, at the conclusion of the audit, the auditor should draft written reports on the entity’s

* financial statements, RSI (including MD&A), and other information included in the annual report (see FAM 580.02–.55);
* internal control over financial reporting (see FAM 580.56–.85);
* financial management systems’ substantial compliance with the three FFMIA requirements (for CFO Act agencies) (see FAM 580.86–.90);[[10]](#footnote-11) and
* compliance with significant provisions of applicable laws, regulations, contracts, and grant agreements (see FAM 580.91–.99).

If the auditor is engaged to report on whether supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole, the auditor should follow the reporting requirements in AU-C 725.

Financial Statement Reporting

The auditor should form an opinion on whether the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework (generally U.S. GAAP) (AU-C 700.12).

Audit Scope

To express an opinion, first the auditor should determine if the audit has been conducted in accordance with GAGAS and, if applicable, OMB audit guidance (see FAM 570). The auditor should conclude whether the auditor has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error (AU-C 700.13). If the auditor is not able to perform all procedures considered necessary, the scope of the audit is restricted, and the auditor should consider whether to modify the GAGAS compliance statement in the report, as discussed in GAGAS (2018) 2.17b, 2.18 and 2.20, and determine whether to qualify or disclaim an opinion.

Limitations on the scope of the auditor’s work resulting in the auditor’s inability to obtain sufficient appropriate audit evidence may be imposed by the entity, may be caused by circumstances beyond the entity’s control, or may result from circumstances related to the nature or the timing of the audit work. Examples of scope limitations are included in AU-C 705.A9 through .A13. Limitations imposed by the entity may have other implications for the audit, such as the auditor’s assessment of risk of material misstatement due to fraud.

Based on AU-C 330.28, the auditor should conclude whether sufficient appropriate audit evidence has been obtained to reduce the risk of undetected material misstatements to an appropriately low level in the financial statements. The auditor’s conclusion on whether sufficient appropriate audit evidence has been obtained is both at the assertion level as well as the financial statement level (AU-C 330.A79). In forming a conclusion, the auditor should consider all relevant audit evidence, regardless of whether it appears to corroborate or contradict the assertions in the financial statements. AU-C 330.A79 presents factors that may influence this conclusion on the sufficiency and appropriateness of audit evidence.

The auditor should determine whether any misstatements affect the audit scope from a qualitative standpoint. The auditor should also determine whether the audit scope is adequate in light of any (1) misstatements or (2) other findings that indicate noncompliance with significant provisions of applicable laws, regulations, contracts, and grant agreements.

Based on AU-C 330.29, if the auditor has not obtained sufficient appropriate audit evidence related to a significant assertion about a material line item, account, note disclosure, or class of transactions, the auditor should attempt to obtain further audit evidence. If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor should determine the implications on the audit opinion following guidance in FAM 580.43 and include the reasons for that inability in the “Basis for Opinion” section (AU-C 705.13 and .25).

Whether to qualify or disclaim an opinion because of a scope limitation is a matter of the auditor’s professional judgment. The auditor should assess how important the omitted procedures were to the auditor’s ability to form an opinion on the financial statements based on sufficient appropriate audit evidence. This assessment is influenced by the nature, significance, and magnitude of the items to which the omitted procedures relate. For example, the potential effect of a scope limitation on a material account is likely to be greater than on an immaterial account.

Departure from U.S. GAAP (Misstatements)

The auditor should evaluate whether the financial statements as a whole, including the related note disclosures, are materially misstated based on a departure from U.S. GAAP, as discussed in FAM 560. If such a departure exists, the auditor should determine the effects of the departure on the financial statements, considering both quantitative and qualitative aspects. The auditor should conclude whether the effects of the misstatements, individually or in the aggregate, are (1) material and (2) pervasive to the financial statements. See FAM 580.43 for further discussion.

In rare cases when the auditor can demonstrate that compliance with U.S. GAAP would result in misleading financial statements, the auditor may issue an unmodified opinion that includes a description of the nature of the departure; the effects, if practicable; and why compliance with U.S. GAAP would result in misleading financial statements (see the *AICPA Code of Professional Conduct*, 1.320.001 Accounting Principles Rule). The auditor’s conclusion regarding a departure from U.S. GAAP must be provided to the reviewer in a timely manner to allow any issues to be promptly identified and resolved.

Uncertainties

Uncertainties are matters affecting the financial statements whose outcome is expected to be resolved at a future date when conclusive evidence becomes available and that could result in a modified opinion. Uncertainties may be related to the resolution of litigation or the valuation of assets, such as real estate owned, and include the contingencies discussed in SFFAS 5, as amended by SFFAS 12, as well as other matters (see FAM 905 for discussion of auditing accounting estimates). Absence of information related to the outcome of an uncertainty does not necessarily indicate that the audit evidence supporting management’s assertions is not sufficient. Rather, the auditor’s professional judgment regarding the sufficiency of the audit evidence is based on the audit evidence that is, or should be, available. If, after considering the existing conditions and available evidence, the auditor concludes that sufficient appropriate audit evidence supports management’s assertions about the nature of a matter involving an uncertainty and its presentation or disclosure in the financial statements, an unmodified opinion ordinarily is appropriate (AU-C 705.A14).

In cases involving multiple uncertainties, the auditor may conclude that it is not possible to form an opinion on the financial statements as a whole due to the interaction and possible cumulative effects of the uncertainties (AU-C 705.A15).

The auditor should express an unmodified opinion if, in the auditor’s judgment, evidence is sufficient to support management’s analysis of the nature of the uncertainty and its presentation or disclosure in the financial statements. The auditor may also add an emphasis-of-matter paragraph.

Comparative Financial Statements and Comparative Information

1. Entities subject to OMB reporting guidance are required to prepare comparative financial statements. Those not subject to the requirement may nevertheless elect to do so. When comparative financial statements are presented, the auditor’s report should refer to each period for which financial statements are presented and on which an audit opinion is expressed (AU-C 700.47).
2. When expressing an opinion on all periods presented, a continuing auditor should update the report on the financial statements of one or more prior periods, presented on a comparative basis, with those of the current period. The auditor’s report on comparative financial statements should not be dated earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to support the opinion for the most recent audit (AU-C 700.48).

If comparative information is presented but not covered by the auditor’s opinion, the auditor should clearly indicate in the auditor’s report the character of the auditor’s work, if any, and the degree of responsibility the auditor is taking (AU-C 700.49).

If comparative information is presented and the auditor has been engaged to express an opinion on all periods presented, the auditor should consider whether the information included for the prior period(s) contains sufficient detail to constitute a fair presentation in accordance with the applicable financial reporting framework (generally U.S. GAAP) (AU-C 700.50).

If comparative financial statements or comparative information is presented for prior periods, the auditor should determine whether the comparative financial statements or comparative information has been presented in accordance with the relevant requirements, if any, of the applicable financial reporting framework (generally U.S. GAAP) (AU-C 700.51-.52). The auditor should also evaluate

* whether the comparative financial statements or comparative information agrees with the amounts and other disclosures presented in the prior period, or when appropriate, has been restated for the correction of a material misstatement or adjusted for the retrospective application of an accounting principle, and
* whether the accounting policies reflected in the comparative financial statements or comparative information are consistent with those applied in the current period or, if there have been changes in accounting policies, whether those changes have been properly accounted for and adequately presented and disclosed (AU-C 700.53).

If the auditor becomes aware of a possible material misstatement in the comparative financial statements or comparative information while performing the current period audit, the auditor should perform such additional audit procedures as are necessary in the circumstances to obtain sufficient appropriate audit evidence to determine whether a material misstatement exists. If the auditor audited the prior period’s financial statements and becomes aware of a material misstatement in those financial statements, the auditor should also follow the requirements of AU-C 560. If the prior-period financial statements are restated, the auditor should determine that the comparative financial statements or comparative information agrees with the restated financial statements (AU-C 700.54). Also see FAM 580.110 for additional guidance.

As noted in FAM 1001.06, the auditor should request written representations for all periods referred to in the auditor’s opinion. The auditor also should obtain a specific written representation regarding any restatement made to correct a material misstatement in a prior period that affects the comparative financial statements (AU-C 700.55).

When reporting on prior period financial statements in connection with the current period’s audit, if the auditor’s opinion on such prior period financial statements differs from the opinion the auditor previously expressed, the auditor should disclose the following matters in an emphasis-of-matter or other matter paragraph in accordance with AU-C 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor’s Report* (AU-C 700.56):

* the date of the auditor’s previous report;
* the type of opinion previously expressed;
* the substantive reasons for the different opinion; and
* that the auditor’s opinion on the amended financial statements is different from the auditor’s previous opinion.

If the financial statements of the prior period were audited by a predecessor auditor, the auditor should follow the reporting requirements of AU-C 700.57 and .58. If comparative financial statements are presented, but the prior period financial statements were not audited, the auditor should follow the reporting requirements of AU-C 700.59 or 60, as applicable.

The auditor should evaluate whether the comparability of the financial statements between periods has been materially affected by a change in accounting principle or by adjustments to correct a material misstatement in previously issued financial statements (AU-C 708.05), and determine the implications of such changes on the auditor’s report, following the requirements of AU-C 708.07 through .10 and .13 through .16.

The periods included in the auditor’s evaluation of consistency depend on the periods covered by the auditor’s opinion on the financial statements. When the auditor’s opinion covers only the current period, the auditor should evaluate whether the current-period financial statements are consistent with those of the preceding period, regardless of whether the prior period’s financial statements are presented. When the auditor’s opinion covers two or more periods, the auditor should evaluate consistency between such periods and the consistency of the earliest period covered by the auditor’s opinion with the period prior thereto, if such prior period is presented with the financial statements being reported on. The auditor should also evaluate whether the financial statements for the periods being reported on are consistent with any previously issued financial statements for those periods (AU-C 708.06).

If the auditor identifies material inconsistencies between the comparative financial statements, the auditor will need to determine the effect on the auditor’s opinion and include an emphasis-of-matter paragraph. The auditor should see AU-C 705, *Modifications to the Opinion in the Independent Auditor’s Report*, and AU-C 708, *Consistency of Financial Statements*, for further guidance.

Report Format

The auditor’s report should have a title that clearly indicates that it is the report of an independent auditor and should be addressed, as appropriate, based on the circumstances of the engagement (AU-C 700.22 and .23).

The auditor’s report should clearly identify the entity audited; the financial statement(s) on which the auditor is reporting; and the period covered by the financial statement(s), usually the current year with comparative prior year.

The auditor’s report on the financial statements should include sections with the following headings in the order shown below (AU-C 700.24, .28, .31, and .34):

* Opinion
* Basis for Opinion
* Responsibilities of Management for the Financial Statements
* Auditor’s Responsibilities for the Audit of the Financial Statements

If the auditor expresses a modified opinion, the auditor should modify the section headings listed above in accordance with AU-C 705. See FAM 595 B auditor’s report examples.

The auditor’s report on the financial statements should also include sections with the following headings, as applicable:

* Required Supplementary Information or other appropriate heading (see FAM 580.38)
* Other Information or other appropriate heading (see FAM 580.39)

The auditor’s report on the audit of internal control over financial reporting should include sections with the following headings in the order shown below (AU-C 940.64):

* Opinion on Internal Control over Financial Reporting
* Basis for Opinion
* Responsibilities of Management for Internal Control over Financial Reporting
* Auditor’s Responsibilities for the Audit of Internal Control over Financial Reporting
* Definition and Inherent Limitations of Internal Control over Financial Reporting or other appropriate heading

1. The auditor may choose to issue a combined report containing both an opinion on the financial statements and an opinion on internal control over financial reporting or separate reports on the entity’s financial statements and on internal control over financial reporting (AU-C 940.A116). If issuing separate reports, the auditor should use the headings listed under FAM 580.26 and .27 above. If issuing a combined report, the auditor should use the headings listed below in the following order:

* Opinion on the Financial Statements
* Opinion on Internal Control over Financial Reporting
* Basis for Opinions
* Responsibilities of Management for the Financial Statements and Internal Control over Financial Reporting
* Auditor’s Responsibilities for the Audits of the Financial Statements and Internal Control over Financial Reporting
* Definition and Inherent Limitations of Internal Control over Financial Reporting
* Required Supplementary Information
* Other Information

See auditor’s report example 1 in FAM 595 A.

1. Based on AU-C 700.39, other reporting responsibilities, such as the auditor’s report on (1) internal control over financial reporting in which no opinion is expressed or (2) report on compliance with laws, regulations, contracts, and grant agreements, should be addressed in a separate section in the auditor’s report with a heading that is appropriate to the content of the section.

The auditor’s report on internal control over financial reporting in which no opinion is expressed should include a section discussing the definition and inherent limitations of internal control over financial reporting, similar to the language the auditor would include in a report on the audit of internal control over financial reporting.[[11]](#footnote-12) The auditor’s report on internal control over financial reporting in which no opinion is expressed should include sections with the following headings:

* Results of Our Consideration of Internal Control over Financial Reporting
* Basis for Results of Our Consideration of Internal Control over Financial Reporting
* Responsibilities of Management for Internal Control over Financial Reporting
* Auditor’s Responsibilities for Internal Control over Financial Reporting
* Definition and Inherent Limitations of Internal Control over Financial Reporting
* Intended Purpose of Report on Internal Control over Financial Reporting (see FAM 580.74)

The auditor’s report on compliance with laws, regulations, contracts, and grant agreements should include sections with the following headings:

* Results of Our Tests for Compliance with Laws, Regulations, Contracts, and Grant Agreements
* Basis for Results of Tests for Compliance with Laws, Regulations, Contracts, and Grant Agreements
* Responsibilities of Management for Compliance with Laws, Regulations, Contracts, and Grant Agreements
* Auditor’s Responsibilities for Tests of Compliance with Laws, Regulations, Contracts, and Grant Agreements
* Intended Purpose of Report on Compliance with Laws, Regulations, Contracts, and Grant Agreements (see FAM 580.96)

See auditor’s report example 2 in FAM 595 A.

Information that is not required by the applicable financial reporting framework (generally U.S. GAAP) but is nevertheless presented as part of the basic financial statements should be covered by the auditor’s opinion if it cannot be clearly differentiated. Information that can be clearly differentiated may be identified as “unaudited” or as “not covered by the auditor’s report” (AU-C 700.61 and .A80).

The auditor’s report should be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor’s opinion on the financial statements. See FAM 580.103 for further guidance.

GAGAS (2018) 6.57 requires the auditor to obtain and report the views of management concerning the findings, conclusions, and recommendations in the audit report, as well as any planned corrective actions. The entity comments and (auditor) evaluation section of the report discusses the extent to which the entity agrees with the facts and conclusions presented by the auditor and the reasons for any disagreements. The auditor should evaluate any disagreements that the entity expresses and present the auditor’s view. The auditor may also outline in the report the entity’s description of the efforts it is taking to correct or mitigate matters. The auditor should disclaim an opinion on this information. See FAM 580.100–.102 for further guidance.

The auditor may prepare a highlights page, executive summary, and/or transmittal letter to provide a high-level presentation of the audit report and significant matters of interest to the users of federal financial reports. The auditor typically presents matters in nontechnical language so that report users can readily grasp their significance.

Types of Reports

The auditor may issue one of the following opinion types: (1) unmodified or (2) modified, which may be a qualified opinion, adverse opinion, or disclaimer of opinion. Additionally, the auditor may be required or may choose to include an emphasis-of-matter and/or other-matter paragraph as discussed below.

Reporting requirements and related guidance are included in AU-C 700, 701, 705, 706, 708, 720, 725, 730, 806, and 940 and GAGAS (2018) 6.39 through 6.41. Additionally, FAM 595 A includes an example of an unmodified report. FAM 595 B includes example wording for an auditor’s report with an unmodified opinion on the financial statements and an opinion on internal controls over financial reporting where a material weakness or significant deficiency is identified. The auditor may use another reporting format; however, the format should meet the requirements of the standards listed above. GAO auditors also should document the reasons for any significant deviations from the example reporting format or language in FAM 595 A or B. When findings are extensive, the auditor may modify the report format to include findings in the report and additional details in an appendix included with the report.

If the auditor expresses an opinion only on a single financial statement, or specific elements, accounts, or items of a financial statement, the auditor should follow AU-C 805, *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*.

Unmodified Opinion

In an unmodified opinion on the financial statements, the auditor concludes that the financial statements are presented fairly, in all material respects, as of the specified date in accordance with U.S. GAAP (AU-C 700.18).[[12]](#footnote-13) The auditor should follow the requirements of AU-C 700.22 through .43 regarding specific wording and structure of the auditor’s report, as specified in FAM 595 A. Additionally, the auditor should include an emphasis-of-matter paragraph, other-matter paragraph, or both to the unmodified report in certain circumstances, as discussed below.

If RSI is applicable to the entity, the auditor should include a separate section in the auditor’s report on the financial statements with the heading “Required Supplementary Information,” or other appropriate heading. The auditor should follow the requirements of AU-C 730.07 through .09 regarding specific wording of this section, as specified in FAM 595 A. Refer to AU-C 730.08d through .08g; .09; and .A3, illustrations 2 through 6, if (1) the auditor is unable to complete the procedures discussed in FAM 280.08, (2) some or all of the RSI is omitted, (3) the auditor has identified material departures from prescribed guidelines, or (4) the auditor has unresolved doubts about whether the RSI is measured or presented in accordance with prescribed guidelines.

If other information is presented in the annual report, at the date of the auditor’s report, when the auditor has obtained all the other information included in the report, the composition of which was determined through discussion with management and for which the auditor obtained management’s written acknowledgment (see FAM 280.09), the auditor should include a separate section in the auditor’s report on the financial statements with the heading “Other Information” or other appropriate heading. The auditor should follow the requirements of AU-C 720.24 and .25 regarding specific wording of this section, as specified in FAM 595 A. Refer to AU-C 720.24f; .25; and .A62, illustration 2, if the auditor has concluded that an uncorrected material misstatement of the other information exists.

For entities that conform to FASB standards, if, as a result of audit procedures performed as specified in AU-C 570.12 through .17, the auditor concludes that substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time remains, the auditor should include a separate section in the auditor’s report with the heading “Substantial Doubt About the Entity’s Ability to Continue as a Going Concern” in accordance with AU-C 570.24 through .25. If adequate disclosure about the entity’s ability to continue as a going concern for a reasonable period of time is not made in the financial statements, the auditor should modify the audit opinion in accordance with AU-C 570.26. If the financial statements have been prepared using the going concern basis of accounting, but in the auditor’s judgment, management’s use of the going concern basis of accounting in the preparation of the financial statements is inappropriate, the auditor should express an adverse opinion (AU-C 570.23). Refer to AU-C 570 for additional requirements pertaining to the entity’s ability to continue as a going concern.

Types of Modified Opinions

Pervasive effects on the financial statements are those that in the auditor’s professional judgment,

* are not confined to specific elements, accounts, or items of the financial statements;
* if so confined, represent or could represent a substantial proportion of the financial statements; or
* with regard to note disclosures, are fundamental to users’ understanding of the financial statements (AU-C 705.06).

The auditor should conclude whether the possible effects of undetected misstatements, if any, could be material to the financial statements and, if so, also conclude whether the possible effects are pervasive to the financial statements (AU-C 705.8b and .10).

If the audit scope is adequate for expressing an opinion on the financial statements, the auditor should determine the appropriate type of opinion. The auditor should make this determination based on

1. the auditor’s conclusions on whether uncorrected misstatements are material, individually or in the aggregate, to the financial statements, as discussed in FAM 540 and AU-C 450.11 (AU-C 700.13b);
2. the auditor’s conclusions on whether the financial statements are prepared, in all material respects, in accordance with the requirements of the applicable financial reporting framework (generally U.S. GAAP), including consideration of the qualitative aspects of the entity’s accounting practices, including indicators of possible bias in management’s judgments, as discussed in FAM 560.05 (AU-C 700.14);
3. the results of the auditor’s evaluation of the financial statement disclosure of accounting policies, the selection of accounting policies, and other items specified in AU-C 700.15a through .15f, as discussed in FAM 560;
4. the results of the auditor’s evaluation about whether the financial statements achieve fair presentation considering the factors in AU-C 700.16a and .16b, as discussed in FAM 560; and
5. the results of the auditor’s evaluation about whether the financial statements adequately refer to or describe the applicable financial reporting framework per AU-C 700.17 and as discussed in FAM 560.

The following table illustrates how the auditor’s professional judgment about the nature of the matter giving rise to the modification and the pervasiveness of its effects or possible effects on the financial statements affect the type of opinion to be expressed (AU-C 705.A1).

|  |  |  |
| --- | --- | --- |
| **Nature of matter giving rise to the modification** | **Auditor’s professional judgment about the pervasiveness of the effects or possible effects on the financial statements** | |
| **Material but not pervasive** | **Material and pervasive** |
| Financial statements are materially misstated | Qualified opinion | Adverse opinion |
| Inability to obtain sufficient appropriate audit evidence | Qualified opinion | Disclaimer of opinion |

The auditor should modify the opinion in the auditor’s report if the auditor concludes that based on the audit evidence obtained, the financial statements as a whole are materially misstated or the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement (AU-C 700.19, AU-C 705.07).

When the auditor modifies the opinion on the financial statements, the auditor should use the heading “Qualified Opinion,” Adverse Opinion,” or “Disclaimer of Opinion,” as appropriate, for the “Opinion” section. The auditor should also amend the heading “Basis for Opinion” to “Basis for Qualified Opinion,” “Basis for Adverse Opinion,” or “Basis for Disclaimer of Opinion,” as appropriate, and within this section of the auditor’s report, include a description of the matter giving rise to the modification (AU-C 705.17 and .21).

If the auditor concludes that it is necessary to express an adverse opinion or disclaim an opinion on the entity’s complete set of financial statements as a whole, an unmodified opinion on a specific element in the same auditor’s report would contradict the adverse opinion or disclaimer of opinion on the entity’s complete set of financial statements as a whole and would be tantamount to expressing a piecemeal opinion (which is prohibited). In the context of a separate audit of a specific element that is included in those financial statements, when the auditor nevertheless considers it appropriate to express an unmodified opinion on that specific element, the auditor should only do so if

1. that opinion is expressed in an auditor’s report that is neither published with nor otherwise accompanies the auditor’s report containing the adverse opinion or disclaimer of opinion and
2. the specific element does not constitute a major portion of the entity’s complete set of financial statements or the specific element is not, or is not based upon, the entity’s stockholders’ equity or net income or the equivalent.

A single financial statement is deemed to constitute a major portion of a complete set of financial statements. Therefore, the auditor should not express an unmodified opinion on a single financial statement of a complete set of financial statements if the auditor has expressed an adverse opinion or disclaimed an opinion on the complete set of financial statements as a whole, even if the auditor’s report on the single financial statement is neither published together nor otherwise accompanies the auditor’s report containing the adverse opinion or disclaimer of opinion (AU-C 705.15 and AU-C 805.21 and .22).

If the auditor concludes that the financial statements do not achieve fair presentation, the auditor should discuss the matter with management and, depending on how the matter is resolved, should determine whether it is necessary to modify the opinion in the auditor’s report in accordance with AU-C 705 (AU-C 700.20).

Emphasis-of-matter paragraphs, other-matter paragraphs, or both may also be included in the auditor’s report when the auditor expresses a qualified or adverse opinion or disclaims an opinion.

If the auditor concludes that the opinion on the financial statements should be modified, the auditor should revise the auditor’s report to reflect the specific wording changes required by AU-C 705.17 through .29. Specific wording is provided for qualified opinions, adverse opinions, and disclaimers of opinion.

Qualified Opinion

The auditor should express a qualified opinion, as discussed in AU-C 705.08, in the following circumstances:

* the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material but not pervasive to the financial statements or
* the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

Adverse Opinion

The auditor should express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements (AU-C 705.09).

Disclaimer of Opinion

In a disclaimer of opinion, the auditor does not express an opinion on the financial statements. The auditor should disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive (AU-C 705.10). When the auditor disclaims an opinion on the financial statements, the auditor’s report should not include an “Other Information” section in accordance with AU-C 720, *The Auditor’s Responsibilities Relating to Other Information Included in Annual Reports* (AU-C 705.30).

Emphasis-of-Matter and Other-Matter Paragraph(s)

As discussed in AU-C 706, the auditor should add an emphasis-of-matter and/or other-matter paragraph when certain conditions exist. Additionally, the auditor may include emphasis-of-matter and/or other-matter paragraphs in the report based on the auditor’s professional judgment. Inclusion of an emphasis-of-matter paragraph does not affect the auditor’s opinion, including an unmodified opinion (AU-C 706.A7).

Emphasis-of-Matter Paragraph

If the auditor considers it necessary to draw users’ attention to a matter appropriately presented or disclosed in the financial statements that in the auditor’s professional judgment, is of such importance that it is fundamental to users’ understanding of the financial statements, the auditor should include an emphasis-of-matter paragraph in the auditor’s report, provided that the auditor would not be required to modify the opinion in accordance with AU-C 705 as a result of the matter (AU-C 706.08). See AU-C 706.A4 through .A8 and .A14 for additional guidance on emphasis-of-matter paragraphs.

The auditor should follow the requirements of AU-C 706.09 for specific wording and placement of emphasis-of-matter paragraphs in the auditor’s report.

Other-Matter Paragraph

If the auditor considers it necessary to communicate a matter other than those presented or disclosed in the financial statements that in the auditor’s professional judgment, is relevant to users’ understanding of the audit, the auditor’s responsibilities, or the auditor’s report, the auditor should do so in an other-matter paragraph in the auditor’s report (AU-C 706.10). See AU-C 706.A9 through .A15 for additional guidance on other-matter paragraphs.

The auditor should follow the requirements of AU-C 706.11 for specific wording and placement of other-matter paragraphs in the auditor’s report.

The following is a list of conditions that may require the auditor to include an emphasis-of-matter paragraph, other-matter paragraph, or both. This is not an all-inclusive list. The auditor should refer to the related AU-C section for further requirements and guidance.

1. Subsequently discovered facts that become known to the auditor after the report release date (see FAM 580.110).
2. The accounting principles or their method of application changes between periods and the effect on the financial statements is material (see FAM 580.21).
3. Previously issued financial statements are restated to correct a material misstatement in the respective period (see AU-C 708.13).
4. Certain situations related to prior period financial statements that are audited by a predecessor auditor or are not audited (see FAM 580.20).
5. There is a departure from U.S. GAAP that has a material effect on the financial statements, and the auditor can demonstrate that the financial statements would be misleading without this departure (see FAM 580.10).

The following table provides a listing of situations that could cause the auditor to modify the opinion or add an emphasis-of-matter and/or other-matter paragraph(s) to the auditor’s unmodified opinion.

| Situation | FAM paragraph and further guidance |
| --- | --- |
| **Relating to the financial statements** | |
| 1. Insufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement (also referred to as limitations on the scope of the audit). (AU-C 705.07b) | FAM 580.48 and .50  AU-C 705 Illustration 4 (qualified)  AU-C 705 Illustrations 5 and 6 (disclaimer) |
| 1. Effects of uncertainties on an audit opinion. | FAM 580.11 |
| 1. Inconsistencies of comparability between the financial statements for all periods presented, including changes in accounting principles. (AU-C 708) | FAM 580.21–.23 |
| 1. Material departures from U.S. GAAP resulting in a qualified or adverse opinion. (AU-C 705.07a) | FAM 580.09–.10  AU-C 705 Illustrations 1 and 2 (qualified)  AU-C 705 Illustration 3 (adverse) |
| **Relating to internal control** | |
| 1. Scope limitation resulting in a disclaimer of opinion on internal control. | FAM 580.64–.65 |
| 1. Material weaknesses and significant deficiencies in a report or opinion on internal control or other control deficiencies that the auditor has decided to describe in the audit report. Additional report modification is needed if one or more material weaknesses are not included in management’s report on internal control over financial reporting. | FAM 580.68–.70  FAM 595 B Example 1 (material weakness in internal control)  FAM 595 B Example 2 (significant deficiency in internal control) |
| 1. Material inconsistencies between management’s FMFIA report and the results of the auditor’s evaluation of internal control and systems’ conformance with financial management systems requirements. | FAM 580.85 |
| 1. Purpose of audit was not to give an opinion on internal control, and significant deficiencies or material weaknesses were found. | FAM 580.73–.74  AU-C 265 |
| **Relating to financial management systems’ substantial compliance with FFMIA requirements (for CFO Act agencies)** | |
| 1. Instances of lack of entity financial management systems’ substantial compliance with the three requirements of FFMIA for CFO Act agencies. | FAM 580.86–.90 |
| **Relating to compliance with significant provisions of applicable laws, regulations, contracts, and grant agreements** | |
| 1. Scope limitation—some significant provisions of applicable laws, regulations, contracts, and grant agreements could not be tested. | FAM 580.97 |
| 1. Scope limitation—all significant provisions of applicable laws, regulations, contracts, and grant agreements could not be tested—disclaimer. | FAM 580.98 |
| 1. Reportable noncompliance—instances of noncompliance with significant provisions of applicable laws, regulations, contracts, and grant agreements that are reportable under GAGAS (which incorporates U.S. GAAS) or OMB audit guidance that are not clearly inconsequential. | FAM 580.95 |
| 1. Material noncompliance with significant provisions of applicable laws, regulations, contracts, and grant agreements. | FAM 580.91–.92 |

Internal Control

Auditors may take one of two different approaches to reporting on internal control: (1) management provides an assessment about the effectiveness of its internal control and the auditor expresses an opinion on internal control or on management’s assessment following the guidance in AU-C 940 (see FAM 580.63–.72)[[13]](#footnote-14) or (2) the auditor reports material weaknesses and significant deficiencies found but does not give an opinion on internal control (see FAM 580.73–.79). OMB reporting guidance requires management to include representations about internal control in the management representation letter and requires CFO Act agencies to include these representations in the MD&A in the annual report. OMB audit guidance does not require auditors to express an opinion on internal control; however, the terms of the engagement may include a requirement for an auditor to express an opinion on the effectiveness of the entity’s internal control over financial reporting. In either case, the auditor should evaluate whether the design and implementation of internal control is sufficient to meet the control objectives insofar as those objectives pertain to providing reasonable assurance that a misstatement or omission in the significant assertion is prevented, or detected and corrected, on a timely basis. These control objectives are as follows:

* **Reliability of financial reporting**—transactions are properly recorded, processed, and summarized to permit the preparation of the financial statements in accordance with U.S. GAAP, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition.
* **Compliance with applicable laws, regulations, contracts, and grant agreements**—transactions are executed in accordance with provisions of applicable laws, including those governing the use of budget authority; regulations; contracts; and grant agreements, noncompliance with which could have a material effect on the financial statements.

Classifying Control Weaknesses

A **control deficiency** exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A deficiency in design exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not designed effectively so that even if the control operates as designed the control objective would not be met. A deficiency in operation exists when an effectively designed control does not operate as designed or when the person performing the control does not possess the necessary authority or competence to perform the control effectively (AU-C 265.07). The auditor should classify internal control deficiencies following AU-C 265 as follows:

* A **significant deficiency** is a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness yet important enough to merit attention by those charged with governance.
* A **material weakness** is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility[[14]](#footnote-15) that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected, on a timely basis (AU-C 265.07).[[15]](#footnote-16)

To avoid confusion, the auditor should include the definitions of these terms in the auditor’s report, as these definitions differ from those in other auditing standards, such as standards issued by the Public Company Accounting Oversight Board (PCAOB).

The auditor should determine whether each control deficiency or combination of control deficiencies constitutes a significant deficiency or material weakness (AU-C 265.09). The severity of a control deficiency depends not only on whether a misstatement has actually occurred but also on the magnitude of the potential misstatement resulting from the deficiency or deficiencies and whether there is a reasonable possibility that the entity’s controls will fail to prevent, or detect and correct, a misstatement of an account balance or note disclosure (AU-C 265.A6). When making this determination, the auditor should evaluate the following:

* The likelihood and magnitude of potential misstatement that would not be prevented or detected because of the control deficiencies. AU-C 265.A7 through .A10 provide examples of factors for evaluating the likelihood and magnitude of misstatement.
* Whether individual control deficiencies that affect the same line item, account, note disclosure, class of transactions, significant assertion, or component of internal control collectively result in an internal control deficiency.
* The possible mitigating effects of effective compensating controls that have been tested and evaluated as part of the financial statement audit.

If the auditor determines that a deficiency, or a combination of deficiencies, in internal control is not a material weakness, the auditor should consider whether prudent officials, having knowledge of the same facts and circumstances, would likely reach the same conclusion (AU-C 265.10).

Additional guidance on evaluating identified deficiencies in internal control is provided in AU-C 265.A6 through .A12. AU-C 265.A12 includes indicators of control deficiencies that the auditor should regard as indicators of a material weakness, such as the auditor’s identification of a material misstatement of the financial statements under audit that was not initially identified by the entity’s internal control. Additionally, circumstances that may be considered control deficiencies, significant deficiencies, or material weaknesses are described in AU-C 265.A38. Guidance on concluding on the effectiveness of internal control and reporting findings is provided in FAM 580.67 through .71.

OMB Circular No. A-123 provides guidance for management to report control weaknesses under 31 U.S.C. § 3512(c), (d), commonly known as the Federal Managers’ Financial Integrity Act of 1982 (FMFIA). The term material weakness as used by OMB (FMFIA material weakness) is different from the above definition and includes matters of an operational nature. Management and the auditor should evaluate the material weaknesses reported under FMFIA to determine whether they meet the auditor’s definitions of material weakness and significant deficiency for reporting as part of management’s assessment about the effectiveness of internal control (see FAM 580.85).

For controls other than financial reporting controls, a weakness is an FMFIA material weakness if it is significant enough to be reported outside the entity, as determined by the entity head. That is, it was included in the annual FMFIA report to the President and the Congress. Entity reporting of system noncompliance is governed by the criteria for FFMIA reporting in OMB Circular No. A-123, Appendix D.

The auditor should determine how threats, incidents, and risk assessments reported in a Federal Information Security Modernization Act of 2014 annual report regarding major incidents relate to the control deficiencies identified during the financial statement audit.

Opinion on Internal Control

Although not required by OMB audit guidance, if the auditor plans to express an opinion on internal control, the auditor’s evaluation of the entity’s internal control and the results of other audit procedures form the basis for this opinion. The opinion may be (1) unmodified, (2) unmodified with reference to significant deficiencies, (3) disclaimer, or (4) adverse (one or more material weaknesses). Additionally, there may be restrictions on the scope of the procedures that result in a disclaimer of opinion (see FAM 580.65). The auditor should communicate any identified internal control deficiencies, including weaknesses in operations controls, and consider the effects of these deficiencies on other entity-prepared reports (see FAM 580.68–.71 and .80–.84).

Scope of Procedures

When performing an audit of internal control over financial reporting, the auditor should do the following:

1. Obtain the agreement of management that it acknowledges and understands its responsibility for the following (AU-C 940.06a):
2. designing, implementing, and maintaining effective internal control over financial reporting;
3. evaluating the effectiveness of the entity’s internal control over financial reporting using suitable and available criteria;
4. providing management’s assessment about internal control over financial reporting in a report that accompanies the auditor’s report;
5. supporting its assessment about the effectiveness of the entity’s internal control over financial reporting with sufficient evaluations and documentation; and
6. providing the auditor with (1) access to all information of which management is aware that is relevant to management’s assessment of internal control over financial reporting, such as records, documentation, and other matters; (2) additional information that the auditor may request from management for the purpose of the audit of internal control over financial reporting; and (3) unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.
7. Determine that the date specified in management’s assessment about the effectiveness of internal control over financial reporting corresponds to the balance sheet date (or period ending date) of the period covered by the financial statements (AU-C 940.04a and .06b).

The auditor should evaluate the effectiveness of the entity’s internal control over financial reporting using the same suitable and available criteria used by management for its assessment (AU-C 940.07). In accordance with FAM 580.64a.iii above, the auditor should request from management a written assessment about the effectiveness of the entity’s internal control over financial reporting. Management’s refusal to provide a written assessment represents a scope limitation, and the auditor should apply the requirements in AU-C 940.74 through .77 (AU-C 940.08).

The auditor should perform all necessary procedures, as described in FAM 300 and FAM 450, on the written assessment from management. The auditor should evaluate whether management has a reasonable basis for its assessment. For example, the assessment may be based on management’s monitoring procedures (see AU-C 940.A10 through .A13 for evidence that management can use to support its assessment). The audit results alone cannot be the basis for management’s assessment.

If there is a restriction on the scope of the audit, such that not all of these procedures can be performed, the auditor should evaluate whether or not to disclaim the opinion on internal control over financial reporting and determine whether or not to modify the GAGAS compliance statement in the report, as discussed in GAGAS (2018) 2.17b, 2.18, and 2.20. Scope restrictions may be imposed by the entity or may be due to other circumstances. The auditor’s decision regarding a scope limitation on internal control must be provided to the reviewer in timely manner to allow any issues to be promptly identified and resolved.

When determining the severity of a scope limitation on internal control, the auditor should use the control objectives listed in the report for internal control over financial reporting, including safeguarding assets. If the scope of work on internal control over financial reporting is limited, the auditor should disclaim the opinion on internal control. If the auditor concludes that the auditor cannot express an opinion because there has been a limitation on the scope of the examination, the auditor should communicate, in writing, to management and those charged with governance that the audit of internal control over financial reporting cannot be satisfactorily completed.

If the auditor determines that an opinion can be expressed, the type of opinion depends on whether any internal control deficiencies are identified and the significance of such deficiencies. In identifying and evaluating deficiencies, the auditor should consider deficiencies in each of the five components of internal control (control environment, entity risk assessment, information and communications, control activities, and monitoring). In concluding on the effectiveness of internal control, the auditor should categorize control deficiencies, in order of decreasing significance, as (1) material weaknesses, (2) significant deficiencies, and (3) other deficiencies that do not meet the criteria for a significant deficiency or material weakness (other deficiencies). Each of these types of weaknesses and its effects on the auditor’s conclusion on internal control is discussed below. If no material weaknesses are identified, the auditor generally should conclude that internal control is effective in meeting the control objectives.

Effects of Control Deficiencies on the Auditor’s Conclusion on the Effectiveness of Internal Control over Financial Reporting

Based on the types of deficiencies noted, the auditor should conclude on the effectiveness of internal control over financial reporting as of the end of the audit period, as discussed below. Management also should conclude on the effectiveness of internal control in deciding what assessment to make. After forming an opinion on the effectiveness of the entity’s internal control, the auditor should evaluate management’s report to determine whether it appropriately contains the following (AU-C 940.55):

* a statement regarding management’s responsibility for internal control over financial reporting;
* a description of the subject matter of the examination (for example, controls over the preparation of the entity’s financial statements in accordance with U.S. GAAP);
* an identification of the criteria against which internal control over financial reporting is measured (for example, criteria established in the GAO’s *Standards for Internal Control in the Federal Government* or the Committee of Sponsoring Organizations of the Treadway Commission’s *Internal Control – Integrated Framework*);
* management’s assessment about the effectiveness of internal control over financial reporting;
* a description of the material weaknesses, if any; and
* the date as of which management’s assessment of internal control over financial reporting is made.

When management includes, either within management’s report or in a document containing management’s report and the related auditor’s report, information in addition to the elements that are subject to the auditor’s evaluation as described above, the auditor should perform the procedures required by AU-C 940.80. If the auditor determines that any required element of management’s report is incomplete or improperly presented, the auditor should request management to revise its report (AU-C 940.56). If management does not revise its report, the auditor should modify the auditor’s report to include an other-matter paragraph describing the reasons for this determination (AU-C 940.72).

Material Weaknesses

If one or more material weaknesses exist at the end of the audit period, the auditor should conclude that the entity’s internal control is ineffective, which would result in an adverse opinion (AU-C 940.68). The existence of a material weakness precludes a conclusion that internal control is effective, which would result in a modified opinion. The auditor’s report should include in the “Basis for Adverse Opinion on Internal Control over Financial Reporting” section (a) the definition of a material weakness and (b) a statement that one or more material weaknesses have been identified and an identification of the material weaknesses described in management’s assessment about internal control over financial reporting (AU-C 940.70).

If one or more material weaknesses have not been included in management’s report accompanying the auditor’s report, the auditor’s report should be modified to state that one or more material weaknesses have been identified but not included in management’s report. Additionally, the auditor’s report should include a description of each material weakness not included in management’s report. The auditor’s description should include specific information about the nature of each material weakness and its actual and potential effect on the presentation of the entity’s financial statements issued during the existence of the weakness. In this case, the auditor also should communicate, in writing, to those charged with governance that one or more material weaknesses were not disclosed or identified as a material weakness in management’s report. If one or more material weaknesses have been included in management’s report but the auditor concludes that the disclosure of such material weaknesses is not fairly presented in all material respects, the auditor’s report should describe this conclusion as well as the information necessary to fairly describe each material weakness (AU-C 940.71).

The auditor should determine the effect an adverse opinion on internal control over financial reporting has on the auditor’s opinion on the financial statements. Additionally, the auditor should disclose, as a separate paragraph within the “Adverse Opinion on Internal Control over Financial Reporting” section of the report, whether the auditor’s opinion on the financial statements was affected by the material weakness (AU-C 940.69). If a material weakness is presented in a report that also includes an unmodified opinion on the financial statements, the auditor should add a statement to the unmodified opinion to indicate that as a result of a material weakness, material misstatements may nevertheless occur in other financial information reported by the entity. Example report modifications for material weaknesses are provided in FAM 595 B.

Significant Deficiencies

If significant deficiencies existed at the end of the audit period, but no material weaknesses were identified, the auditor generally should conclude that the controls are effective in achieving the control objectives. However, as required by GAGAS, the auditor should indicate in the report that the work performed identified significant deficiencies and should describe the deficiencies (see FAM 595 B).

Control Deficiencies That Do Not Meet the Criteria for Material Weaknesses or Significant Deficiencies

Control deficiencies that do not meet the criteria for material weaknesses or significant deficiencies in FAM 580.57 do not affect the auditor’s conclusion on the effectiveness of internal control. The auditor also should communicate to management at an appropriate level of responsibility—on a timely basis either in writing (e.g., in a separate report to management or a write-up of the deficiency to management for its concurrence with the facts) or orally—these deficiencies in internal control identified during the audit that have not been communicated to management by other parties and that in the auditor’s professional judgment, are of sufficient importance to merit management’s attention. If these deficiencies in internal control are communicated orally, the auditor should document the communication (AU-C 265.12b). This communication should be made no later than 60 days following the report release date (AU-C 265.13). The auditor should document any oral communication of these deficiencies. When performing an integrated audit, the auditor should communicate these deficiencies in writing and inform those charged with governance when such communication was made. The auditor is not required to communicate those deficiencies that are not material weaknesses or significant deficiencies that were included in previous written communications, regardless of whether those communications were made by the auditor, internal auditors, or others within the organization (AU-C 940.62).

Type of Opinion

As described in FAM 580.65, if the auditor is unable to apply all the audit procedures considered necessary in the circumstances, a scope limitation exists and the auditor should issue a disclaimer of opinion on internal control over financial reporting in accordance with AU-C 940.75 and .76. If all the procedures considered necessary were performed, the auditor should issue one of the following opinions:

* If the auditor and management agree on the effectiveness of internal control and there are no material weaknesses, the auditor should issue an unmodified opinion on internal control (see FAM 595 A).
* If the auditor and management agree on the effectiveness of internal control and there are no material weaknesses in internal control, but there are significant deficiencies, the auditor should issue an unmodified opinion, including a statement that internal control is effective but could be improved and referring to the significant deficiencies (see FAM 595 B).
* If the auditor and management agree on the effectiveness of internal control and there *are* material weaknesses in internal control, the auditor should modify the opinion on internal control by (1) referring to the material weakness(es) noted in management’s assessment (which states that internal control over financial reporting is ineffective (adverse opinion)) and (2) describing the material weakness(es) (see FAM 595 B). OMB Circular No. A‑123 guidance for FMFIA allows management to provide a qualified assessment of internal control effectiveness even if material weaknesses exist.
* If the auditor and management disagree on the effectiveness of internal control, either because (1) management does not agree that material weakness(es) exist or (2) management does not appropriately modify its assessment about the effectiveness of internal control in light of the material weakness(es), the auditor should issue an adverse opinion. The existence of a material weakness precludes management from asserting that its internal control is effective. Thus, an adverse opinion is appropriate if management states that internal control is effective “except for” the material weakness when, in the auditor’s professional judgment, the material weakness indicates that internal control is ineffective (see FAM 580.68).

Nonopinion Report

If the purpose of the audit is not to express an opinion on internal control, the auditor should still report any identified material weaknesses and significant deficiencies in internal control in accordance with AU-C 265.11 through .16. Per OMB audit guidance, if the auditor did not identify any material weaknesses during the audit, the auditor should state, in the report on internal control, that no deficiencies in internal control were identified that were considered to be material weaknesses during the audit of the financial statements and include matters required by AU-C 265.15 (see auditor’s report example 2 in FAM 595 A). Including a statement in the report on internal control indicating that no material weaknesses were identified during the audit does not provide any assurance about the effectiveness of an entity’s internal control over financial reporting (AU-C 265.A35). The auditor should not issue a written communication stating that no significant deficiencies were identified during the audit because of the potential for users to misinterpret the amount of assurance provided by such communication (AU-C 265.16). If there are one or more material weaknesses, the auditor may state in its report that internal control was ineffective for one or more objectives. Further, the auditor should conclude whether the scope of the work and the related audit evidence are sufficient to meet the audit objectives described in the OMB audit guidance. If the work is not sufficient, the auditor should report a scope limitation.

Based on AU-C 905, *Alert That Restricts the Use of the Auditor’s Written Communication*, a report on internal control in which no opinion is expressed is considered a by-product report of a financial statement audit. Based on AU-C 905.11, because the distribution of government audit reports is not restricted, the report on internal control should include an alert, in a separate paragraph, to (1) describe the purpose of the report and (2) state that the report is not suitable for any other purpose. See FAM 595 A, example 2, for an auditor’s report example that includes this alert.

Where and When to Report Control Deficiencies for Nonopinion Report

The means of communicating deficiencies in internal control depends on the type of weakness, as discussed in FAM 580.57. The auditor should communicate in writing to those charged with governance on a timely basis significant deficiencies and material weaknesses identified during the audit, including those that were remediated during the audit (AU-C 265.11). The auditor also should communicate to management at an appropriate level of responsibility, on a timely basis in writing, significant deficiencies and material weaknesses that the auditor has communicated or intends to communicate to those charged with governance, unless it would be inappropriate to communicate directly to management in the circumstances (AU-C 265.12a). This communication is part of the auditor’s report on financial statements (GAGAS (2018) 6.40). For other deficiencies, the auditor should communicate no later than 60 days following the report release date. However, the auditor may issue other written communication containing further details on the deficiencies. The auditor should include any material weaknesses or other significant deficiencies that were communicated in previous financial statement audits that have not yet been corrected. The auditor may do this by referring to the previously issued written communication and the date of the communication. Communicating each type of deficiency is discussed below.

Material Weaknesses and Significant Deficiencies

The auditor should report material weaknesses and significant deficiencies in the internal control section of the auditor’s report. The auditor may report these deficiencies in a separate report that is referenced to in the auditor’s report on the financial statements. If management’s assessment about the effectiveness of internal control is printed with the audit report, the auditor’s report should refer to the discussion of the material weakness (or other significant deficiency) in management’s assessment.

The auditor generally should limit the internal control section of the auditor’s report to summarized information. As such, the auditor may limit the discussion of control deficiencies included in this section to providing the reader with an understanding of the nature and extent of the deficiency. The auditor may combine related control deficiencies. To the extent that any such control deficiencies contribute to a significant deficiency, the auditor generally should describe them in conjunction with the related significant deficiency.

If more complete information concerning control deficiencies is provided in other reports issued prior to or at the same time as the auditor’s report, the auditor generally should refer to such other reports (such as date and title or report number) in the auditor’s report. The auditor may also subsequently report significant deficiencies in more detail in a separate report to management or other written communication that includes other elements of the findings, as discussed in FAM 580.81.

Other Control Deficiencies

The auditor should communicate to management at an appropriate level of responsibility, on a timely basis in writing or orally, other deficiencies in internal control identified during the audit that have not been communicated to management by other parties and that in the auditor's professional judgment, are of sufficient importance to merit management’s attention. If other deficiencies in internal control are communicated orally, the auditor should document the communication (AU-C 265.12b).

What to Report about Control Deficiencies

Control deficiencies identified by the auditor are findings. GAGAS (2018) 6.25 through 6.28 describe the four elements of a finding:

* **Criteria** (what should be).
* **Condition** (what is).
* **Cause** (why the condition occurred).
* **Effect** (the nature of the possible past or future impact).

The auditor should decide whether to fully develop each of the four elements of a finding. The auditor uses professional judgment in determining whether to apply resources to investigate a control deficiency, based on the elements that the auditor decides to report. For each significant deficiency, the extent to which the auditor should develop the elements of a finding depends on how it is communicated.

* **Material weaknesses and significant deficiencies reported in the auditor’s report.** The auditor generally should identify at least the criteria, condition, cause, and possible asserted effect (related to the nature, not necessarily amount) to permit management to determine the effect and to take prompt and proper corrective action. The auditor may provide recommendations to improve internal control and obtain management’s response as part of entity comments on the auditor’s report.
* **Significant deficiencies described briefly in the auditor’s report and detailed in a separate report to management.** The auditor should identify at least the condition and the criteria and generally should identify the possible asserted effect to bring them to management’s attention, particularly if there are sensitive or information technology issues. The auditor may also evaluate the benefits of identifying the cause. The auditor generally should provide recommendations or suggestions to improve reported findings and obtain management’s response as part of entity comments on the auditor’s report.

In discussing each material weakness that meets FMFIA reporting criteria, the auditor should determine whether the material weakness was identified in the entity’s FMFIA report or in the FMFIA report of the organization of which the entity is a part (see FAM 580.85).

For control deficiencies that do not meet the criteria for a material weakness or significant deficiency, the auditor need not develop all of the elements of a finding if the auditor decides to report these control deficiencies.

Other Considerations

To communicate findings promptly, the auditor may issue written communications during the audit. For example, GAO issued a report to a federal entity where on an interim basis some installations were reporting in millions of dollars and others in billions of dollars, causing materially inaccurate consolidations of amounts. GAO issued this report to provide information so that the entity could improve the consistency and accuracy of amounts in time for year-end reporting. In such instances, the auditor may describe the control deficiency and refer to the reports as discussed in FAM 580.78.

The auditor should determine whether internal control deficiencies, particularly material weaknesses, could affect information in other reports generated by the entity for external distribution or internal decision-making. The auditor generally should make inquiries and evaluate other knowledge obtained during the audit concerning use of reports affected by these deficiencies. The auditor uses professional judgment to determine whether such reports might contain inaccuracies as a result of control deficiencies that would likely influence the judgment of report users. If so, the auditor generally should describe, in the auditor’s report, the nature of such reports and the effect of control deficiencies on them. In determining if such reports are significant, the auditor should evaluate whether user judgments or management decisions based on such reports could affect the entity in amounts that would be material in relation to the financial statements.

#### **Reporting on Management’s FMFIA Reports**

In the internal control section of the auditor’s report, the auditor should disclose whether material weaknesses or financial management systems’ nonconformance with financial systems requirements identified during the audit was identified in management’s FMFIA report.

If the auditor found material weaknesses or systems’ nonconformance that should have been reported under FMFIA, the auditor should refer to such findings as indicated in FAM 580.60 and .61 and determine whether management’s FMFIA process has deficiencies that the auditor should report. Such deficiencies might result from the following:

* Management did not initially recognize internal control deficiencies or systems’ nonconformance, perhaps due to a lack of training, understanding, or limitations in the scope of the FMFIA process. For example, certain areas were not reviewed annually or certain types of controls or systems were not reviewed.
* Management did not recognize that identified deficiencies were FMFIA material weaknesses or systems’ nonconformance.
* Management relied on controls that the auditor concluded were ineffective.
* Management failed to report identified deficiencies due to inappropriate report preparation. This could occur because of errors in aggregating the internal control deficiencies or systems’ nonconformance of individual components or locations.

The auditor may refer to the assessment of management’s FMFIA process performed during planning, as discussed in FAM 260.39 through .45, when concluding on how to report these matters.

### Financial Management Systems

FFMIA requires the auditor to report whether the financial management systems of the 24 CFO Act agencies comply substantially with three federal financial management systems requirements. These requirements are as follows:

* federal financial management systems requirements, including those found in the *Treasury Financial Manual*, volume 1, part 6, chapter 9500, *Revised Federal Financial Management System Requirements*;
* applicable federal accounting standards; and
* the USSGL at the transaction level.

Further information on FFMIA compliance can be found in OMB Circular No. A-123, appendix D.

The auditor should conclude on whether the agency’s financial management systems complied substantially with the three FFMIA requirements, following the guidance provided in FAM 701 and by OMB.

#### **Reporting on Systems’ Substantial Compliance with FFMIA Requirements**

If the auditor is required to report whether an agency’s financial management systems comply with the three FFMIA requirements, the example reports in FAM 595 A should be revised to include this item. OMB audit guidance provides information for reporting on FFMIA compliance without expressing an opinion.

If the auditor finds that the entity’s financial management systems do not comply substantially with any of the three FFMIA requirements, the auditor should summarize the lack of substantial compliance in the auditor’s report. Frequently, the financial management systems’ lack of substantial compliance is related to significant deficiencies in internal control. If so, the auditor may make reference to another report or another section within a combined report, as necessary.

If the auditor finds that the entity’s financial management systems did not comply substantially with the requirements, FFMIA requires the auditor to identify the entity or organization responsible for the systems found not to comply. The auditor should include pertinent facts, such as the nature and extent of noncompliance, areas in which there is substantial but not full compliance, primary reason or cause, and any relevant comments from management or responsible employees. The auditor may make recommendations for corrective actions and obtain management’s response as part of agency comments on the auditor’s report.

#### **Scope of Procedures**

If the auditor is unable to perform all the procedures considered necessary, as discussed in FAM 350, the scope of the financial statement audit is restricted. Generally, if the scope of the financial statement audit is restricted, for example, because needed information from the systems is not available, the auditor should report that the financial management systems do not comply substantially with FFMIA requirements. Also, if the auditor concluded that the systems did not comply substantially with FFMIA based on limited testing, the auditor should report that the work on FFMIA would not necessarily disclose all instances of noncompliance with FFMIA requirements.

Compliance with Applicable Laws, Regulations, Contracts, and Grant Agreements and Instances of Fraud

The auditor should report on the results of compliance testing and on compliance matters (including fraud, as discussed in FAM 540.24–.28) that come to the auditor’s attention during procedures other than compliance tests.

If the auditor concludes that the noncompliance has a material effect on the financial statements, and it has not been adequately reflected in the financial statements, the auditor should express a qualified or adverse opinion on the financial statements (AU-C 250.24). If the auditor is precluded by management or those charged with governance from obtaining sufficient appropriate audit evidence to evaluate whether noncompliance that may be material to the financial statements has, or is likely to have, occurred, the auditor should express a qualified opinion or disclaim an opinion on the financial statements on the basis of a limitation on the scope of the audit (AU-C 250.25). If the auditor is unable to determine whether noncompliance has occurred because of limitations imposed by circumstances rather than by management or those charged with governance, the auditor should evaluate the effect on the auditor’s opinion (AU-C 250.26). See FAM 580.41 through .50 for guidance on modifications to the audit opinion.

If the auditor concludes, based on sufficient appropriate evidence, that any of the following have occurred or are likely to occur, the auditor should include in the report on internal control or compliance the relevant information about

* fraud that is material, either quantitatively or qualitatively, to the financial statements or other financial data significant to the audit objectives or
* noncompliance with provisions of laws, regulations, contracts, or grant agreements that has a material effect on the financial statements or other financial data significant to the audit objectives (GAGAS (2018) 6.41), regardless of whether the noncompliance has been appropriately reflected in the financial statements.

The auditor should consult with the entity’s legal counsel regarding conclusions on the entity’s compliance with provisions of applicable laws, regulations, contracts, and grant agreements.

When the auditor identifies or suspects instances of fraud or noncompliance with provisions of laws, regulations, contracts, or grant agreements that have an effect on the financial statements or other financial data significant to the audit objectives that is less than material but warrants the attention of those charged with governance, the auditor should communicate those findings in writing to audited entity officials (GAGAS (2018) 6.44). When the auditor identifies or suspects any instances of noncompliance with provisions of applicable laws, regulations, contracts, or grant agreements that do not warrant the attention of those charged with governance, the auditor’s determination of whether and how to communicate such instances to audited entity officials is a matter of professional judgment (GAGAS (2018) 6.48).

When the auditor identifies or suspects either noncompliance with provisions of laws, regulations, contracts, or grant agreements or instances of fraud, the auditor may consult with authorities or legal counsel about whether publicly reporting such information would compromise investigative or legal proceedings. The auditor may limit public reporting to matters that would not compromise those proceedings and, for example, report only on information that is already a part of the public record (GAGAS (2018) 6.49).

Reporting on Compliance Tests

The auditor should state directly whether any reportable noncompliance was detected during compliance tests. This type of direct statement is illustrated in FAM 595 A for a situation in which the compliance tests disclosed no reportable noncompliance. If the auditor identifies any reportable noncompliance, the auditor should modify the statement, and the auditor should discuss the reportable noncompliance in the auditor’s report as described above.

Based on AU-C 905, a report on compliance is considered a by-product report of a financial statement audit. Based on AU-C 905.11, because the distribution of government audit reports is not restricted, the report on compliance should include an alert, in a separate paragraph, to (1) describe the purpose of the report and (2) state that the report is not suitable for any other purpose. See FAM 595 A and B for auditor’s report examples that include this alert.

#### **Scope of Procedures**

The auditor should perform all of the procedures considered necessary to test compliance with significant provisions of applicable laws, regulations, contracts, and grant agreements. If the auditor is unable to perform all of the necessary procedures for one or more significant provisions, the auditor should report based on the provisions tested. However, the auditor should modify the report, as appropriate, to alert the reader that not all of the significant provisions of applicable laws, regulations, contracts, and grant agreements were tested.

If the scope limitation is so significant that the auditor believes that any discussion of testing could be misleading, the auditor should report that the auditor could not test compliance due to the scope limitation. The auditor should describe significant scope limitations in the auditor’s report and should modify the auditor’s report. The auditor also should determine the effect of such a scope limitation on the auditor’s opinion on the financial statements.

If deficiencies in compliance controls are identified but no instances of noncompliance are found during compliance testing, the auditor should determine whether additional controls or mitigating factors prevented or detected instances of noncompliance. If sufficient additional controls or mitigating factors are not identified, the auditor should consult with OGC to determine the appropriate reporting of such deficiencies and compliance tests. The auditor’s determinations must be provided to the reviewer in a timely manner to allow any issues to be promptly identified and resolved.

Entity Comments

The auditor should obtain and report the views of responsible entity officials concerning the findings, conclusions, recommendations, and planned corrective actions, if included. The auditor should allow the audited entity to review a draft of the report prior to issuance and provide either written or oral comments. This entity review helps the auditor to identify any errors in fact; avoid surprises in the message; and strive for fairness, balance, objectivity, accuracy, and completeness. Written comments are generally preferred, especially when the report is sensitive or controversial, when significant disagreements exist, or when the report makes wide-ranging recommendations. When the entity provides written comments, the auditor should include a copy of these comments or summarize the comments in the auditor’s report.

Oral comments may be appropriate when (1) there is a reporting date critical to meeting a user’s needs; (2) the auditor has worked closely with the entity so that it is familiar with the findings and issues addressed in the draft report; or (3) the auditor does not expect major disagreements with the findings, conclusions, or recommendations in the draft report or major controversies with regard to the issues discussed in the draft report. If the entity provides only oral comments, the auditor should prepare a summary of these comments and provide a copy of the summary to the responsible officials to verify that the comments are accurately stated, and may report the entity’s views. If the report is unmodified and does not include any material weaknesses or material noncompliance, the entity may decide not to comment.

The auditor generally should include an entity comments and (auditor’s) evaluation section in the auditor’s report. The auditor generally should briefly characterize the overall response to the draft regarding facts and conclusions, such as whether the entity generally agrees, partially agrees, or disagrees with the report. The auditor generally should summarize the major points made in the comments, whether written or oral, usually in the last section of the auditor’s report, and should include an evaluation of the comments, as appropriate. If entity officials concurred with all the findings, conclusions, and recommendations, the auditor should state that they concurred, mention any actions the entity has agreed to take, and provide the auditor’s response to those actions. If entity officials disagree with or have concerns regarding portions of the report, the auditor should discuss these concerns in the auditor’s report and provide the auditor’s evaluation of them.

The auditor generally should include the entity’s written comments as an appendix to the report. These comments may include, for example, a description of corrective actions taken by the entity, the entity’s plans to implement new controls, or a statement indicating that management believes the cost of correcting a significant deficiency or material weakness would exceed the benefits to be derived from doing so. If these types of comments are included in the document containing the auditor’s written communication regarding material weaknesses or other significant deficiencies, the auditor should disclaim an opinion on such information.

Auditor’s Report Date, Report Release Date, and Documentation Completion Date

#### **Auditor’s Report Date**

1. The auditor’s report should be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor’s opinion on the financial statements, including evidence of the following (AU-C 700.43):

* All the statements and notes that the financial statements comprise have been prepared.
* Management has asserted that it has taken responsibility for those financial statements.

1. For comparative financial statements, the auditor’s report should not be dated earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to support the opinion for the most recent audit (AU-C 700.48).

If the auditor identifies a material subsequent event for disclosure in the report, as discussed in FAM 550.04 through .05, the auditor should follow guidance in AU-C 560 with respect to report dating.

1. The engagement partner should take responsibility for reviews being performed in accordance with the audit organization’s review policies and procedures (AU-C 220A.18). On or before the date of the auditor’s report, the engagement partner should, through a review of the audit documentation and discussion with the engagement team, be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor’s report to be issued (AU-C 220A.19).
2. Based on AU-C 220A.A25, if the auditor identifies instances after the auditor’s report date but before the report release date where additional procedures or evidence is necessary, the auditor should change the date of the auditor’s report to the date that the additional procedures have been satisfactorily completed or the additional evidence has been obtained (see FAM 590.02 for documentation requirements). However, if additional procedures or evidence obtained are the result of facts discovered between the auditor’s report date and report release date, the auditor should follow the requirements in AU-C 560.12 through .14.

#### **Report Release Date**

1. The report release date is the date the auditor grants the entity permission to use the auditor’s report in connection with the financial statements (AU-C 230.06). Often, this will be the date that the auditor provides the audit report to the entity. The report release date will ordinarily be a date that is close to the auditor’s report date. The report release date is important because it starts the period when the auditor should complete the audit documentation. If there are delays in releasing the report, the auditor should perform additional procedures to comply with AU-C 560 and AU-C 700.

#### **Documentation Completion Date**

1. The documentation completion date is the date on which the auditor has assembled for retention a complete and final set of documentation in an audit file (AU-C 230.06). The auditor should assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis, no later than 60 days following the report release date (AU-C 230.16). See FAM 590.03 for additional guidance.

Restatement of Audited Financial Statements

If the auditor becomes aware of information or subsequently discovered facts after the report release date, the auditor should follow AU-C 560.15 through .18. SFFAS 21, *Reporting Corrections of Errors and Changes in Accounting Principles*, addresses restatement of prior-year federal entity financial statements. AU-C 708 (on consistency of financial statements) and AU-C 560 (on subsequent events and subsequently discovered facts) provide guidance on when to reissue auditor’s reports on restated financial statements. Additionally, OMB reporting guidance requires management to notify its auditor when material errors are found in published financial statements and provides guidance regarding note disclosure of restatements.

590 – Documentation

1. As discussed in FAM 290.01, the auditor should prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand
   * + - * the nature, timing, and extent of the audit procedures performed to comply with GAGAS, including the AICPA Statements on Auditing Standards and applicable attestation standards, and applicable legal and regulatory requirements;
         * the results of the audit procedures performed and the audit evidence obtained; and
         * the significant findings or issues arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.

The audit documentation should include, but is not limited to

1. audit summary memorandum (FAM 590.05–.06);
2. overall analytical procedures (FAM 590.07);
3. deficiencies in internal control (FAM 590.08);
4. evaluation and communication of misstatements (FAM 540);
5. responses from the entity’s legal counsel (FAM 1002);
6. subsequent events (FAM 1005);
7. management representations (FAM 1001);
8. names of identified disclosure entities, related parties, and public-private partnerships and the nature of the relationships (AU-C 550.30);
9. procedures performed to determine consistency of the other information in the annual report with the financial statements and in accordance with U.S. GAAP or OMB reporting guidance, currently OMB Circular No. A-136, and the final version of the other information on which the auditor has performed the work (FAM 280.09 and AU-C 720.26);
10. evidence of exit conference(s) (FAM 590.15);
11. applicable audit completion checklists (FAM 1003); and
12. report release date (AU-C 230.15).

If, in rare circumstances, the auditor performs new or additional audit procedures or draws new conclusions after the date of the auditor’s report, the auditor should document

* + 1. the circumstances encountered;
    2. the new or additional audit procedures performed, audit evidence obtained, and conclusions reached, and their effect on the auditor’s report; and
    3. when and by whom the resulting changes to audit documentation were made and reviewed (AU-C 230.14).

Examples of these circumstances include the following (AU-C 230.A23):

* when, after the date of the auditor’s report, the auditor becomes aware of facts that existed at the date and, which if known at that date, might have caused the financial statements to be revised or the auditor to modify the opinion in the auditor’s report (see FAM 550.06) and
* when the auditor concludes that procedures necessary at the time of the audit, in the circumstances then existing, were omitted from the audit of the financial statements (see FAM 580.107).

The auditor should assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis, no later than 60 days following the report release date (AU-C 230.16). After the documentation completion date, the auditor should not delete or discard audit documentation of any nature before the end of the specified retention period. Such retention period, however, should not be shorter than 5 years from the report release date (AU-C 230.17).

In circumstances other than those discussed in FAM 590.02 in which the auditor finds it necessary to modify existing audit documentation or add new audit documentation after the documentation completion date, the auditor should, regardless of the nature of the modifications or additions, document

1. the specific reasons for making the changes and
2. when and by whom they were made and reviewed (AU-C 230.18).

Specific Documentation Considerations

Audit Summary Memorandum

At the completion of the audit, the auditor should prepare an audit summary memorandum that summarizes the audit results and demonstrates the adequacy of the audit procedures, appropriateness and sufficiency of the audit evidence, and the reasonableness of the conclusions on

* the financial statements;
* internal control;
* the financial management systems’ substantial compliance with FFMIA requirements (for CFO Act agencies);
* the entity’s compliance with significant provisions of applicable laws, regulations, contracts, and grant agreements;
* RSI, including MD&A; and
* other information.

In the audit summary memorandum, the auditor may refer to other documentation that describes this information in more detail. The auditor generally should summarize and refer in the documentation to

1. any significant changes from the auditor’s original assessment of materiality for the financial statements as a whole and the risks of material misstatement;
2. any additional fraud risks or other conditions beyond those considered in planning (FAM 265), including analytical relationships identified during the audit that caused the auditor to believe that additional audit procedures or any other response was required, as well as any further response the auditor concluded was appropriate;
3. the results of the procedures performed to specifically address the risk of management override of controls, including the consideration of the qualitative aspects of the entity’s accounting practices, including indicators of possible bias in management’s judgments (AU-C 240.44b and 700.14);
4. the work performed that demonstrates information in the financial statements agrees or reconciles with the underlying accounting records, including agreeing or reconciling note disclosures, whether such information is obtained from within or outside of the general and subsidiary ledgers (AU-C 330.33);
5. the auditor’s evaluation of misstatements that the auditor believes are or might be the result of fraud;
6. the nature of any communications about fraud or possible fraud (and any significant abuse) made to management, those charged with governance, the Special Investigator Unit, the Office of Inspector General, or others (AU-C 240.45);
7. the auditor’s summary conclusions related to the consideration of fraud;
8. significant accounting, auditing, or reporting issues;
9. how the auditor addressed inconsistencies if the auditor identified information that is inconsistent with the auditor’s final conclusion regarding a significant finding or issue (AU-C 230.12);
10. any limitations on the audit scope;
11. the auditor’s conclusions, at the financial statement and assertion levels, on whether the audit evidence obtained is sufficient and appropriate, and supports the auditor’s reports on the financial statements, RSI (including MD&A), and other information included in the annual report; internal control over financial reporting; financial management systems’ substantial compliance with the three FFMIA requirements (for CFO Act agencies); and compliance with significant provisions of applicable laws, regulations, contracts, and grant agreements;
12. the auditor’s conclusions on whether sufficient appropriate audit evidence was obtained to reduce audit risk to an appropriately low level;
13. the auditor’s conclusion on whether the audit was performed in compliance with GAGAS, OMB audit guidance, and, if used, the FAM, and whether the report is appropriate;
14. the auditor’s conclusion on whether the entity’s financial statements are in accordance with U.S. GAAP;
15. significant subsequent events, if any;
16. findings with respect to transactions with disclosure entities, related parties, and public-private partnerships and complex or unusual transactions (AU-C 940.54c.);
17. the summary of uncorrected misstatements, the summary of corrected misstatements (FAM 595 C), communication of the misstatements to management and those charged with governance, and the auditor’s conclusion about whether uncorrected misstatements are material, individually or in the aggregate, and the basis for that conclusion (AU-C 450.12b and 12c);
18. a summary of internal control weaknesses classified as material weaknesses, other significant deficiencies, and other control deficiencies, and a comparison of material weaknesses the auditor found to the weaknesses reported in management’s assessment about the effectiveness of internal control;
19. a summary of instances of the systems’ lack of substantial compliance with FFMIA requirements, as well as areas in which there is substantial but not full compliance (for CFO Act agencies);
20. a summary of instances of noncompliance with significant provisions of applicable laws, regulations, contracts, and grant agreements;
21. documentation of overall analytical procedures;
22. documentation of required oral or written communication with management, those charged with governance (see FAM 550.18–.20), and others, including the nature of the significant findings or issues discussed, and when and with whom the discussions took place (AU-C 230.11 and 260.21);
23. a copy or summary of management’s communications provided to those charged with governance if, as part of its communication to those charged with governance, management communicated some or all of the matters the auditor is required to communicate, and as a result, the auditor did not communicate these matters at the same level of detail as management (AU-C 260.21);
24. the auditor’s conclusion on the adequacy of two-way communication with those charged with governance (see FAM 550.21–.22); and
25. any departures from the applicable “should” procedures and the basis for them, including the audit director’s approval and a statement about whether the engagement team provided supporting documentation to the reviewer in a timely manner to allow any issues to be promptly identified and resolved.

Overall Analytical Procedures

The auditor should document the following:

* **Expectations.** The auditor develops these for account/line item balances based on plausible relationships that can be reasonably expected to exist.
* **Data used and sources of data.** These data consist of documentation on the specific financial data used for the current-year amounts and expectations, including the amounts of the financial items; the dates or periods covered by the data; whether the data were audited or unaudited; the persons from whom the data were obtained, if applicable; and the source of the information, such as the general ledger trial balance, prior-year audit documentation, or prior-year financial statements.
* **Parameters for identifying significant fluctuations.** These parameters are left to the auditor’s professional judgment based on performance materiality.
* **Explanations for significant fluctuations from expectations and sources of these explanations.** The auditor should determine ifexplanations obtained are consistent with corroborating evidence in the documentation and should reference to this work.
* **Auditor’s conclusions on the results of the procedures.** The auditor should document conclusions reached on the results of overall analytical procedures.

Deficiencies in Internal Control

The auditor should document

* the basis for considering internal control deficiencies as material weaknesses, significant deficiencies, or other control deficiencies;
* any oral communications of control deficiencies that are not included in a written report; and
* procedures performed, such as inquires, to determine the effects of deficiencies in internal control on information in other reports that the entity generated for external distribution or internal decision-making (see FAM 580.84).

Lack of Systems’ Substantial Compliance with FFMIA Requirements

The auditor should document the basis for deciding whether systems’ noncompliance with FFMIA requirements (for CFO Act agencies) represents a lack of substantial compliance with the three FFMIA requirements for financial management systems (see FAM 580.86–.90 and FAM 701).[[16]](#footnote-17)

Instances of Noncompliance or Suspected Noncompliance

The auditor should include a description of the identified and suspected noncompliance with significant provisions of applicable laws, regulations, contracts, and grant agreements; the results of discussions with management; and the results of any discussions with those charged with governance and other parties inside or outside the entity (AU-C 250.28).

The auditor should document the basis for classifying instances of noncompliance as material noncompliance, other reportable noncompliance, or not reportable. The auditor should also document any oral communications of noncompliance that are not included in a written report. See FAM 580.91 through .99 and FAM 800.

Other Reporting Matters

If the auditor identifies matters arising after the date of the auditor’s report, the auditor should refer to AU-C 230.14 and AU-C 560.

The auditor should document procedures performed with respect to any subsequent discovery of facts that could have affected a previously issued audit report on the financial statements (FAM 550.06 and 580.110).

The auditor should document procedures performed with respect to comparative information (FAM 580.14–.17).

Exit Conference(s)

The auditor should document exit conference(s) with appropriate entity officials. The auditor should also document any exit conference held with those charged with governance, as appropriate.

595 A – Example Unmodified Auditor’s Reports

OMB audit guidance requires the auditor to report on internal control but does not require the auditor to express an opinion on the effectiveness of internal control over financial reporting. Example 1 presents a report in which the auditor expresses an opinion on the effectiveness of internal control over financial reporting. Example 2 presents a report in which the auditor has not identified any material weaknesses in internal control and does not express an opinion on internal control effectiveness. In both examples, the audited entity has a fiscal year ending September 30; the auditor’s opinion on the financial statements is unmodified; and no reportable noncompliance with selected provisions of applicable laws, regulations, contracts, and grant agreements is identified.

If the auditor is required to report whether an agency’s systems comply substantially with the three FFMIA requirements, the example reports should be revised to include this item.

See FAM 595 B for modifications to the auditor’s report for a variety of situations.

Example 1 – Unmodified Opinions on Financial Statements and Effectiveness of Internal Control over Financial Reporting, No Significant Deficiencies in Internal Control over Financial Reporting; No Reportable Noncompliance with Applicable Laws, Regulations, Contracts and Grant Agreements

**[Auditor’s Address (including city and state where the auditor’s report is issued)]**

**Independent Auditor’s Report**

To **[appropriate addressee]**

In our audits of the fiscal years **[20X2 and 20X1[[17]](#footnote-18)]** financial statements of **[entity[[18]](#footnote-19)]**, we found

* **[entity’s]** financial statements as of and for the fiscal years ended **[September 30, 20X2, and 20X1]**, are presented fairly, in all material respects, in accordance with U.S. generally accepted accounting principles;
* **[entity]** maintained, in all material respects, effective internal control over financial reporting as of **[September 30, 20X2]**; and
* no reportable noncompliance for **[fiscal year 20X2]** with provisions of applicable laws, regulations, contracts, and grant agreements we tested.

The following sections discuss in more detail (1) our report on the financial statements and on internal control over financial reporting, which includes **[if applicable, insert “an emphasis-of-matter paragraph related to (include brief description),” “an other-matter paragraph related to (include brief description),” or both]** a section on required supplementary information (RSI)[[19]](#footnote-20) and a section on other information included with the financial statements; [[20]](#footnote-21) (2) our report on compliance with laws, regulations, contracts, and grant agreements; and (3) agency comments **[if applicable, add “and our evaluation” and revise related heading on page 595 A-7 for consistency]**.

**Report on the Financial Statements and on Internal Control over Financial Reporting**

Opinion on the Financial Statements

In accordance with **[cite audit authority],** we have audited **[entity’s]** financial statements. **[Entity’s]** financial statements comprise the balance sheets as of **[September 30, 20X2, and 20X1]**; the related statements of net cost **[if included in statement title, insert “of operations”]**, changes in net position, and budgetary resources for the fiscal years then ended;[[21]](#footnote-22) and the related notes to the financial statements. In our opinion, **[entity’s]** financial statements present fairly, in all material respects, **[entity’s]** financial position as of **[September 30, 20X2, and 20X1]**, and its net cost of operations, changes in net position, and budgetary resources for the fiscal years then ended in accordance with U.S. generally accepted accounting principles.

Opinion on Internal Control over Financial Reporting

We also have audited **[entity’s]** internal control over financial reporting as of **[September 30, 20X2]**, based on criteria established under 31 U.S.C. § 3512(c), (d), commonly known as the Federal Managers’ Financial Integrity Act of 1982 (FMFIA). In our opinion, **[entity]** maintained, in all material respects, effective internal control over financial reporting as of **[September 30, 20X2]**, based on criteria established under FMFIA.

**[If applicable]** During our **[20X2]** audit, we identified deficiencies in **[entity’s]** internal control over financial reporting that we do not consider to be material weaknesses or significant deficiencies.[[22]](#footnote-23) Nonetheless, these deficiencies warrant **[entity]** management’s attention. We have communicated these matters to **[entity]** management and, where appropriate, will report on them separately.

Basis for Opinions

We conducted our audits in accordance with U.S. generally accepted government auditing standards. Our responsibilities under those standards are further described in the Auditor’s Responsibilities for the Audits of the Financial Statements and Internal Control over Financial Reporting section of our report. We are required to be independent of **[entity]** and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

**[Note: If applicable, insert emphasis-of-matter paragraph(s), other-matter paragraph(s), or both in accordance with AU-C 706. Include related heading(s).]**

Responsibilities of Management for the Financial Statements and Internal Control over Financial Reporting

Management is responsible for

* the preparation and fair presentation of the financial statements in accordance with U.S. generally accepted accounting principles;
* preparing, measuring, and presenting the RSI in accordance with U.S. generally accepted accounting principles;
* preparing and presenting other information included in **[entity’s]** **[insert name of annual report, e.g., agency financial report]**, and ensuring the consistency of that information with the audited financial statements and the RSI;
* designing, implementing, and maintaining effective internal control over financial reporting relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error;
* assessing the effectiveness of internal control over financial reporting based on the criteria established under FMFIA; and
* its assessment about the effectiveness of internal control over financial reporting as of **[September 30, 20X2]**, included in the accompanying Management’s Report on Internal Control over[[23]](#footnote-24) Financial Reporting **[or other title of management’s report]** in appendix I.

**[For entities that conform to FASB standards]** In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about **[entity’s]** ability to continue as a going concern for a reasonable period of time.

Auditor’s Responsibilities for the Audits of the Financial Statements and Internal Control over Financial Reporting

Our objectives are to (1) obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and whether effective internal control over financial reporting was maintained in all material respects, and (2) issue an auditor’s report that includes our opinions.

Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit of the financial statements or an audit of internal control over financial reporting conducted in accordance with U.S. generally accepted government auditing standards will always detect a material misstatement or a material weakness when it exists.[[24]](#footnote-25) The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements, including omissions, are considered to be material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.[[25]](#footnote-26)

In performing an audit of financial statements and an audit of internal control over financial reporting in accordance with U.S. generally accepted government auditing standards, we:

* + Exercise professional judgment and maintain professional skepticism throughout the audits.
  + Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
  + Obtain an understanding of internal control relevant to our audit of the financial statements in order to design audit procedures that are appropriate in the circumstances.
  + Obtain an understanding of internal control relevant to our audit of internal control over financial reporting, assess the risks that a material weakness exists, and test and evaluate the design and operating effectiveness of internal control over financial reporting based on the assessed risk. Our audit of internal control also considered **[entity’s]** process for evaluating and reporting on internal control over financial reporting based on criteria established under FMFIA. We did not evaluate all internal controls relevant to operating objectives as broadly established under FMFIA, such as those controls relevant to preparing performance information and ensuring efficient operations. We limited our internal control testing to testing controls over financial reporting. Our internal control testing was for the purpose of expressing an opinion on whether effective internal control over financial reporting was maintained, in all material respects. Consequently, our audit may not identify all deficiencies in internal control over financial reporting that are less severe than a material weakness.
  + Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
  + Perform other procedures we consider necessary in the circumstances.
  + **[For entities that conform to FASB standards]** Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about **[entity’s]** ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control–related matters that we identified during the financial statement audit.

Definition and Inherent Limitations of Internal Control over Financial Reporting

An entity’s internal control over financial reporting is a process effected by those charged with governance, management, and other personnel. The objectives of internal control over financial reporting are to provide reasonable assurance that

* transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in accordance with U.S. generally accepted accounting principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition, and
* transactions are executed in accordance with provisions of applicable laws, including those governing the use of budget authority, regulations, contracts, and grant agreements, noncompliance with which could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements due to fraud or error. We also caution that projecting any evaluation of effectiveness to future periods is subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Required Supplementary Information

U.S. generally accepted accounting principles issued by the Federal Accounting Standards Advisory Board (FASAB) require that the RSI be presented to supplement the financial statements. Such information is the responsibility of management and, although not a part of the financial statements, is required by FASAB, which considers it to be an essential part of financial reporting for placing the financial statements in appropriate operational, economic, or historical context.

We have applied certain limited procedures to the RSI in accordance with U.S. generally accepted government auditing standards. These procedures consisted of (1) inquiring of management about the methods used to prepare the RSI and (2) comparing the RSI for consistency with management’s responses to our inquiries, the financial statements, and other knowledge we obtained during the audit of the financial statements, in order to report omissions or material departures from FASAB guidelines, if any, identified by these limited procedures. We did not audit and we do not express an opinion or provide any assurance on the RSI because the limited procedures we applied do not provide sufficient evidence to express an opinion or provide any assurance.[[26]](#footnote-27)

Other Information

**[Entity’s]** other information contains a wide range of information, some of which is not directly related to the financial statements. This information is presented for purposes of additional analysis and is not a required part of the financial statements or the RSI. Management is responsible for the other information included in **[entity’s]** **[insert name of annual report, e.g., agency financial report]**. The other information comprises the following sections: **[list section titles of other information included in the annual report]**.Other information does not include the financial statements and our auditor’s report thereon. Our opinion on the financial statements does not cover the other information, and we do not express an opinion or any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and consider whether a material inconsistency exists between the other information and the financial statements, or the other information otherwise appears to be materially misstated. If, based on the work performed, we conclude that an uncorrected material misstatement of the other information exists, we are required to describe it in our report.[[27]](#footnote-28)

**Report on Compliance with Laws, Regulations, Contracts, and Grant Agreements**

In connection with our audits of **[entity’s]** financial statements, we tested compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements consistent with our auditor’s responsibilities discussed below.

Results of Our Tests for Compliance with Laws, Regulations, Contracts, and Grant Agreements

Our tests for compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements disclosed no instances of noncompliance for **[fiscal year 20X2]** that would be reportable under U.S. generally accepted government auditing standards. However, the objective of our tests was not to provide an opinion on compliance with laws,regulations, contracts, and grant agreements applicable to **[entity]**. Accordingly, we do not express such an opinion.

Basis for Results of Our Tests for Compliance with Laws, Regulations, Contracts, and Grant Agreements

We performed our tests of compliance in accordance with U.S. generally accepted government auditing standards.

Responsibilities of Management for Compliance with Laws, Regulations, Contracts, and Grant Agreements

**[Entity]** management is responsible for complying with laws, regulations, contracts, and grant agreements applicable to **[entity]**.

Auditor’s Responsibilities for Tests of Compliance with Laws, Regulations, Contracts, and Grant Agreements

Our responsibility is to test compliance with selected provisions of laws, regulations, contracts, and grant agreements applicable to **[entity]** that have a direct effect on the determination of material amounts and disclosures in **[entity’s]** financial statements, and to perform certain other limited procedures. Accordingly, we did not test compliance with all provisions of laws, regulations, contracts, and grant agreements applicable to **[entity]**. We caution that noncompliance may occur and not be detected by these tests.

Intended Purpose of Report on Compliance with Laws, Regulations, Contracts, and Grant Agreements

The purpose of this report is solely to describe the scope of our testing of compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements, and the results of that testing, and not to provide an opinion on compliance. This report is an integral part of an audit performed in accordance with U.S. generally accepted government auditing standards in considering compliance. Accordingly, this report on compliance with laws, regulations, contracts, and grant agreements is not suitable for any other purpose.

**Agency Comments [If applicable, add “and Our Evaluation.” Heading should be consistent with related wording on page 595 A-2.]**

In commenting on a draft of this report, **[entity[[28]](#footnote-29)]** ………………………The complete text of **[entity’s]** response is reprinted in appendix II.

**[Signature]**

**[Title]**

**[Date of auditor’s report]**

Example 2 – Unmodified Opinion on Financial Statements, No Opinion on Effectiveness of Internal Control over Financial Reporting (No Material Weakness or Significant Deficiency Identified), No Reportable Noncompliance with Applicable Laws, Regulations, Contracts, and Grant Agreements

**[Auditor’s Address (including city and state where the auditor’s report is issued)]**

**Independent Auditor’s Report**

To **[appropriate addressee]**

In our audits of the fiscal years **[20X2 and 20X1[[29]](#footnote-30)]** financial statements of **[entity[[30]](#footnote-31)]**, we found

* **[entity’s]** financial statements as of and for the fiscal years ended **[September 30, 20X2, and 20X1]**, are presented fairly, in all material respects, in accordance with U.S. generally accepted accounting principles;
* no material weaknesses in internal control over financial reporting based on the limited procedures we performed;[[31]](#footnote-32) and
* no reportable noncompliance for **[fiscal year 20X2]** with provisions of applicable laws, regulations, contracts, and grant agreements we tested.

The following sections discuss in more detail (1) our report on the financial statements, which includes **[if applicable, insert “an emphasis-of-matter paragraph related to (include brief description),” “an other-matter paragraph related to (include brief description),” or both]** a section onrequired supplementary information (RSI)[[32]](#footnote-33) and a section on other information included with the financial statements;[[33]](#footnote-34) (2) our report on internal control over financial reporting; (3) our report on compliance with laws, regulations, contracts, and grant agreements; and (4) agency comments **[if applicable, add “and our evaluation” and revise related heading on page 595 A-14 for consistency]**.

**Report on the Financial Statements**

Opinion

In accordance with [**cite audit authority**], we have audited **[entity’s]** financial statements. **[Entity’s]** financial statements comprise the balance sheets as of **[September 30, 20X2, and 20X1]**; the related statements of net cost **[if included in the statement title, insert “of operations”]**, changes in net position, and budgetary resources for the fiscal years then ended;[[34]](#footnote-35) and the related notes to the financial statements. In our opinion, **[entity’s]** financial statements present fairly, in all material respects, **[entity’s]** financial position as of **[September 30, 20X2, and 20X1]**, and its net cost of operations, changes in net position, and budgetary resources for the fiscal years then ended in accordance with U.S. generally accepted accounting principles.

Basis for Opinion

We conducted our audits in accordance with U.S. generally accepted government auditing standards. Our responsibilities under those standards are further described in the Auditor’s Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of **[entity]** and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

**[Note: If applicable, insert emphasis-of-matter paragraph(s), other-matter paragraph(s), or both in accordance with AU-C 706. Include related heading(s).]**

Responsibilities of Management for the Financial Statements

Management is responsible for

* the preparation and fair presentation of the financial statements in accordance with U.S. generally accepted accounting principles;
* preparing, measuring, and presenting the RSI in accordance with U.S. generally accepted accounting principles;
* preparing and presenting other information included in **[entity’s]** **[insert name of annual report, e.g., agency financial report]**, and ensuring the consistency of that information with the audited financial statements and the RSI; and
* designing, implementing, and maintaining effective internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

**[For entities that conform to FASB standards]** In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about **[entity’s]** ability to continue as a going concern for a reasonable period of time.

Auditor’s Responsibilities for the Audit of the Financial Statements

Our objectives are to (1) obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and (2) issue an auditor’s report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit of the financial statements conducted in accordance with U.S. generally accepted government auditing standards will always detect a material misstatement or a material weakness when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements, including omissions, are considered to be material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.[[35]](#footnote-36)

In performing an audit in accordance with U.S. generally accepted government auditing standards, we:

* Exercise professional judgment and maintain professional skepticism throughout the audit.
* Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
* Obtain an understanding of internal control relevant to our audit of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of **[entity’s]** internal control over financial reporting. Accordingly, no such opinion is expressed.
* Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
* Perform other procedures we consider necessary in the circumstances.
* **[For entities that conform to FASB standards]** Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about **[entity’s]** ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control–related matters that we identified during the financial statement audit.

Required Supplementary Information

U.S. generally accepted accounting principles issued by the Federal Accounting Standards Advisory Board (FASAB) require that the RSI be presented to supplement the financial statements. Such information is the responsibility of management and, although not a part of the financial statements, is required by FASAB, which considers it to be an essential part of financial reporting for placing the financial statements in appropriate operational, economic, or historical context.

We have applied certain limited procedures to the RSI in accordance with U.S. generally accepted government auditing standards. These procedures consisted of (1) inquiring of management about the methods used to prepare the RSI and (2) comparing the RSI for consistency with management’s responses to our inquiries, the financial statements, and other knowledge we obtained during the audit of the financial statements, in order to report omissions or material departures from FASAB guidelines, if any, identified by these limited procedures. We did not audit and we do not express an opinion or provide any assurance on the RSI because the limited procedures we applied do not provide sufficient evidence to express an opinion or provide any assurance.[[36]](#footnote-37)

Other Information

**[Entity’s]** other information contains a wide range of information, some of which is not directly related to the financial statements. This information is presented for purposes of additional analysis and is not a required part of the financial statements or the RSI. Management is responsible for the other information included in **[entity’s]** **[insert name of annual report, e.g., agency financial report]**. The other information comprises the following sections: **[list section titles of other information included in the annual report]**.Other information does not include the financial statements and our auditor’s report thereon. Our opinion on the financial statements does not cover the other information, and we do not express an opinion or any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and consider whether a material inconsistency exists between the other information and the financial statements, or the other information otherwise appears to be materially misstated. If, based on the work performed, we conclude that an uncorrected material misstatement of the other information exists, we are required to describe it in our report.[[37]](#footnote-38)

**Report on Internal Control over Financial Reporting**

In connection with our audits of **[entity’s]** financial statements, we considered **[entity’s]** internal control over financial reporting, consistent with our auditor’s responsibilities discussed below.

Results of Our Consideration of Internal Control over Financial Reporting

Our consideration of internal control was for the limited purpose described below, and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies[[38]](#footnote-39) or to express an opinion on the effectiveness of **[entity’s]** internal control over financial reporting. Given these limitations, during our **[20X2]** audit, we did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses. However, material weaknesses or significant deficiencies may exist that have not been identified.

**[If applicable]** During our **[20X2]** audit, we identified deficiencies in **[entity’s]** internal control over financial reporting that we do not consider to be material weaknesses or significant deficiencies. Nonetheless, these deficiencies warrant **[entity]** management’s attention. We have communicated these matters to **[entity]** management and, where appropriate, will report on them separately.

Basis for Results of Our Consideration of Internal Control over Financial Reporting

We performed our procedures related to **[entity’s]** internal control over financial reporting in accordance with U.S. generally accepted government auditing standards and Office of Management and Budget audit guidance.[[39]](#footnote-40)

Responsibilities of Management for Internal Control over Financial Reporting

**[Entity]** management is responsible for designing, implementing, and maintaining effective internal control over financial reporting relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor’s Responsibilities for Internal Control over Financial Reporting

In planning and performing our audit of **[entity’s]** financial statements as of and for the fiscal year ended **[September 30, 20X2]**, in accordance with U.S. generally accepted government auditing standards, we considered **[entity’s]** internal control relevant to the financial statement audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of **[entity’s]** internal control over financial reporting. Accordingly, we do not express an opinion on **[entity’s]** internal control over financial reporting. We are required to report all deficiencies that are considered to be significant deficiencies or material weaknesses. We did not consider all internal controls relevant to operating objectives, such as those controls relevant to preparing performance information and ensuring efficient operations.

Definition and Inherent Limitations of Internal Control over Financial Reporting

An entity’s internal control over financial reporting is a process effected by those charged with governance, management, and other personnel. The objectives of internal control over financial reporting are to provide reasonable assurance that

* transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in accordance with U.S. generally accepted accounting principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition, and
* transactions are executed in accordance with provisions of applicable laws, including those governing the use of budget authority, regulations, contracts, and grant agreements, noncompliance with which could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements due to fraud or error.

Intended Purpose of Report on Internal Control over Financial Reporting

The purpose of this report is solely to describe the scope of our consideration of **[entity’s]** internal control over financial reporting and the results of our procedures, and not to provide an opinion on the effectiveness of **[entity’s]** internal control over financial reporting. This report is an integral part of an audit performed in accordance with U.S. generally accepted government auditing standards in considering internal control over financial reporting. Accordingly, this report on internal control over financial reporting is not suitable for any other purpose.

**Report on Compliance with Laws, Regulations, Contracts, and Grant Agreements**

In connection with our audits of **[entity’s]** financial statements, we tested compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements consistent with our auditor’s responsibilities discussed below.

Results of Our Tests for Compliance with Laws, Regulations, Contracts, and Grant Agreements

Our tests for compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements disclosed no instances of noncompliance for **[fiscal year 20X2]** that would be reportable under U.S. generally accepted government auditing standards. However, the objective of our tests was not to provide an opinion on compliance with laws,regulations, contracts, and grant agreements applicable to **[entity]**. Accordingly, we do not express such an opinion.

Basis for Results of Our Tests for Compliance with Laws, Regulations, Contracts, and Grant Agreements

We performed our tests of compliance in accordance with U.S. generally accepted government auditing standards.

Responsibilities of Management for Compliance with Laws, Regulations, Contracts, and Grant Agreements

**[Entity]** management is responsible for complying with laws, regulations, contracts, and grant agreements applicable to **[entity]**.

Auditor’s Responsibilities for Tests of Compliance with Laws, Regulations, Contracts, and Grant Agreements

Our responsibility is to test compliance with selected provisions of laws, regulations, contracts, and grant agreements applicable to **[entity]** that have a direct effect on the determination of material amounts and disclosures in **[entity’s]** financial statements, and to perform certain other limited procedures. Accordingly, we did not test compliance with all provisions of laws, regulations, contracts, and grant agreements applicable to **[entity]**. We caution that noncompliance may occur and not be detected by these tests.

Intended Purpose of Report on Compliance with Laws, Regulations, Contracts, and Grant Agreements

The purpose of this report is solely to describe the scope of our testing of compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements, and the results of that testing, and not to provide an opinion on compliance. This report is an integral part of an audit performed in accordance with U.S. generally accepted government auditing standards in considering compliance. Accordingly, this report on compliance with laws, regulations, contracts, and grant agreements is not suitable for any other purpose.

**Agency Comments [if applicable, add “and Our Evaluation.” Heading should be consistent with related wording on page 595 A-8.]**

In commenting on a draft of this report, **[entity[[40]](#footnote-41)]** ………………………The complete text of **[entity’s]** response is reprinted in appendix II.

**[Signature]**

**[Title]**

**[Date of auditor’s report]**

595 B – Example of Reporting Material Weakness or Significant Deficiency on Internal Control over Financial Reporting

Example 1 presents a report in which the auditor expresses an adverse opinion on the effectiveness of internal control over financial reporting and a material weakness exists.

Example 2 presents a report in which the auditor expresses an unmodified opinion on the effectiveness of internal control over financial reporting and a significant deficiency exists.

In both examples, the audited entity has a fiscal year ending September 30; the auditor’s opinion on the financial statements is unmodified; and no reportable noncompliance with selected provisions of applicable laws, regulations, contracts, and grant agreements is identified.

If the auditor is required to report whether an agency’s systems comply substantially with the three FFMIA requirements, the example reports should be revised to include this item.

Example 1 – Unmodified Opinion on Financial Statements; Adverse Opinion on Internal Control over Financial Reporting; No Reportable Noncompliance with Applicable Laws, Regulations, Contracts, and Grant Agreements

**[Auditor’s Address (including city and state where the auditor’s report is issued)]**

**Independent Auditor’s Report**

To **[appropriate addressee]**

In our audits of the fiscal years **[20X2 and 20X1[[41]](#footnote-42)]** financial statements of **[entity[[42]](#footnote-43)]**, we found

* **[entity’s]** financial statements as of and for the fiscal years ended **[September 30, 20X2, and 20X1]**, are presented fairly, in all material respects, in accordance with U.S. generally accepted accounting principles;
* **[entity’s]** internal control over financial reporting was not effective as of **[September 30, 20X2]**; and
* no reportable noncompliance for **[fiscal year 20X2]** with provisions of applicable laws, regulations, contracts, and grant agreements we tested.

The following sections discuss in more detail (1) our report on the financial statements and on internal control over financial reporting, which includes **[if applicable, insert “an emphasis-of-matter paragraph related to (include brief description),” “an other-matter paragraph related to (include brief description),” or both]** a section on required supplementary information (RSI)[[43]](#footnote-44) and a section onother information included with the financial statements;[[44]](#footnote-45) (2) our report on compliance with laws, regulations, contracts, and grant agreements; and (3) agency comments **[if applicable, add “and our evaluation” and revise related heading on page 595 B-8 for consistency]**.

**Report on the Financial Statements and on Internal Control over Financial Reporting**

Opinion on the Financial Statements

In accordance with **[cite audit authority],** we have audited **[entity’s]** financial statements. **[Entity’s]** financial statements comprise the balance sheets as of **[September 30, 20X2, and 20X1]**; the related statements of net cost **[if included in statement title, insert “of operations”]**, changes in net position, and budgetary resources for the fiscal years then ended;[[45]](#footnote-46) and the related notes to the financial statements. In our opinion, **[entity’s]** financial statements present fairly, in all material respects, **[entity’s]** financial position as of **[September 30, 20X2, and 20X1]**, and its net cost of operations, changes in net position, and budgetary resources for the fiscal years then ended in accordance with U.S. generally accepted accounting principles.

However, misstatements may nevertheless occur in unaudited financial information reported internally or externally by **[entity]** as a result of the internal control deficiencies described in this report.

Adverse Opinion on Internal Control over Financial Reporting

We also have audited **[entity’s]** internal control over financial reporting as of **[September 30, 20X2]**, based on criteria established under 31 U.S.C. § 3512(c), (d), commonly known as the Federal Managers’ Financial Integrity Act of 1982 (FMFIA). In our opinion, because of a material weakness in internal control over **[briefly name the deficiency]**, **[entity]** did not maintain, in all material respects, effective internal control over financial reporting as of **[September 30, 20X2]**, based on criteria established under FMFIA.[[46]](#footnote-47)

**[Customize as appropriate]** Although **[entity]** had a material weakness ininternal control over **[briefly name the deficiency], [which existed in prior years, (if applicable)] [entity]** made any necessary adjustments to its records and was therefore able to prepare financial statements that were fairly presented in all material respects for fiscal year **[20X2].** This material weakness, which is discussed in more detail in the Basis for Adverse Opinion on Internal Control over Financial Reporting section,is also disclosed by **[entity]** in its fiscal year **[20X2]** (1) FMFIA assurance statement and (2) Management’s Report on Internal Control over Financial Reporting. We considered this material weakness in determining the nature, timing, and extent of our audit procedures on **[entity’s]** fiscal year **[20X2]** financial statements.

**[If applicable]** In addition to thematerial weakness in internal control over **[insert description of material weakness from above]**, we also identified other deficiencies in **[entity’s]** internal control over financial reporting that we do not consider to be material weaknesses or significant deficiencies.[[47]](#footnote-48) Nonetheless, these deficiencies warrant **[entity]** management’s attention. We have communicated these matters to **[entity]** management and, where appropriate, will report on them separately.[[48]](#footnote-49)

Basis for Opinion on the Financial Statements

We conducted our audits in accordance with U.S. generally accepted government auditing standards. Our responsibilities under those standards are further described in the Auditor’s Responsibilities for the Audits of the Financial Statements and Internal Control over Financial Reporting section of our report. We are required to be independent of **[entity]** and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion on the financial statements.

Basis for Adverse Opinion on Internal Control over Financial Reporting

We identified the following material weakness in our audits of the fiscal years **[20X2 and 20X1]** financial statements of **[entity]**.

**Material Weakness in Internal Control over** **[briefly name the deficiency]**

**[Describe material weakness, including any progress or changes in the internal control deficiencies identified if they were previously reported.]**

We conducted our audits in accordance with U.S. generally accepted government auditing standards. Our responsibilities under those standards are further described in the Auditor’s Responsibilities for the Audits of the Financial Statements and Internal Control over Financial Reporting section of our report. We are required to be independent of **[entity]** and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our adverse audit opinion on internal control over financial reporting.

**[Note: If applicable, insert emphasis-of-matter paragraph(s), other-matter paragraph(s), or both in accordance with AU-C 706. Include related heading(s).]**

Responsibilities of Management for the Financial Statements and Internal Control over Financial Reporting

Management is responsible for

* the preparation and fair presentation of the financial statements in accordance with U.S. generally accepted accounting principles;
* preparing, measuring, and presenting the RSI in accordance with U.S. generally accepted accounting principles;
* preparing and presenting other information included in **[entity’s]** **[insert name of annual report, e.g., agency financial report]**, and ensuring the consistency of that information with the audited financial statements and the RSI;
* designing, implementing, and maintaining effective internal control over financial reporting relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error;
* assessing the effectiveness of internal control over financial reporting based on the criteria established under FMFIA; and
* its assessment about the effectiveness of internal control over financial reporting as of **[September 30, 20X2]**, included in the accompanying Management’s Report on Internal Control over[[49]](#footnote-50) Financial Reporting **[or other title of management’s report]** in appendix I.

**[For entities that conform to FASB standards]** In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about **[entity’s]** ability to continue as a going concern for a reasonable period of time.

Auditor’s Responsibilities for the Audits of the Financial Statements and Internal Control over Financial Reporting

Our objectives are to (1) obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and whether effective internal control over financial reporting was maintained in all material respects, and (2) issue an auditor’s report that includes our opinions. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit of the financial statements or an audit of internal control over financial reporting conducted in accordance with U.S. generally accepted government auditing standards will always detect a material misstatement or a material weakness when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements, including omissions, are considered to be material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.[[50]](#footnote-51)

In performing an audit of financial statements and an audit of internal control over financial reporting in accordance with U.S. generally accepted government auditing standards, we:

* + Exercise professional judgment and maintain professional skepticism throughout the audits.
  + Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
  + Obtain an understanding of internal control relevant to our audit of the financial statements in order to design audit procedures that are appropriate in the circumstances.
  + Obtain an understanding of internal control relevant to our audit of internal control over financial reporting, assess the risks that a material weakness exists, and test and evaluate the design and operating effectiveness of internal control over financial reporting based on the assessed risk. Our audit of internal control also considered **[entity’s]** process for evaluating and reporting on internal control over financial reporting based on criteria established under FMFIA. We did not evaluate all internal controls relevant to operating objectives as broadly established under FMFIA, such as those controls relevant to preparing performance information and ensuring efficient operations. We limited our internal control testing to testing controls over financial reporting. Our internal control testing was for the purpose of expressing an opinion on whether effective internal control over financial reporting was maintained, in all material respects. Consequently, our audit may not identify all deficiencies in internal control over financial reporting that are less severe than a material weakness.
  + Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
  + Perform other procedures we consider necessary in the circumstances.
  + **[For entities that conform to FASB standards]** Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about **[entity’s]** ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control–related matters that we identified during the financial statement audit.

Definition and Inherent Limitations of Internal Control over Financial Reporting

An entity’s internal control over financial reporting is a process effected by those charged with governance, management, and other personnel. The objectives of internal control over financial reporting are to provide reasonable assurance that

* transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in accordance with U.S. generally accepted accounting principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition, and
* transactions are executed in accordance with provisions of applicable laws, including those governing the use of budget authority, regulations, contracts, and grant agreements, noncompliance with which could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements due to fraud or error. We also caution that projecting any evaluation of effectiveness to future periods is subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Required Supplementary Information

U.S. generally accepted accounting principles issued by the Federal Accounting Standards Advisory Board (FASAB) require that the RSI be presented to supplement the financial statements. Such information is the responsibility of management and, although not a part of the financial statements, is required by FASAB, which considers it to be an essential part of financial reporting for placing the financial statements in appropriate operational, economic, or historical context.

We have applied certain limited procedures to the RSI in accordance with U.S. generally accepted government auditing standards. These procedures consisted of (1) inquiring of management about the methods used to prepare the RSI and (2) comparing the RSI for consistency with management’s responses to our inquiries, the financial statements, and other knowledge we obtained during the audit of the financial statements, in order to report omissions or material departures from FASAB guidelines, if any, identified by these limited procedures. We did not audit and we do not express an opinion or provide any assurance on the RSI because the limited procedures we applied do not provide sufficient evidence to express an opinion or provide any assurance.[[51]](#footnote-52)

Other Information

**[Entity’s]** other information contains a wide range of information, some of which is not directly related to the financial statements. This information is presented for purposes of additional analysis and is not a required part of the financial statements or the RSI. Management is responsible for the other information included in **[entity’s]** **[insert name of annual report, e.g., agency financial report]**. The other information comprises the following sections: **[list section titles of other information included in the annual report]**.Other information does not include the financial statements and our auditor’s report thereon. Our opinion on the financial statements does not cover the other information, and we do not express an opinion or any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and consider whether a material inconsistency exists between the other information and the financial statements, or the other information otherwise appears to be materially misstated. If, based on the work performed, we conclude that an uncorrected material misstatement of the other information exists, we are required to describe it in our report.[[52]](#footnote-53)

**Report on Compliance with Laws, Regulations, Contracts, and Grant Agreements**

In connection with our audits of **[entity’s]** financial statements, we tested compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements consistent with our auditor’s responsibilities discussed below.

Results of Our Tests for Compliance with Laws, Regulations, Contracts, and Grant Agreements

Our tests for compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements disclosed no instances of noncompliance for **[fiscal year 20X2]** that would be reportable under U.S. generally accepted government auditing standards. However, the objective of our tests was not to provide an opinion on compliance with laws,regulations, contracts, and grant agreements applicable to **[entity]**. Accordingly, we do not express such an opinion.

Basis for Results of Our Tests for Compliance with Laws, Regulations, Contracts, and Grant Agreements

We performed our tests of compliance in accordance with U.S. generally accepted government auditing standards.

Responsibilities of Management for Compliance with Laws, Regulations, Contracts, and Grant Agreements

**[Entity]** management is responsible for complying with laws, regulations, contracts, and grant agreements applicable to **[entity]**.

Auditor’s Responsibilities for Tests of Compliance with Laws, Regulations, Contracts, and Grant Agreements

Our responsibility is to test compliance with selected provisions of laws, regulations, contracts, and grant agreements applicable to **[entity]** that have a direct effect on the determination of material amounts and disclosures in **[entity’s]** financial statements, and to perform certain other limited procedures. Accordingly, we did not test compliance with all provisions of laws, regulations, contracts, and grant agreements applicable to **[entity]**. We caution that noncompliance may occur and not be detected by these tests.

Intended Purpose of Report on Compliance with Laws, Regulations, Contracts, and Grant Agreements

The purpose of this report is solely to describe the scope of our testing of compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements, and the results of that testing, and not to provide an opinion on compliance. This report is an integral part of an audit performed in accordance with U.S. generally accepted government auditing standards in considering compliance. Accordingly, this report on compliance with laws, regulations, contracts, and grant agreements is not suitable for any other purpose.

**Agency Comments [If applicable, add “and Our Evaluation.” Heading should be consistent with related wording on page 595 B-2.]**

In commenting on a draft of this report, **[entity[[53]](#footnote-54)]** ………………………The complete text of **[entity’s]** response is reprinted in appendix II.

**[Signature]**

**[Title]**

**[Date of auditor’s report]**

Example 2 – Unmodified Opinion on Financial Statements; Unmodified Opinion on Internal Control over Financial Reporting, but Significant Deficiency Exists (No Material Weaknesses); No Reportable Noncompliance with Applicable Laws, Regulations, Contracts, and Grant Agreements

**[Auditor’s Address (including city and state where the auditor’s report is issued)]**

**Independent Auditor’s Report**

To **[appropriate addressee]**

In our audits of the fiscal years **[20X2 and 20X1[[54]](#footnote-55)]** financial statements of **[entity[[55]](#footnote-56)]**, we found

* **[entity’s]** financial statements as of and for the fiscal years ended **[September 30, 20X2, and 20X1]**, are presented fairly, in all material respects, in accordance with U.S. generally accepted accounting principles;
* although internal controls could be improved, **[entity]** maintained, in all material respects, effective internal control over financial reporting as of **[September 30, 20X2]**; and
* no reportable noncompliance for **[fiscal year 20X2]** with provisions of applicable laws, regulations, contracts, and grant agreements we tested.

The following sections discuss in more detail (1) our report on the financial statements and on internal control over financial reporting, which includes **[if applicable insert “an emphasis-of-matter paragraph related to (include brief description),” “an other-matter paragraph related to (include brief description),” or both]** a section onrequired supplementary information (RSI)[[56]](#footnote-57) and a section onother information included with the financial statements;[[57]](#footnote-58) (2) our report on compliance with laws, regulations, contracts, and grant agreements; and (3) agency comments **[if applicable, add “and our evaluation” and revise related heading on page 595 B-15 for consistency]**.

**Report on the Financial Statements and on Internal Control over Financial Reporting**

Opinion on the Financial Statements

In accordance with **[cite audit authority],** we have audited **[entity’s]** financial statements. **[Entity’s]** financial statements comprise the balance sheets as of **[September 30, 20X2, and 20X1]**; the related statements of net cost **[if included in statement title, insert “of operations”]**, changes in net position, and budgetary resources for the fiscal years then ended;[[58]](#footnote-59) and the related notes to the financial statements. In our opinion, **[entity’s]** financial statements present fairly, in all material respects, **[entity’s]** financial position as of **[September 30, 20X2, and 20X1]**, and its net cost of operations, changes in net position, and budgetary resources for the fiscal years then ended in accordance with U.S. generally accepted accounting principles.

Opinion on Internal Control over Financial Reporting

We also have audited **[entity’s]** internal control over financial reporting as of **[September 30, 20X2]**, based on criteria established under 31 U.S.C. § 3512(c), (d), commonly known as the Federal Managers’ Financial Integrity Act of 1982 (FMFIA). In our opinion, although certain internal controls could be improved, **[entity]** maintained, in all material respects, effective internal control over financial reporting as of **[September 30, 20X2]**, based on criteria established under FMFIA. As discussed below in more detail, our **[20X2]** audit identified deficiencies in **[entity’s]** controls over **[describe account or process where significant deficiency identified, for example, accounts receivable process]** that collectively represent a significant deficiency in **[entity’s]** internal control over financial reporting.[[59]](#footnote-60) We considered this significant deficiency in determining the nature, timing, and extent of our audit procedures on **[entity’s]** fiscal year **[20X2]** financial statements.

Although the significant deficiency in internal control did not affect our opinion on **[entity’s]** fiscal year **[20X2]** financial statements, misstatements may occur in unaudited financial information reported internally and externally by **[entity]** because of this significant deficiency.

**[If applicable]** In addition to the significant deficiency in internal control over **[insert description of significant deficiency from above]**, we also identified other deficiencies in **[entity’s]** internal control over financial reporting that we do not consider to be material weaknesses or significant deficiencies. Nonetheless, these deficiencies warrant **[entity]** management’s attention. We have communicated these matters to **[entity]** management and, where appropriate, will report on them separately.[[60]](#footnote-61)

Significant Deficiency in Internal Control over **[briefly name the deficiency]**

**[Describe significant deficiency, including any progress or changes in the internal control deficiencies identified if they were previously reported.]**

Basis for Opinions

We conducted our audits in accordance with U.S. generally accepted government auditing standards. Our responsibilities under those standards are further described in the Auditor’s Responsibilities for the Audits of the Financial Statements and Internal Control over Financial Reporting section of our report. We are required to be independent of **[entity]** and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

**[Note: If applicable, insert emphasis-of-matter paragraph(s), other-matter paragraph(s), or both in accordance with AU-C 706. Include related heading(s).]**

Responsibilities of Management for the Financial Statements and Internal Control over Financial Reporting

Management is responsible for

* the preparation and fair presentation of the financial statements in accordance with U.S. generally accepted accounting principles;
* preparing, measuring, and presenting the RSI in accordance with U.S. generally accepted accounting principles;
* preparing and presenting other information included in **[entity’s]** **[insert name of annual report, e.g., agency financial report]**, and ensuring the consistency of that information with the audited financial statements and the RSI;
* designing, implementing, and maintaining effective internal control over financial reporting relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error;
* assessing the effectiveness of internal control over financial reporting based on the criteria established under FMFIA; and
* its assessment about the effectiveness of internal control over financial reporting as of **[September 30, 20X2]**, included in the accompanying Management’s Report on Internal Control over[[61]](#footnote-62) Financial Reporting **[or other title of management’s report]** in appendix I.

**[For entities that conform to FASB standards]** In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about **[entity’s]** ability to continue as a going concern for a reasonable period of time.

Auditor’s Responsibilities for the Audits of the Financial Statements and Internal Control over Financial Reporting

Our objectives are to (1) obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and whether effective internal control over financial reporting was maintained in all material respects, and (2) issue an auditor’s report that includes our opinions. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit of the financial statements or an audit of internal control over financial reporting conducted in accordance with U.S. generally accepted government auditing standards will always detect a material misstatement or a material weakness when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements, including omissions, are considered to be material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.[[62]](#footnote-63)

In performing an audit of financial statements and an audit of internal control over financial reporting in accordance with U.S. generally accepted government auditing standards, we:

* + Exercise professional judgment and maintain professional skepticism throughout the audits.
  + Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
  + Obtain an understanding of internal control relevant to our audit of the financial statements in order to design audit procedures that are appropriate in the circumstances.
  + Obtain an understanding of internal control relevant to our audit of internal control over financial reporting, assess the risks that a material weakness exists, and test and evaluate the design and operating effectiveness of internal control over financial reporting based on the assessed risk. Our audit of internal control also considered **[entity’s]** process for evaluating and reporting on internal control over financial reporting based on criteria established under FMFIA. We did not evaluate all internal controls relevant to operating objectives as broadly established under FMFIA, such as those controls relevant to preparing performance information and ensuring efficient operations. We limited our internal control testing to testing controls over financial reporting. Our internal control testing was for the purpose of expressing an opinion on whether effective internal control over financial reporting was maintained, in all material respects. Consequently, our audit may not identify all deficiencies in internal control over financial reporting that are less severe than a material weakness.
  + Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
  + Perform other procedures we consider necessary in the circumstances.
  + **[For entities that conform to FASB standards]** Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about **[entity’s]** ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control–related matters that we identified during the financial statement audit.

Definition and Inherent Limitations of Internal Control over Financial Reporting

An entity’s internal control over financial reporting is a process effected by those charged with governance, management, and other personnel. The objectives of internal control over financial reporting are to provide reasonable assurance that

* transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in accordance with U.S. generally accepted accounting principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition, and
* transactions are executed in accordance with provisions of applicable laws, including those governing the use of budget authority, regulations, contracts, and grant agreements, noncompliance with which could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements due to fraud or error. We also caution that projecting any evaluation of effectiveness to future periods is subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Required Supplementary Information

U.S. generally accepted accounting principles issued by the Federal Accounting Standards Advisory Board (FASAB) require that the RSI be presented to supplement the financial statements. Such information is the responsibility of management and, although not a part of the financial statements, is required by FASAB, which considers it to be an essential part of financial reporting for placing the financial statements in appropriate operational, economic, or historical context.

We have applied certain limited procedures to the RSI in accordance with U.S. generally accepted government auditing standards. These procedures consisted of (1) inquiring of management about the methods used to prepare the RSI and (2) comparing the RSI for consistency with management’s responses to our inquiries, the financial statements, and other knowledge we obtained during the audit of the financial statements, in order to report omissions or material departures from FASAB guidelines, if any, identified by these limited procedures. We did not audit and we do not express an opinion or provide any assurance on the RSI because the limited procedures we applied do not provide sufficient evidence to express an opinion or provide any assurance.[[63]](#footnote-64)

Other Information

**[Entity’s]** other information contains a wide range of information, some of which is not directly related to the financial statements. This information is presented for purposes of additional analysis and is not a required part of the financial statements or the RSI. Management is responsible for the other information included in **[entity’s]** **[insert name of annual report, e.g., agency financial report]**. The other information comprises the following sections: **[list section titles of other information included in the annual report]**. Other information does not include the financial statements and our auditor’s report thereon. Our opinion on the financial statements does not cover the other information, and we do not express an opinion or any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and consider whether a material inconsistency exists between the other information and the financial statements, or the other information otherwise appears to be materially misstated. If, based on the work performed, we conclude that an uncorrected material misstatement of the other information exists, we are required to describe it in our report.[[64]](#footnote-65)

**Report on Compliance with Laws, Regulations, Contracts, and Grant Agreements**

In connection with our audits of **[entity’s]** financial statements, we tested compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements consistent with our auditor’s responsibilities discussed below.

Results of Our Tests for Compliance with Laws, Regulations, Contracts, and Grant Agreements

Our tests for compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements disclosed no instances of noncompliance for **[fiscal year 20X2]** that would be reportable under U.S. generally accepted government auditing standards. However, the objective of our tests was not to provide an opinion on compliance with laws,regulations, contracts, and grant agreements applicable to **[entity]**. Accordingly, we do not express such an opinion.

Basis for Results of Our Tests for Compliance with Laws, Regulations, Contracts, and Grant Agreements

We performed our tests of compliance in accordance with U.S. generally accepted government auditing standards.

Responsibilities of Management for Compliance with Laws, Regulations, Contracts, and Grant Agreements

**[Entity]** management is responsible for complying with laws, regulations, contracts, and grant agreements applicable to **[entity]**.

Auditor’s Responsibilities for Tests of Compliance with Laws, Regulations, Contracts, and Grant Agreements

Our responsibility is to test compliance with selected provisions of laws, regulations, contracts, and grant agreements applicable to **[entity]** that have a direct effect on the determination of material amounts and disclosures in **[entity’s]** financial statements, and perform certain other limited procedures. Accordingly, we did not test compliance with all provisions of laws, regulations, contracts, and grant agreements applicable to **[entity]**. We caution that noncompliance may occur and not be detected by these tests.

Intended Purpose of Report on Compliance with Laws, Regulations, Contracts, and Grant Agreements

The purpose of this report is solely to describe the scope of our testing of compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements, and the results of that testing, and not to provide an opinion on compliance. This report is an integral part of an audit performed in accordance with U.S. generally accepted government auditing standards in considering compliance. Accordingly, this report on compliance with laws, regulations, contracts, and grant agreements is not suitable for any other purpose.

**Agency Comments [If applicable, add “and Our Evaluation.” Heading should be consistent with related wording on page 595 B-9.]**

In commenting on a draft of this report, **[entity[[65]](#footnote-66)]** ………………………The complete text of **[entity’s]** response is reprinted in appendix II.

**[Signature]**

**[Title]**

**[Date of auditor’s report]**

595 C – Accumulating Misstatements

1. As discussed in FAM 540, the auditor should accumulate misstatements identified during the audit (other than those that are clearly trivial). The paragraphs and illustrative examples that follow provide guidance on preparing the summary of uncorrected misstatements (SUM), including the list of adjusting entries needed to correct the uncorrected misstatements, and preparing the summary of corrected misstatements.

Prepare Summary of Uncorrected Misstatements

1. When accumulating uncorrected misstatements, the auditor should prepare the list of adjusting entries needed to correct the uncorrected misstatements, including any nontrivial misstatements that management brings to the auditor’s attention that management has not corrected, under the balance sheet approach. The auditor should also list the adjustments to transition from the balance sheet approach to the net cost approach (i.e., reversal of net cost misstatements included in the prior-year SUM under the balance sheet approach). The misstatements under the current-year balance sheet approach carry over to the net cost approach and are not included as transition adjustments.[[66]](#footnote-67)
2. The **balance sheet approach** quantifies a misstatement with the objective of making the balance sheet correct as of the end of the current year. The other side(s) of the entry to correct the balance sheet is(are) generally made to the statement of net cost within the appropriate components of net cost (e.g., gross cost or earned revenue).[[67]](#footnote-68)

An example of a misstatement that would be quantified under the balance sheet approach is an understatement of accrued liabilities at the end of the current year and a corresponding understatement of gross cost. The adjustment to correct the balance sheet would be to credit accrued liabilities and debit gross cost. In addition, the following misstatements would be quantified under the balance sheet approach:[[68]](#footnote-69)

* Misstatements solely within the balance sheet, statement of net cost, or statement of changes in net position.[[69]](#footnote-70)
* Misstatements affecting both the statement of net cost and statement of changes in net position (e.g., misclassification between earned revenue and nonexchange revenue), other than the carryover of total net cost from the statement of net cost to the net cost of operations line item on the statement of changes in net position.

The **net cost approach** quantifies a misstatement with the objective of making the current-year statement of net cost correct. Under this approach, the auditor quantifies misstatements from two sources:

* all misstatements under the **current-year** balance sheet approach (as discussed above) and
* reversal of net cost misstatements included in the **prior-year** SUM under the balance sheet approach, with the offsetting entry to beginning net position (transition adjustments from the balance sheet approach to the net cost approach).[[70]](#footnote-71)

An example of a misstatement that would be quantified under the net cost approach only (i.e., balance sheet approach results in no adjustments) is a cutoff error at the end of the prior year. The entity overaccrued liabilities and gross cost on its prior-year financial statements, resulting in current year costs being recorded on its prior-year financial statements. The prior-year SUM under the balance sheet approach included a debit entry to accrued liabilities and a credit entry to gross cost. The adjustment to correct the statement of net cost in the current year would be a debit entry to gross cost, which reverses the prior-year credit entry to gross cost, and a credit entry to beginning net position.

The following two examples illustrate the application of the balance sheet and net cost approaches. They are reflected in FAM 595 C, example 1, tables I and II. Auditors should also consider the budgetary effects of the misstatements on the statement of budgetary resources, such as the need to record an obligation. The examples discussed below do not consider any effect on the statement of budgetary resources.

1. **Example 1:** The auditor identified an improper expense accrual in Program A at the end of the current year of $100,000, which has accrued at $20,000 per year over 5 years.

* Year 1 – 4 (prior years): Other Liabilities is overstated by a cumulative amount of $80,000 through year 4. This amount is included in the prior-year SUM under the balance sheet approach.
* Year 5 (current year): Other Liabilities is overstated by an additional $20,000 in the current year (included in gross cost), resulting in a cumulative overstatement of $100,000 through year 5.

Under the **balance sheet** approach, the auditor quantifies the misstatement based on correcting the misstatement in the balance sheet at the end of the current year and making an offsetting entry to current-year gross cost. In this example, the adjusting entries would be a debit to other liabilities for $100,000 and a corresponding credit to current-year gross cost (see FAM 595 C, example 1, table I, adjusting entry 6a).

Under the net cost approach, the auditor quantifies the misstatement based on correcting the misstatement in the current-year statement of net cost. This is composed of two parts:

* + - * + all misstatements under the **current-year** balance sheet approach (debit other liabilities and credit gross cost of $100,000) (discussed above) and
        + reversal of net cost misstatements under the **prior-year** balance sheet approach, with the offsetting entry to beginning net position (debit gross cost and credit beginning net position of $80,000).

The $100,000 entry is recorded on the SUM under thecurrent-yearbalance sheet approach, and the $80,000 entry is an adjustment to transition the balance sheet approach to the net cost approach. The result of these two parts is a $100,000 debit entry to other liabilities, $80,000 credit entry to beginning net position, and net $20,000 credit entry to gross cost. The auditor would record the $80,000 reversal of net cost misstatements under the **prior-year** balance sheet approach as an adjustment to transition the balance sheet approach to the net cost approach (see FAM 595 C, example 1, table I, adjusting entry 6b).

1. **Example 2:** The auditor identified an overaccrual of other liabilities and gross cost during the **prior-year** audit, in which $300,000 of Program A gross cost related to the **current year** was improperly accrued in the **prior year**. The **prior-year** SUM under the balance sheet approach included a debit entry to other liabilities and a credit entry to gross cost of $300,000. Because management chose not to record the adjustment in the **prior-year** audit, the **current-year** expense is understated by $300,000. Other liabilities are properly stated at the end of the current year.

Because the misstatement does not affect the balance sheet at the end of current year and is not a misstatement that would be quantified under the balance sheet approach as discussed in FAM 595 C.06, no adjusting entry is needed under the **balance sheet** approach.

Under the **net cost** approach, the auditor quantifies the misstatement based on correcting the misstatement in the current-year statement of net cost. In this example, since there is no effect under the **current-year** balance sheet approach, the misstatement (and transition from the current-year balance sheet approach) is composed of the reversal of net cost misstatements under the **prior-year** balance sheet approach, with the offsetting entry to beginning net position. In this example, the adjusting entries in the current year would be a debit to gross cost for $300,000 and a corresponding credit to beginning net position. The auditor would record an adjusting entry to transition from the balance sheet approach to the net cost approach (see FAM 595 C, example 1, table I, adjusting entry 7).

The list of adjusting entries needed to correct the uncorrected misstatements under the balance sheet approach and the adjustments to transition from the balance sheet approach to the net cost approach would typically include the following information (see FAM 595 C, example 1, table I):

1. reference to an adjustment number or documentation reference;
2. whether the misstatement is factual, judgmental, or projected;
3. description of the adjustment;
4. *U.S. Standard General Ledger* (USSGL) account numbers and line items affected in the entity’s financial statements;
5. indication of whether each USSGL/line item affected is a federal intragovernmental (F) or a nonfederal public account (N); and
6. amounts of the debit and credit.
7. The auditor should prepare a SUM or equivalent documentation (AU-C 450.12b) based on the list of adjusting entries needed to correct the uncorrected misstatements to show the financial statement effect of the uncorrected misstatements under both the balance sheet and net cost approaches (see FAM 595 C, example 1, table II).
8. The auditor enters the adjusting entries needed to correct the uncorrected misstatements under the balance sheet approach and the adjustments to transition from the balance sheet approach to the net cost approach on the SUM. These entries are entered in the following columns as shown on the illustrative example in FAM 595 C, example 1, table II.

* The misstatements under the balance sheet approach are entered in column 4.
* The adjustments to transition from the balance sheet approach to the net cost approach are entered in column 7.

The auditor then completes the other columns on the SUM to show the adjusted line item balances under the balance sheet approach in column 5 and the adjusted line item balances under the net cost approach in column 8. The auditor also completes the related information on the statement of changes in net position, including the effect of the adjustments on the balance sheet and statement of net cost. While not presented in the illustrative example in FAM 595 C, example 1, table II, the auditor should also consider the budgetary effects of the misstatements on the statement of budgetary resources, such as the need to record an obligation.

1. The auditor should also consider and document the effects (other than clearly trivial) of uncorrected misstatements (including omissions) on the notes to the entity’s financial statements on a quantitative and qualitative basis. Such information related to the notes would typically include the note number, note name, and a description of the misstatement (see FAM 595 C, example 1, table III).
2. As discussed in FAM 540.14, the auditor should communicate the uncorrected misstatements accumulated on the SUM with management. Management is responsible for determining whether the uncorrected misstatements on the SUM are material, individually or in the aggregate, to the entity’s financial statements under either the net cost or balance sheet approach and whether to make any further adjustments to the financial statements. If management makes any further adjustments to correct the misstatements accumulated on the SUM, the auditor should update the (1) list of adjusting entries needed to correct the uncorrected misstatements to accumulate only those that remain uncorrected, (2) SUM, and (3) summary of corrected misstatements (see FAM 595 C.13–.14 below). In the illustrative example in FAM 595 C, examples 1 and 2, management has declined to record adjusting entries 1 through 4, 6, and 7, and declined to correct note 17 because management has determined that they are immaterial to the financial statements. Management has agreed to record adjusting entry 5 and correct notes 10 and 19 because management has determined that they are material to the financial statements.

The auditor should provide the final SUM (see FAM 595 C, example 1), including any uncorrected misstatements on the notes to the financial statements, without the auditor’s calculations, evaluation, and conclusion, to management as an attachment to the management representation letter, as discussed in FAM 1001.

1. The SUM should include management’s conclusion about whether uncorrected misstatements are material, individually or in the aggregate, and the basis for that conclusion (including consideration of the balance sheet and net cost approaches). The SUM should also include the auditor’s conclusion about whether uncorrected misstatements are material, individually or in the aggregate, and the basis for that conclusion (AU-C 450.12c). The auditor’s conclusion should include consideration of the balance sheet and net cost approaches. The SUM should also discuss any differences between management’s and the auditor’s conclusions and its effect on the audit conclusions or report. The SUM should indicate that the auditor communicated the effects of the uncorrected misstatements on the financial statements with those charged with governance (see FAM 595 C, example 1, table 2).

Prepare Summary of Corrected Misstatements

1. The auditor should accumulate misstatements for financial statement line items that the auditor has identified and management has corrected in the summary of corrected misstatements. The summary of corrected misstatements would typically include the information listed in FAM 595 C.06 (see FAM 595 C, example 2, table I).
2. The auditor should also consider and document the effects (other than clearly trivial) of corrected misstatements on the notes to the entity’s financial statements on a quantitative and qualitative basis. Such information related to the notes would typically include the note number, note name, and a description of the misstatement (see FAM 595 C, example 2, table II).

Example 1 – List of Adjusting Entries Needed to Correct the Uncorrected Misstatements and Summary of Uncorrected Misstatements

Table I lists the adjusting entries needed to correct the uncorrected misstatements accumulated by the auditor (other than those that are clearly trivial) and includes the information listed in FAM 595 C.06. Adjusting entries 6 and 7 illustrate the application of the balance sheet and net cost approaches as discussed in FAM 595 C.05. After discussions with management, the auditor finalizes this table to include only misstatements that management has declined to correct (see FAM 595 C.10). In this example, management decided to record adjusting entry 5 (see example 2) and declined to record all other adjusting entries.

**Table I: List of Adjusting Entries Needed to Correct the Uncorrected Misstatements**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| Adj. # | Factual, judgmental, or projected? | Description of uncorrected misstatement | Federal governmental (F) or nonfederal public (N) | | |  | |
|  | USSGL account number | | (Dollars in thousands) | |
|  |  | Financial statement line item | Debit | Credit |
| Misstatements under balance sheet approach | | | | | | | |
| 1 | Judgmental | To accrue accounts payable for Program A. | N | 6100 | Gross cost – Program A | $230 |  |
|  |  |  | N | 2110 | Accounts payable |  | $230 |
| 2 | Factual | To decrease operating expenses overstated due to a cutoff error at the end of the current year. | N | 2990 | Other liabilities | $200 |  |
| N | 6100 | Gross cost – Program A |  | $200 |
| 3 | Factual | To increase current-year loan bad debt expense in Program B. [Actual error amount of an intragovernmental sample item.] | F | 6100 | Gross cost – Program B | $25 |  |
|  |  | F | 1310 | Accounts receivable |  | $25 |
| 4 | Projected | To increase current-year loan bad debt expense in Program B. [Additional projected misstatement as a result of actual error amount of sample item from adj. #3 above projected to the population. Total projected misstatement of $105 less $25 actual misstatement] | F | 6100 | Gross cost – Program B | $80 |  |
|  | F | 1310 | Accounts receivable |  | $80 |
| 6a | Factual | To decrease improper expense accrual for the current year and prior 4 years. | N | 2990 | Other liabilities | $100 |  |
| N | 6100 | Gross cost – Program A |  | $100 |
| Adjustments to transition from balance sheet approach to net cost approach | | | | | | | |
| 6b | Factual | To reverse improper expense accrual as of the end of the prior year. | N | 6100 | Gross cost – Program A | $80 |  |
| N | 3310 | Beginning net position |  | $80 |
| 7 | Factual | To increase current-year operating expenses understated due to a cutoff error at the end of the prior year. | N | 6100 | Gross cost – Program A | $300 |  |
| N | 3310 | Beginning net position |  | $300 |

Table II shows the effects of the misstatements that management declined to correct (uncorrected misstatements) based on the list of adjusting entries needed to correct the uncorrected misstatements (see table I above).

**Table II: Summary of Uncorrected Misstatements - Effect of Uncorrected Misstatements on Financial Statement Line Items**

| **Line item**  (Dollars in thousands) | **Adjustment number** | **Line item balance**  **Debit/(Credit)** | **Misstatements under balance sheet approach**  **Debit/(Credit)** | **Adjusted line item balance under balance sheet approach**  **Debit/(Credit)** | **Misstatement as percentage of reported line item under balance sheet approach** | **Adjustments to transition from balance sheet approach to net cost approach**  **Debit/(Credit)** | **Adjusted line item balance under net cost approach**  **Debit/(Credit)** | **Misstatement as percentage of reported line item under net cost approach** |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| (1) | (2) | (3) | (4) | (5) = (3) + (4) | (6) = [(5) – (3)] / (3) | (7) | (8) = (5) + (7) | (9) = [(8) – (3)] / (3) |
| **Balance Sheet:** |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |
| Assets |  |  |  |  |  |  |  |  |
| Intragovernmental: |  |  |  |  |  |  |  |  |
| Fund Balance with Treasury |  | 40,000 | - | 40,000 | 0.00% | - | 40,000 | 0.00% |
| Accounts receivable, net | 3 | 125 | (25) | 20 | -84.00% | - | 20 | -84.00% |
|  | 4 |  | (80) |  |  |  |  |  |
| Loans receivable |  | 1,000 | - | 1,000 | 0.00% | - | 1,000 | 0.00% |
| Total intragovernmental |  | 41,125 | (105) | 41,020 | -0.26% | - | 41,020 | -0.26% |
|  |  |  |  |  |  |  |  |  |
| Other than intragovernmental: |  |  |  |  |  |  |  |  |
| Inventory and related property, net |  | 8,000 | - | 8,000 | 0.00% | - | 8,000 | 0.00% |
| General property, plant and equipment, net |  | 40,000 | - | 40,000 | 0.00% | - | 40,000 | 0.00% |
| Total other than intragovernmental |  | 48,000 | - | 48,000 | 0.00% | - | 48,000 | 0.00% |
| Total assets |  | 89,125 | (105) | 89,020 | -0.12% | - | 89,020 | -0.12% |
|  |  |  |  |  |  |  |  |  |
| Liabilities |  |  |  |  |  |  |  |  |
| Other than intragovernmental: |  |  |  |  |  |  |  |  |
| Accounts payable | 1 | (2,000) | (230) | (2,230) | 11.50% | - | (2,230) | 11.50% |
| Other liabilities | 2 | (5,250) | 200 | (4,950) | -5.71% | - | (4,950) | -5.71% |
|  | 6a |  | 100 |  |  |  |  |  |
| Total other than intragovernmental |  | (7,250) | 70 | (7,180) | -0.97% | - | (7,180) | -0.97% |
| Total liabilities |  | (7,250) | 70 | (7,180) | -0.97% | - | (7,180) | -0.97% |
|  |  |  |  |  |  |  |  |  |
| Net Position: |  |  |  |  |  |  |  |  |
| Total net position |  | (81,875) | 35 | (81,840) | -0.04% | - | (81,840) | -0.04% |
| Total liabilities and net position |  | (89,125) | 105 | (89,020) | -0.12% | - | (89,020) | -0.12% |
| **Statement of Changes in Net Position:** |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |
| Cumulative Results of Operations: |  |  |  |  |  |  |  |  |
| Beginning Balances | 6b | (104,675) | - | (104,675) | 0.00% | (80) | (105,055) | 0.36% |
|  | 7 |  |  |  |  | (300) |  |  |
| Adjustments: |  |  |  |  |  |  |  |  |
| Changes in accounting principles |  | - | - | - | 0.00% | - | - | 0.00% |
| Corrections of errors |  | - | - | - | 0.00% | - | - | 0.00% |
| Beginning Balance, as adjusted |  | (104,675) | - | (104,675) | 0.00% | (380) | (105,055) | 0.36% |
|  |  |  |  |  |  |  |  |  |
| Net Cost of Operations |  | 22,800 | 35 | 22,835 | 0.15% | 380 | 23,215 | 1.82% |
|  |  |  |  |  |  |  |  |  |
| Net Changes in Cumulative Results of  Operations |  | 22,800 | 35 | 22,835 | 0.15% | 380 | 23,215 | 1.82% |
|  |  |  |  |  |  |  |  |  |
| Net Position |  | (81,875) | 35 | (81,840) | -0.04% | - | (81,840) | -0.04% |
| **Statement of Net Cost:** |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |
| Gross Program Costs |  |  |  |  |  |  |  |  |
| Program A: |  |  |  |  |  |  |  |  |
| Gross Costs | 1 | 19,800 | 230 | 19,730 | -0.35% | - | 20,110 | 1.57% |
|  | 2 |  | (200) |  |  | - |  |  |
|  | 6a |  | (100) |  |  | - |  |  |
|  | 6b |  |  |  |  | 80 |  |  |
|  | 7 |  |  |  |  | 300 |  |  |
| Less: Earned Revenue |  | (23,000) | - | (23,000) | 0.00% | - | (23,000) | 0.00% |
| Net Costs Program A |  | (3,200) | (70) | (3,270) | 2.19% | 380 | (2,890) | -9.69% |
|  |  |  |  |  |  |  |  |  |
| Program B: |  |  |  |  |  |  |  |  |
| Gross Costs (nonfederal public) |  | 31,000 | - | 31,000 | 0.00% | - | 31,000 | 0.00% |
| Gross Costs (intragovernmental) | 3 | 500 | 25 | 605 | 21.00% | - | 605 | 21.00% |
|  | 4 |  | 80 |  |  |  |  |  |
| Less: Earned Revenue |  | (5,500) | - | (5,500) | 0.00% | - | (5,500) | 0.00% |
| Net Costs Program B |  | 26,000 | 105 | 26,105 | 0.40% | - | 26,105 | 0.40% |
|  |  |  |  |  |  |  |  |  |
| Total Net Cost of Operations |  | 22,800 | 35 | 22,835 | 0.15% | 380 | 23,215 | 1.82% |

**Note:** For illustration purposes, this summary includes only line items from the balance sheet, statement of changes in net position, and statement of net cost. The auditor should add other line items from these and other financial statements so that the line items listed on the summary of uncorrected misstatements agree with the entity’s financial statements. Sample forms for preparing the summary of uncorrected misstatements electronically are available at <https://www.gao.gov/financial_audit_manual> (accessed June 6, 2024).

**Legend:**

(4) Misstatements under balance sheet approach – All misstatements affecting the balance sheet as of the end of the current year are included in this column, including (a) misstatements solely within the balance sheet, statement of net cost, or statement of changes in net position and (b) misstatements affecting both the statement of net cost and statement of changes in net position other than the carryover of total net cost from the statement of net cost to the statement of changes in net position (e.g., misclassification between earned revenue and nonexchange revenue). Misstatements in this column correspond to adjusting entries 1 through 6a.

(5) Adjusted line item balance under balance sheet approach – This column shows the adjusted line item balance after accounting for the effect of misstatements under the balance sheet approach.

(6) Misstatement as percentage of reported line item under balance sheet approach – The effect of misstatements under the balance sheet approach as a percentage of the reported line item balance is shown in this column to help assess the materiality of the misstatement on each line item.

(7) Adjustments to transition from balance sheet approach to net cost approach – This column includes the reversal of net cost misstatements under the prior-year balance sheet approach, with the offsetting entry to beginning net position. Misstatements in this column correspond to adjusting entries 6b and 7.

(8) Adjusted line item balance under net cost approach – This column shows the adjusted line item balance after accounting for the effect of misstatements under the net cost approach.

(9) Misstatement as percentage of reported line item under net cost approach – The effect of misstatements under the net cost approach as a percentage of the reported line item balance is shown in this column to help assess the materiality of the misstatement on each line item.

Table III shows the effects (other than clearly trivial) of uncorrected misstatements (including omissions) on the notes to the entity’s financial statements on a quantitative and qualitative basis. Management decided to correct notes 10 and 19 (see example 2) and declined to correct note 17.

**Table III: Summary of Uncorrected Misstatements - Effect of Uncorrected Misstatements on the Notes to the Financial Statements**

|  |  |  |  |
| --- | --- | --- | --- |
| Note no. | Note name | Factual, judgmental, or projected | Description of uncorrected misstatement (qualitative and quantitative) |
| 17 | Other Liabilities | F | As included in table I, the other liabilities line item was overstated on the balance sheet by $200,000. The related misstatement in Note 17, Other Liabilities, is a $200,000 overstatement of accrued funded payroll and leave. See adjustment 2. |

**Auditor’s analysis:**

We discussed the summary of uncorrected misstatements with Joe Jones, CFO, and Sandra Hawkins, COO, on 11/1/XX. We encouraged them to correct all factual misstatements and to investigate judgmental and projected misstatements. They recorded adjusting entry 5 in the financial statements because they believed it was material. They also corrected the misstatements in notes 10 and 19. When considering the effect of misstatements under the net cost and balance sheet approaches and qualitative factors, they concluded that the other misstatements in the financial statements and note disclosures were not material. They indicated that after the audit, they will consider whether internal controls need to be strengthened in these areas. On 11/4/xx, we communicated the effect of the uncorrected misstatements on the financial statements to those charged with governance.

**Conclusion:**

The quantitative effect of uncorrected misstatements for net cost is 0.15 percent and 1.82 percent of total net cost of $22,800,000 under the balance sheet and net cost approaches, respectively. The quantitative effect of uncorrected misstatements for assets is -0.12 percent of total assets of $89,125,000 under both the balance sheet and net cost approaches. The quantitative effect of uncorrected misstatements for liabilities is -0.97 percent of total liabilities of ($7,250,000) under both the balance sheet and net cost approaches. The quantitative effect of uncorrected misstatements for net position is -0.04 percent of total net position of ($81,875,000) under both the balance sheet and net cost approaches. The uncorrected misstatements, individually and in the aggregate, did not exceed our established materiality threshold of $X,XXX,XXX. We also considered the effect of uncorrected misstatements on other financial statement line items and whether these misstatements were qualitatively material. We considered whether misstatements in the note disclosures were qualitatively or quantitatively material. Based on our analysis, we concur with management that the uncorrected misstatements were not material to the financial statements as a whole. We also conclude that the scope of procedures performed in light of the total uncorrected misstatements identified above is adequate.

### Example 2 – Summary of Corrected Misstatements

Table I shows the misstatements for the financial statement line items that management corrected. See FAM 595 C.13.

**Table I: Summary of Corrected Misstatements for Financial Statement Line Items**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| Adj. # | Factual, judgmental, or projected? | Description of corrected misstatement | Federal governmental (F) or nonfederal public (N) | | | (Dollars in thousands) | |
|  | USSGL account number | |
|  |  | Financial statement line item | Debit | Credit |
| 5 | Factual | To adjust Fund balance with Treasury for receipts after cutoff date. | N | 5200 | Earned revenue - Program B | $10,000 |  |
|  |  | F | 1010 | Fund balance with Treasury |  | $10,000 |

Table II shows the misstatements for the notes to the financial statements that management corrected. See FAM 595 C.14.

**Table II: Summary of Corrected Misstatements for the Notes to the Financial Statements**

|  |  |  |  |
| --- | --- | --- | --- |
| Note no. | Note name | Factual, judgmental, or projected | Description of corrected misstatement (qualitative and quantitative) |
| 10 | General Property, Plant, and Equipment, Net | F | While this line item was not misstated on the balance sheet, $5,000,000 of equipment was misclassified as internal-use software in the related note. Management corrected this misstatement by reclassifying $5,000,000 from internal-use software to equipment in this note. |
| 19 | Commitments and Contingencies | F | Required narrative related to contingent liabilities was omitted. Although the entity recognized the minimum amount in a range of amounts for an estimated liability where no amount within the range was a better estimate than any other amount, it did not disclose the amount recognized, the range, and a description of the nature of the contingency in Note 19, Commitments and Contingencies. Management corrected this misstatement by including the omitted information. |

1. For example, if assets have been materially overstated, the financial statements as a whole will be materially misstated, even if the effect of the misstatement on net position is completely offset by an equivalent overstatement of liabilities. It may be appropriate to offset misstatements within the same account balance or class of transactions; however, the risk that further undetected misstatements may exist is considered before concluding that offsetting even immaterial misstatements is appropriate. See AU-C 450.A26. [↑](#footnote-ref-2)
2. Such a request may be made, for example, based on the auditor’s projection of misstatements identified in an audit sample to the entire population from which it was drawn. Management may establish valuation allowances for projected misstatements, net of factual misstatements (since the projected misstatement represents the best estimate of the total correction needed). Generally, entities resist booking projected misstatements citing no supporting transactions. However, the amount can be booked through a general journal entry and reversed the following year. [↑](#footnote-ref-3)
3. The balance sheet and net cost approaches are also known as iron curtain and rollover approaches, respectively. The auditor considers the effect of misstatements on all financial statements under each of these approaches. [↑](#footnote-ref-4)
4. Per OMB reporting guidance, the reconciliation of net cost to net outlays may be presented as a financial statement or note to the financial statements. [↑](#footnote-ref-5)
5. An audit sampling specialist may perform or be consulted on all statistical calculations. [↑](#footnote-ref-6)
6. Under Federal Accounting Standards Advisory Board (FASAB) standards, organizations are considered to be related parties if the existing relationship or one party to the existing relationship has the ability to exercise significant influence over the other party’s policy decisions. In the federal government, there are additional relationships that present risks similar to related parties, as defined by FASAB. These include disclosure entities and public-private partnerships. Consequently, while AU-C 550, *Related Parties*, addresses only related parties, the auditor should apply audit procedures required for related parties in AU-C 550 to disclosure entities and public-private partnerships. Note that FASAB and the Financial Accounting Standards Board (FASB) provide different definitions for related parties. Procedures pertaining to disclosure entities and public-private partnerships do not apply to entities issuing financial statements in accordance with FASB accounting standards. [↑](#footnote-ref-7)
7. GASB establishes U.S. GAAP for units of state and local governments. [↑](#footnote-ref-8)
8. The Federal Financial Reporting Checklist is contained in FAM volume 3, which is available at <https://www.gao.gov/financial_audit_manual> (accessed June 6, 2024). [↑](#footnote-ref-9)
9. See AU-C 540.A46, .A47, and .A49 for discussion of instances where U.S. GAAP specifies an approach to selecting management’s point estimate from a range of reasonably possible outcomes (e.g., a contingent liability) and instances where U.S. GAAP may require disclosure of a range of possible outcomes. [↑](#footnote-ref-10)
10. Non-GAO auditors may combine bullets 3 and 4. [↑](#footnote-ref-11)
11. Although AICPA standards do not require the auditor to include the definition and inherent limitations of internal control over financial reporting in an audit report where no opinion is expressed on internal control over financial reporting, it is important for auditors of federal entities to include such information in order to provide transparency regarding the objectives and limitations of internal control over financial reporting in the federal government. [↑](#footnote-ref-12)
12. These are usually comparative statements for the current and prior years unless it is the entity’s initial audit. [↑](#footnote-ref-13)
13. If the auditor finds no material weaknesses in internal control, the auditor may express an opinion on management’s assessment or directly on internal control. [↑](#footnote-ref-14)
14. A reasonable possibility exists when the likelihood of an event occurring is either reasonably possible or probable. Reasonably possible is defined as the chance of the future event or events occurring is more than remote but less than likely. Probable is defined as the future event or events are likely to occur (AU-C 265.07). [↑](#footnote-ref-15)
15. This definition is used to determine whether a material weakness exists. [↑](#footnote-ref-16)
16. OMB audit guidancecontains additional information regarding FFMIA audit requirements. [↑](#footnote-ref-17)
17. Note to auditor: 20X2 denotes the current year, and 20X1 denotes the prior year, under audit. [↑](#footnote-ref-18)
18. Note to auditor: This example assumes the acronym of the entity does not include the word “the” in front of it as part of its common usage (example: CFPB). If “the” is part of the common usage of the acronym (example: the FBI), apply throughout the example. [↑](#footnote-ref-19)
19. The RSI consists of **[insert description of the RSI, such as “Management’s Discussion and Analysis” and the “Combined Statement of Budgetary Resources”]**, which are included with the financial statements. [↑](#footnote-ref-20)
20. Other information consists of information included with the financial statements, other than the RSI **[if applicable]** and the auditor’s report. [↑](#footnote-ref-21)
21. Note to auditor: The names of the financial statements should be modified as appropriate. [↑](#footnote-ref-22)
22. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. [↑](#footnote-ref-23)
23. Note to auditor: GAO does not capitalize the “o” in “over” in the phrase “internal control over financial reporting” when used in a heading or title. However, when referring to the title of management’s report included with the auditor’s report, the wording and capitalization should be consistent with management’s presentation. [↑](#footnote-ref-24)
24. **[Insert this footnote if this is the first time the term “material weakness” is used in the auditor’s report.]** A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected, on a timely basis. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. [↑](#footnote-ref-25)
25. Note to auditor: Statement of Federal Financial Accounting Concepts (SFFAC) 1 issued by FASAB provides a slightly different definition of materiality. Since SFFACs are nonauthoritative, and in SFFAC 1, the board recognizes differences from the audit definition, the FAM is based on the definition provided in AU-C 200.07. [↑](#footnote-ref-26)
26. Note to auditor: Refer to AU-C 730.08d through .08g; .09; and .A3, illustrations 2 through 6, if (1) the auditor is unable to complete the procedures described in this paragraph, (2) some or all of the RSI is omitted, (3) the measurement or presentation of the RSI departs materially from prescribed guidelines, or (4) the auditor has unresolved doubts about whether the RSI is measured or presented in accordance with prescribed guidelines. [↑](#footnote-ref-27)
27. Note to auditor: Refer to AU-C 720.24f; .25; and .A62, illustration 2, if the auditor has concluded that an uncorrected material misstatement of the other information exists. [↑](#footnote-ref-28)
28. Note to auditor: For GAO reports, only the entity name is cited in this section if the entity provides written comments. Do not include the name or title of the commenting official. If the entity provides email or oral comments, the title of the commenting official is included. See Words@Work on the GAO intranet. [↑](#footnote-ref-29)
29. Note to auditor: 20X2 denotes the current year, and 20X1 denotes the prior year, under audit. [↑](#footnote-ref-30)
30. Note to auditor: This example assumes the acronym of the entity does not include the word “the” in front of it as part of its common usage (example: CFPB). If “the” is part of the common usage of the acronym (example: the FBI), apply throughout the example. [↑](#footnote-ref-31)
31. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected, on a timely basis. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. [↑](#footnote-ref-32)
32. The RSI consists of **[insert description of the RSI, such as “Management’s Discussion and Analysis” and the “Combined Statement of Budgetary Resources”]**, which are included with the financial statements. [↑](#footnote-ref-33)
33. Other information consists of information included with the financial statements, other than the RSI **[if applicable]** and the auditor’s report. [↑](#footnote-ref-34)
34. Note to auditor: The names of the financial statements should be modified as appropriate. [↑](#footnote-ref-35)
35. Note to auditor: Statement of Federal Financial Accounting Concepts (SFFAC) 1 issued by FASAB provides a slightly different definition of materiality. Since SFFACs are nonauthoritative, and in SFFAC 1, the board recognizes differences from the audit definition, the FAM is based on the definition provided in AU-C 200.07. [↑](#footnote-ref-36)
36. Note to auditor: Refer to AU-C 730.08d through .08g; .09; and .A3, illustrations 2 through 6, if (1) the auditor is unable to complete the procedures described in this paragraph, (2) some or all of the RSI is omitted, (3) the measurement or presentation of the RSI departs materially from prescribed guidelines, or (4) the auditor has unresolved doubts about whether the RSI is measured or presented in accordance with prescribed guidelines. [↑](#footnote-ref-37)
37. Note to auditor: Refer to AU-C 720.24f; .25; and .A62, illustration 2, if the auditor has concluded that an uncorrected material misstatement of the other information exists. [↑](#footnote-ref-38)
38. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. [↑](#footnote-ref-39)
39. Office of Management and Budget (OMB) Bulletin No. 24-01, *Audit Requirements for Federal Financial Statements*, issued on October 19, 2023. According to the guidance, for those controls that have been suitably designed and implemented, the auditor should perform sufficient tests of such controls to conclude on whether the controls are operating effectively (i.e., sufficient tests of controls to support a low level of assessed control risk). OMB audit guidance does not require the auditor to express an opinion on the effectiveness of internal control. [↑](#footnote-ref-40)
40. Note to auditor: For GAO reports, only the entity name is cited in this section if the entity provides written comments. Do not include the name or title of the commenting official. If the entity provides email or oral comments, the title of the commenting official is included. See Words@Work on the GAO intranet. [↑](#footnote-ref-41)
41. Note to auditor: 20X2 denotes the current year, and 20X1 denotes the prior year, under audit. [↑](#footnote-ref-42)
42. Note to auditor: This example assumes the acronym of the entity does not include the word “the” in front of it as part of its common usage (example: CFPB). If “the” is part of the common usage of the acronym (example: the FBI), apply throughout the example. [↑](#footnote-ref-43)
43. The RSI consists of **[insert description of the RSI, such as “Management’s Discussion and Analysis” and the “Combined Statement of Budgetary Resources”]**, which are included with the financial statements. [↑](#footnote-ref-44)
44. Other information consists of information included with the financial statements, other than the RSI **[if applicable]** and the auditor’s report. [↑](#footnote-ref-45)
45. Note to auditor: The names of the financial statements should be modified as appropriate. [↑](#footnote-ref-46)
46. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected, on a timely basis. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. [↑](#footnote-ref-47)
47. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. [↑](#footnote-ref-48)
48. Note to auditor: If applicable, consider adding the following sentence to the beginning of the paragraph “We will be reporting additional details concerning this material weakness separately to **[entity]** management, along with recommendations for corrective actions.” [↑](#footnote-ref-49)
49. Note to auditor: GAO does not capitalize the “o” in “over” in the phrase “internal control over financial reporting” when used in a heading or title. However, when referring to the title of management’s report included with the auditor’s report, the wording and capitalization should be consistent with management’s presentation. [↑](#footnote-ref-50)
50. Note to auditor: Statement of Federal Financial Accounting Concepts (SFFAC) 1 issued by FASAB provides a slightly different definition of materiality. Since SFFACs are nonauthoritative, and in SFFAC 1, the board recognizes differences from the audit definition, the FAM is based on the definition provided in AU-C 200.07. [↑](#footnote-ref-51)
51. Note to auditor: Refer to AU-C 730.08d through .08g; .09; and .A3, illustrations 2 through 6, if (1) the auditor is unable to complete the procedures described in this paragraph, (2) some or all of the RSI is omitted, (3) the measurement or presentation of the RSI departs materially from the prescribed guidelines, or (4) the auditor has unresolved doubts about whether the RSI is measured or presented in accordance with prescribed guidelines. [↑](#footnote-ref-52)
52. Note to auditor: Refer to AU-C 720.24f; .25; and .A62, illustration 2, if the auditor has concluded that an uncorrected material misstatement of the other information exists. [↑](#footnote-ref-53)
53. Note to auditor: For GAO reports, only the entity name is cited in this section if the entity provides written comments. Do not include the name or title of the commenting official. If the entity provides email or oral comments, the title of the commenting official is included. See Words@Work on the GAO intranet. [↑](#footnote-ref-54)
54. Note to auditor: 20X2 denotes the current year, and 20X1 denotes the prior year, under audit. [↑](#footnote-ref-55)
55. Note to auditor: This example assumes the acronym of the entity does not include the word “the” in front of it as part of its common usage (example: CFPB). If “the” is part of the common usage of the acronym (example: the FBI), apply throughout the example. [↑](#footnote-ref-56)
56. The RSI consists of **[insert description of the RSI, such as “Management’s Discussion and Analysis” and the “Combined Statement of Budgetary Resources”]**, which are included with the financial statements. [↑](#footnote-ref-57)
57. Other information consists of information included with the financial statements, other than the RSI **[if applicable]** and the auditor’s report. [↑](#footnote-ref-58)
58. Note to auditor: The names of the financial statements should be modified as appropriate. [↑](#footnote-ref-59)
59. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected, on a timely basis. [↑](#footnote-ref-60)
60. Note to auditor: If applicable, consider adding the following sentence to the beginning of the paragraph “We will be reporting additional details concerning this significant deficiency separately to **[entity]** management, along with recommendations for corrective actions.” [↑](#footnote-ref-61)
61. Note to auditor: GAO does not capitalize the “o” in “over” in the phrase “internal control over financial reporting” when used in a heading or title. However, when referring to the title of management’s report included with the auditor’s report, the wording and capitalization should be consistent with management’s presentation. [↑](#footnote-ref-62)
62. Note to auditor: Statement of Federal Financial Accounting Concepts (SFFAC) 1 issued by FASAB provides a slightly different definition of materiality. Since SFFACs are nonauthoritative, and in SFFAC 1, the board recognizes differences from the audit definition, the FAM is based on the definition provided in AU-C 200.07. [↑](#footnote-ref-63)
63. Note to auditor: Refer to AU-C 730.08d through .08g; .09; and .A3, illustrations 2 through 6, if (1) the auditor is unable to complete the procedures described in this paragraph, (2) some or all of the RSI is omitted, (3) the measurement or presentation of the RSI departs materially from the prescribed guidelines, or (4) the auditor has unresolved doubts about whether the RSI is measured or presented in accordance with prescribed guidelines. [↑](#footnote-ref-64)
64. Note to auditor: Refer to AU-C 720.24f; .25; and .A62, illustration 2, if the auditor has concluded that an uncorrected material misstatement of the other information exists. [↑](#footnote-ref-65)
65. Note to auditor: For GAO reports, only the entity name is cited in this section if the entity provides written comments. Do not include the name or title of the commenting official. If the entity provides email or oral comments, the title of the commenting official is included. See Words@Work on the GAO intranet. [↑](#footnote-ref-66)
66. The balance sheet and net cost approaches are also known as iron curtain and rollover approaches, respectively. The auditor considers the effect of misstatements on all financial statements under each of these approaches. [↑](#footnote-ref-67)
67. In some instances, the other side(s) of the entry to correct the balance sheet may be made directly to the statement of changes in net position (e.g., for nonexchange revenue to recipient entities, transfers, etc.). [↑](#footnote-ref-68)
68. The effects of these two types of misstatements are included under both the balance sheet and net cost approaches to consider their aggregate effect on individual line items under both approaches. [↑](#footnote-ref-69)
69. Misstatements that are solely within the balance sheet could be between assets, between liabilities, or between assets and liabilities. Misstatements that are solely within the statement of net cost could be between responsibility segments or between gross cost and exchange revenue. Misstatements that are solely within the statement of changes in net position could be between unexpended appropriations and cumulative results of operations. Although misstatements that are solely within the statement of net cost or statement of changes in net position do not affect the balance sheet, the auditor would still quantify those misstatements under the balance sheet approach with the objective of correcting the affected financial statements. [↑](#footnote-ref-70)
70. Generally, comparative financial statements are presented, and a SUM is prepared for both the current-year and prior-year financial statements. The prior-year SUM should be updated for any misstatements identified in the current-year audit that affect the prior-year financial statements and, as appropriate, for any other changes based on updated information. The reversal of net cost misstatements included in the updated prior-year SUM under the balance sheet approach would be in the current-year SUM as transition adjustments from the balance sheet approach to the net cost approach. For example, if the prior-year SUM under the balance sheet approach had a debit entry to other liabilities and a credit entry to gross costs, the reversal of the net cost entry in the current year would be a debit to gross cost, with an offsetting credit entry to beginning net position. [↑](#footnote-ref-71)