SECTION 300

Internal Control Phase

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310 – Overview of the Internal Control Phase

In the internal control phase, the auditor continues the risk assessment procedures begun in the planning phase. The auditor expands the understanding of the entity’s internal control gained during the planning phase and separately assesses control risk and the risk of material misstatement (i.e., combined assessment of inherent risk and control risk). The auditor performs and documents the following procedures:

* Understand the entity’s design of the information systems for financial reporting; compliance with applicable provisions of laws, regulations, contracts, and grant agreements; and relevant operations (see FAM 320).
* Identify control objectives for each identified risk of material misstatement at the assertion level for which inherent risk is more than remote (see FAM 330).
* Identify and understand the design of control activities that are likely to achieve the control objectives, if implemented and operating effectively, for each identified risk of material misstatement at the assertion level for which inherent risk is more than remote (see FAM 340).
* Identify control activities the auditor plans to test (i.e., relevant control activities); determine whether relevant control activities have been implemented; and determine the nature, extent, and timing of tests of relevant control activities (see FAM 350).
* Determine the nature, extent, and timing of tests of compliance with the Federal Financial Management Improvement Act of 1996 (FFMIA) for CFO Act agencies (see FAM 350).
* Test the operating effectiveness of each relevant control activity that has been implemented and test entity-level controls related to the other four components of internal control (see FAM 360). Sampling control tests, if necessary, are performed in the testing phase and are discussed in FAM 450.
* Test compliance with FFMIA (see FAM 360).
* Assess, on a preliminary basis, (1) the effectiveness of financial reporting, compliance, and relevant operations controls; (2) control risk; and (3) the risk of material misstatement (see FAM 370).
* Consider partial-year controls and planned changes in controls (see FAM 380).

See FAM 390 for detailed documentation requirements.

1. The auditor uses the results of internal control work to

* determine the nature, extent, and timing of further audit procedures (sampling control, compliance, and substantive testing discussed in FAM 400);
* update the evaluation of internal control as further evidence is obtained throughout the audit;
* determine any effects on the risk of material misstatement and the related sufficiency of other audit procedures (discussed in FAM 400 and 500); and
* obtain audit evidence for forming an opinion or reporting on internal control over financial reporting (discussed in FAM 500).

1. The auditor may also use the results of internal control work in determining whether a population from which the auditor plans to select an audit sample is complete and valid. This may be appropriate in circumstances when the population is not reconcilable to an appropriate data source. Such internal control work may include testing the relevant general controls and application controls over the source of the population. See FAM 360 for guidance on testing IS controls and FAM 480 for guidance on performing substantive detail tests.

According to Office of Management and Budget (OMB) audit guidance, for those controls that have been suitably designed and implemented, the auditor should perform sufficient tests of such controls to conclude whether the controls are operating effectively (i.e., sufficient tests of controls to support a low level of assessed control risk). Thus, the auditor should not elect to forgo control tests because it is more efficient to extend substantive and compliance audit procedures. If the auditor determined in a prior year that a control was not suitably designed or implemented, and if management indicates that the control has not improved, the auditor need not test it in the current year.

Management, with oversight by those charged with governance or other oversight bodies, sets objectives to meet the entity’s mission, strategic plan, and goals and requirements of applicable laws and regulations. Management groups objectives into one or more of the three categories of objectives: operations, reporting, and compliance.

Operations objectives relate to program operations that achieve an entity’s mission. Reporting objectives relate to the preparation of reports for use by the entity, its stakeholders, or other external parties. Reporting objectives may be grouped further into the following subcategories: external financial reporting objectives, external nonfinancial reporting objectives, internal financial reporting objectives, and internal nonfinancial reporting objectives. Compliance objectives relate to compliance with applicable laws, regulations, contracts, and grant agreements. Entity management is responsible for establishing and maintaining internal control over financial reporting to provide reasonable assurance that the entity’s objectives will be met. In a financial statement audit, the auditor evaluates those internal controls designed to provide reasonable assurance that the following objectives are met.

* **Reliability of financial reporting:** Transactions are properly recorded, processed, and summarized to permit the preparation of the financial statements in accordance with U.S. generally accepted accounting principles (U.S. GAAP), and assets are safeguarded against loss from unauthorized acquisition, use, or disposition.
* **Compliance with significant provisions of applicable laws, regulations, contracts, and grant agreements:** Transactions are executed in accordance with significant 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.

The auditor should determine whether such internal control provides reasonable assurance that misstatements, losses, or noncompliance, material in relation to the financial statements, would be prevented, or detected and corrected, during the period under audit. If the auditor intends to opine on internal control, the auditor should form a separate conclusion on internal control over financial reporting as of the end of the period. Additionally, the auditor may test certain operations controls, as discussed in FAM 275.

Internal control over safeguarding assets is a process, implemented by management and other personnel, designed to provide reasonable assurance regarding the prevention, or prompt detection and correction, of unauthorized acquisition, use, or disposition of entity assets that could have a material effect on the financial statements *(*AU-C 940.29d). Safeguarding controls consist of (1) controls that prevent, or detect and correct, unauthorized access (direct or indirect) to assets and (2) segregation of duties.

The auditor should understand the design of certain safeguarding controls as part of financial reporting controls. These controls relate to protecting assets from loss arising from handling the related assets and resulting in misstatements in processing transactions. FAM 395 C includes a list of typical control activities. The auditor need not evaluate safeguarding controls related to the loss of assets arising from management’s business decisions. Such a loss may occur from incurring expenditures for equipment or material that might prove to be unnecessary, which is part of operations controls.

Just as safeguarding controls are a subset of operations, reporting, and compliance controls, budget controls are a subset of financial reporting and compliance controls. Budget controls that provide reasonable assurance that budgetary transactions, such as obligations and outlays, are properly recorded, processed, and summarized to permit the preparation of the financial statements, primarily the statement of budgetary resources, in accordance with U.S. GAAP, are financial reporting controls. Budget controls are generally also compliance controls in that they provide reasonable assurance that transactions are executed in accordance with laws governing the use of budget authority. Some budget controls may be compliance controls only, for example, controls over allotments to prevent Antideficiency Act violations.

If the auditor’s understanding is that the relevant control has been implemented, the auditor should test the following types of controls:

* **Financial reporting controls** (including certain **safeguarding** and **budget controls**) for each identified risk of material misstatement at the assertion level for which inherent risk is more than remote, for each material line item, account, note disclosure, and class of transactions (identified in FAM 235). In rare circumstances in which the auditor assessed all identified risks of material misstatement at remote for a material line item, account, note disclosure, or class of transactions, the auditor should perform control tests, as appropriate, if the auditor is providing an opinion on internal control.
* **Compliance controls** for each significant provision of applicable laws, regulations, contracts, and grant agreements identified for testing (see FAM 245), including **budget controls** for each relevant budget restriction (see FAM 250).
* **Operations controls** (1) for data relied on in performing financial audit procedures or (2) selected for testing by the engagement team (see FAM 275).

If the auditor expects to disclaim an opinion because of scope limitations, the auditor may limit internal control work to updating the understanding of the design of controls and whether they have been implemented. The auditor may do this by inquiring as to whether previously identified control weaknesses have been corrected. In the year the auditor expects to issue an opinion on the financial statements, the auditor should perform sufficient work on internal control to support the opinion.

The auditor should obtain an understanding of how the entity uses the services of a **service organization** in the entity’s operations for assessing risk and planning other audit procedures,[[1]](#footnote-2) including the following (AU-C 402.09):

* the nature of the services provided by the service organization and the significance of those services to the entity, including their effect on the entity’s internal control;
* the nature and materiality of the transactions processed or accounts or financial reporting processes effected by the service organization;
* the degree of interaction between the activities of the service organization and those of the entity; and
* the nature of the relationship between the entity and the service organization, including the relevant contractual terms for the activities undertaken by the service organization.

Based on AU-C 402.10, the auditor should determine whether relevant controls at the entity that relate to the services provided by the service organization, including those that are applied to the transactions processed by the service organization, have been implemented. If performing an audit of internal control over financial reporting, the auditor should consider the activities of the service organization when determining the evidence required to support the auditor’s opinion on the effectiveness of the entity’s internal control over financial reporting (AU-C 940.88).

In addition, the auditor should inquire of management about whether the service organization has reported to the entity, or whether the entity is otherwise aware of, any fraud; noncompliance with provisions of laws, regulations, contracts, or grant agreements; or uncorrected misstatements affecting the financial statements of the entity. The auditor should evaluate how such matters, if any, affect the nature, timing, and extent of the auditor’s further audit procedures, including the effect on the auditor’s conclusions and auditor's report (AU-C 402.19).

See FAM 640 for additional requirements and guidance regarding service organizations.

If the auditor is not providing an opinion on internal control, the auditor should evaluate whether the audit evidence is sufficient to achieve the audit objectives related to internal control described in OMB audit guidance.

If the auditor is not providing an opinion on internal control or is disclaiming an opinion on internal control, the auditor should evaluate whether the scope of the work is sufficient to meet the audit objective related to compliance with significant provisions of applicable laws, regulations, contracts, and grant agreements. If the scope is not sufficient, the auditor should report a scope limitation as discussed in FAM 580.97 through .98.

320 – Understand Information Systems

1. The auditor should obtain an understanding of the design of the entity’s information systems (whether automated or manual), including the processes relevant to financial reporting, for

* processing and reporting of accounting, budget, compliance, and operations data and
* maintaining accountability for the related assets, liabilities, equity, and budgetary resources.[[2]](#footnote-3)

These systems include procedures established to initiate, authorize, record, process, and report entity transactions (as well as events and conditions) to maintain accountability and to monitor compliance. Information systems are part of the information and communication component of internal control (see FAM 260).

The auditor should obtain sufficient knowledge of each type of system to understand the information reflected in FAM 320.03 through .07 in a manner that is appropriate to the entity’s circumstances. This includes obtaining an understanding of how transactions originate within the entity’s business processes, as discussed in AU-C 315.A154. It also includes understanding procedures for preparing financial statements and note disclosures (including year-end journal entries and reclassifications) and understanding how misstatements may occur. The auditor should identify the points within the entity’s processes at which a misstatement, including a misstatement due to fraud, could arise that individually or in combination with other misstatements, would be material (for example, points at which information is initiated, transferred, or otherwise modified) (AU-C 940.29b).

If the auditor has determined that a service organization maintains any of the significant financial management systems, then the auditor should follow the guidance outlined in FAM 640.

Because of the technical nature of many IS controls, the auditor generally should obtain assistance from an IS controls auditor in understanding the entity’s use of information system processing (i.e., processing performed by information systems using information technology) and in planning, directing, or performing audit procedures related to assessing IS controls. Additionally, an information technology specialist may assist the auditor in understanding technical aspects of information system processing and IS controls. The auditor may also coordinate with or leverage work of the Federal Information Security Modernization Act of 2014 auditor or evaluator in understanding entity’s IS controls environment. The auditor should document the understanding of the information system processing and IS controls in cycle memorandums, or other equivalent narratives, and may prepare or obtain related flowcharts. FAM 340 and 350 discuss identifying and documenting controls that achieve control objectives.

Walk-throughs of Information Systems

The auditor generally should perform sufficient system walk-throughs to confirm the understanding of significant information about such systems and discuss any system changes with management. FAM 350.08 discusses walk-throughs to confirm the auditor’s understanding of controls. In a walk-through of a financial management system, the auditor traces one or more transactions from initiation through all processing to inclusion in the general ledger, observing the processing in operation, making inquiries of entity staff, and inspecting related documents.

Walk-throughs are important for understanding the transaction process and for determining appropriate audit procedures. The auditor should perform walk-throughs for all material line items, accounts, note disclosures, and classes of transactions. Walk-throughs of financial management, budget, compliance, and operations systems provide evidence about the functioning of such systems. The auditor should document these walk-throughs. The auditor should incorporate the information technology aspects of each system into the audit documentation and may include additional flowcharts, narratives, and checklists.

Financial Management Systems

1. For each material line item, account, note disclosure, and class of transactions identified in FAM 235, the auditor should obtain an understanding of and should document the design of

* procedures by which transactions are initiated, authorized, recorded, processed, summarized, and reported in the financial statements;
* nature and type of related records, journals, ledgers, feeder systems, and source documents and the accounts involved;
* processing involved from the initiation of transactions to their inclusion in the financial statements, including the nature of computer files and the manner in which they are accessed, updated, and deleted;
* process for resolving the incorrect processing of transactions, for example, such an understanding might include how the entity determines whether suspense items are cleared out of an automated suspense file on a timely basis and how system overrides or bypasses to controls are processed and accounted for;
* processes for reconciling transaction detail to the general ledger and correcting reconciling items as needed;
* processes by which the information systems capture events and conditions, other than classes of transactions, that are significant to the financial statements; and
* processes used to prepare the entity’s financial statements and budget execution information, including significant accounting estimates, note disclosures, and information system processing. Because of its importance to financial reporting and to the integrated audit, the auditor should evaluate the period-end financial reporting process (AU-C 940.24). These processes include
  + - procedures used to enter transaction totals into the general ledger;
    - procedures related to the selection and application of accounting policies;
    - procedures used to initiate, authorize, record, and process journal entries in the general ledger;
    - procedures used to record recurring and nonrecurring adjustments to the financial statements;
    - procedures for preparing financial statements (AU-C 940.24); and
    - procedures used to combine and consolidate general ledger data.

As part of evaluating the period-end financial reporting process, the auditor should assess

* + the inputs, procedures performed, and outputs of the processes the entity uses to produce its financial statements;
  + the extent of information system processing in the period-end financial reporting process;
  + who participates from management;
  + the locations involved in the period-end financial reporting process;
  + the types of adjusting and consolidating entries; and
  + the nature and extent of the oversight of the process by management and those charged with governance (AU-C 940.25).

1. When the auditor is required to report on compliance with FFMIA, the auditor’s understanding of these processes can help the auditor determine whether the financial management systems comply substantially with federal financial management systems requirements, federal accounting standards, and the *U.S. Standard General Ledger* (USSGL) at the transaction level. If the entity is likely to receive an unmodified opinion and to have no identified material weaknesses in internal control, the auditor should test significant information that the entity provides to support its assertion about the substantial compliance of its financial management systems. The auditor may perform this testing in conjunction with control tests (see FAM 350).

Budget Systems

1. Through discussions with appropriate entity personnel, the auditor should understand and document the design of the entity’s processes for

* developing and requesting apportionments from OMB;
* establishing and allocating allotments within the entity, including reprogramming of allotments;
* establishing and recording commitments, if applicable;
* establishing, recording, and monitoring obligations (such as undelivered orders, which include contracts and purchase orders);
* establishing and recording expended authority (delivered orders);
* establishing and recording outlays;
* monitoring supplemental appropriations;
* recording deobligations when the entity has made a formal decision to cancel or reduce an obligation, supported by any necessary documentation that has been fully executed (e.g., SF-30 for contract amendments).
* recording transactions in and adjustments to expired accounts; and
* monitoring canceled (closed) accounts.

Compliance Systems

1. The compliance system includes the entity’s policies and procedures to monitor compliance with provisions of laws, regulations, contracts, and grant agreements applicable to the entity. Through discussions with appropriate entity personnel, the auditor should understand and document the design of the entity’s process for

* identifying and documenting all laws, regulations, contracts, and grant agreements applicable to the entity;
* monitoring changes in applicable laws, regulations, contracts, and grant agreements and responding on a timely basis;
* establishing policies and procedures for complying with provisions of applicable laws, regulations, contracts, and grant agreements and clearly documenting and communicating these policies and procedures to appropriate personnel;
* ensuring that an appropriate number of competent individuals at appropriate levels within the entity monitor the entity’s compliance with applicable laws, regulations, contracts, and grant agreements; and
* investigating, resolving, communicating, and reporting any noncompliance with provisions of applicable laws, regulations, contracts, and grant agreements.

Operations Systems

1. Through discussions with appropriate entity personnel, the auditor should understand and document the design of entity systems in which the operations controls to be evaluated and tested operate. The auditor should test operations controls relied on in performing financial audit procedures, such as using entity-prepared data for substantive tests. For example, if the auditor intends to evaluate and test an operations control that depends on certain statistical information that will be used in a substantive analytical procedure, the auditor should understand how the statistical information is developed. See FAM 275.08 for examples of the auditor using entity-prepared reports for substantive tests and discussions of tests of related controls over the report data, such as operational controls.

330 – Identify Control Objectives

1. In designing their systems, entities identify control objectives for each type of control that, if achieved, would provide the entity with reasonable assurance that individual and aggregate misstatements (whether caused by error or fraud), losses, or noncompliance material to the financial statements would be prevented, or detected and corrected. For social insurance and nonmonetary information in the financial statements, such as physical units of heritage assets, the objectives would relate to controls that would provide reasonable assurance that misstatements, losses, or noncompliance that would be considered material by users of the information would be prevented, or detected and corrected. These control objectives can be classified as follows:

* **Financial reporting controls** to prevent, or detect and correct, misstatements in the financial statements. These include **safeguarding controls** to safeguard assets against loss from unauthorized acquisition, use, or dispositionand **segregation-of-duties controls** to prevent one person from controlling multiple aspects of a transaction, allowing that person to both cause and conceal misstatements whether due to error or fraud.
* **Budget controls** to provide reasonable assurance that the entity (1) properly records, processes, and summarizes transactions to permit the preparation of the statement of budgetary resources and reconciliation of net cost to net outlays[[3]](#footnote-4) in accordance with U.S. GAAP and (2) executes transactions in accordance with budget authority.
* **Compliance controls** to comply with significant provisions of applicable laws, regulations, contracts, and grant agreements.
* **Operations controls** to achieve the performance desired by management for planning, productivity, quality, economy, efficiency, or effectiveness of the entity’s operations.

This section describes the process for identifying control objectives.

Financial Reporting Controls

1. The auditor should test relevant **financial reporting controls** for each material line item, account, note disclosure, and class of transactions (see FAM 235), if the auditor has determined that controls have been implemented. The first step in identifying control objectives for financial reporting controls is to consider the identified risks of material misstatement at the assertion level for which inherent risk is more than remote for each material line item, account, note disclosure, and class of transactions. The auditor may identify multiple types of potential misstatements in an assertion. Some types of potential misstatements may affect only a portion or component of a line item, account, note disclosure, or class of transactions (see FAM 265). For example, for the existence or occurrence assertion, risks of material misstatement might be identified in four areas.

* **Occurrence/validity:** Recorded transactions and events did not actually occur or do not pertain to the entity.
* **Cutoff:** Transactions and events are recorded in the current period, but occurred in a different period.
* **Summarization:** Transactions are summarized improperly, resulting in an overstated total.
* **Existence:** Recorded assets, liabilities, net position, and budgetary balances do not exist at a given date. Projected revenues or expenditures in the sustainability financial statements are not valid.

For each identified risk of material misstatement at the assertion level for which inherent risk is more than remote, there is one or more control objectives that, if achieved, would prevent, or detect and correct, the potential misstatement. These control objectives provide the auditor with the primary basis for assessing the effectiveness of an entity’s control activities. See FAM 395 B for a list of potential misstatements that could occur in each assertion and the related control objectives.

As discussed in FAM 235, the auditor identifies the material classes of transactions that provide input for or support each material line item, account, and note disclosure. Classes of transactions are classified as (1) transaction related or (2) line item/account related.

* Transaction-related classes of transactions are the activities and events that occur during the period under audit and result in debit and credit entries to the entity’s accounts (e.g., billing, purchasing, cash receipts, cash disbursements, journal vouchers, and adjusting entries). Transactions within each class are generally subject to similar risks and internal controls. These classes of transactions generally affect line items reported on all financial statements.
* Line item/account-related classes of transactions are the activities that support balances that exist at period-end (e.g., cash balance, property balance, and accounts payable balance). These classes of transactions generally affect line items reported on the balance sheet or ending balances reported on the statement of budgetary resources.

For example, when cash is received, the entity typically debits cash and credits revenue or accounts receivable. At period-end, the entity will typically also perform reconciliations and other activities to support the ending cash balance. As illustrated in FAM 395 A, classes of transactions that affect the cash line item typically include the cash receipts, cash disbursements, and cash balance, while classes of transactions that affect the revenue line item typically include billing and cash receipts.

The auditor should understand how misstatements in material classes of transactions could affect the related line items, accounts, and note disclosures at the assertion level. For example, an overstatement of cash receipts typically results in (1) an overstatement of the cash account (by overstating the debit to cash) and (2) an overstatement of revenue (by overstating the credit to revenue) or an understatement of accounts receivable (by overstating the credit to accounts receivable). To illustrate this concept using assertions, a misstatement in the occurrence assertion for cash receipts typically results in misstatements in (1) the existence assertion for the cash account and (2) the completeness assertion for accounts receivable or the occurrence assertion for revenue.

To understand the effect of misstatements on those line items and accounts that reflect balances at period-end (i.e., period-end balances), such as asset, liability, net position, or ending budgetary balances, the auditor should consider both transaction-related and line item/account-related assertions. The auditor may consult table 330.1 regarding how transaction-related assertions may affect line item/account-related assertions.

**Table 330.1: Effect of Transaction-Related Assertions on Line Item/ Account-Related Assertions for Period-End Balances**

| Transaction-related assertions | Line item/account-related assertions affected |
| --- | --- |
| Occurrence/validity | * Existence, if the transaction increases the line item/account balance * Account completeness, if the transaction decreases the line item/account balance |
| Transaction  completeness | * Account completeness, if the transaction increases the line item/account balance * Existence, if the transaction decreases the line item/account balance |
| Accuracy | * Accuracy, valuation, and allocation, if the transaction increases/decreases the line item/account balance |

1. FAM 395 B includes a list of potential misstatements that could occur in each assertion and the related control objectives. As discussed in FAM 265, the auditor tailors the potential misstatements included in FAM 395 B to the specific circumstances of the entity. These potential misstatements represent identified risks of material misstatement at the assertion level for material line items, accounts, note disclosures, and classes of transactions. For each identified risk of material misstatement at the assertion level for which inherent risk is more than remote, the auditor should identify the control objectives (and ultimately related control activities) that could prevent, or detect and correct, the potential misstatement. The auditor should tailor the list of control objectives in FAM 395 B, as appropriate, which may include supplementing the list with additional objectives or subobjectives.
2. The auditor should prepare specific control evaluation (SCE) worksheets or equivalent documentation that collectively documents, for material line items, accounts, note disclosures, and classes of transactions,

* the identified risks of material misstatement at the assertion level and
* the control objectives and control activities that address those risks for which inherent risk is more than remote.

The auditor should also link each SCE worksheet to the related LIRA form(s) where the assessment of inherent risk, control risk, and risk of material misstatement is documented. See FAM 395 G and 395 H for instructions on preparing an SCE worksheet and LIRA form, respectively. Sample forms for preparing the LIRA form and SCE worksheet electronically are available at <https://www.gao.gov/financial_audit_manual> (accessed June 3, 2024).

Safeguarding Controls

1. **Safeguarding controls** related to preventing, or detecting and correcting, unauthorized access (direct or indirect) to assetsare often critical to the effectiveness of controls over liquid (easily sold or traded) and readily marketable assets (such as cash, inventories, or property) that are highly susceptible to theft, loss, or misappropriation in material amounts. These controls are also important when there is an increased risk of fraud. **Before selecting specific control activities to test**, the auditor should determine whether safeguarding controls over assets are relevant and consider materiality of the assets.

If the auditor determines that (1) an asset is highly liquid or marketable and (2) material amounts are susceptible to theft, loss, or misappropriation, the auditor should include control objectives for safeguarding such assets and understand whether safeguarding controls over assets have been designed and implemented effectively and, if so, should test safeguarding controls over assets. On the other hand, if the asset is not liquid or marketable or amounts readily susceptible to theft, loss, or misappropriation are not material, the auditor might not need to understand and test safeguarding controls over assets. The auditor may evaluate safeguarding controls over assets in connection with other financial reporting controls.

The auditor should test safeguarding controls related to segregation of duties controls as discussed in FAM 360.09 through .10.

Budget Controls

1. The objectives of **budget controls** are to provide reasonable assurance that the entity (1) properly records, processes, and summarizes transactions to permit the preparation of the statement of budgetary resources and reconciliation of net cost to net outlays in accordance with U.S. GAAP and (2) executes transactions in accordance with budget authority. FAM 395 F presents a list of budget control objectives, organized by steps in the budget process. In addition, FAM 395 D presents a list of selected statutes relevant to the budget, and FAM 395 E describes budget steps of interest to the auditor in evaluating an entity’s budget controls. The auditor may document budget control objectives in a separate SCE worksheet for budget controls or in a memo, or incorporate them in an SCE worksheet with related financial reporting controls.

Compliance Controls

1. The objective of **compliance controls** is to provide reasonable assurance that the entity complies with significant provisions of applicable laws, regulations, contracts, and grant agreements. The auditor should identify compliance control objectives for the related provision identified for testing and may document these objectives in a separate SCE worksheet for compliance controls or in a memo, or incorporate them in an SCE worksheet with related financial reporting controls.

Operations Controls

1. The objectives of **operations controls** are to provide reasonable assurance that the entity effectively and efficiently meets its mission. The auditor should identify control objectives for any operations controls identified for testing and may document operations control objectives in a separate SCE worksheet for operations controls or in a memo, or incorporate them into an SCE worksheet with related financial reporting controls.

The auditor should test operations controls relied on in performing financial audit procedures, and any others selected for testing by the engagement team, if any. See FAM 275.08 and FAM 495 A.20 through .22 for examples of the auditor using entity-prepared reports for substantive tests, such as substantive analytical procedures, and discussions of tests of related controls over the report data, such as operations controls.

340 – Identify and Understand Control Activities

1. As discussed in FAM 330, for each identified risk of material misstatement at the assertion level for which inherent risk is more than remote, the auditor should identify the control objectives that could prevent, or detect and correct, the potential misstatement. For each control objective identified, based on discussions with entity personnel and the results of other procedures performed, the auditor should identify the control activities that, if effectively designed, implemented, and operating, would allow management to achieve the control objective. These control activities include

* controls in the control environment, entity risk assessment, information and communication, and monitoring components that directly address the risks of material misstatement at the assertion level (see FAM 360.19) and
* those that are designed and implemented by a service organization used by the entity (see FAM 640).

1. The auditor should determine whether the control activities identified depend on information system processing. A dependency on information system processing exists if a control activity cannot reasonably be expected to achieve a specific control objective without effective information system processing—either in the performance of the control activity or in the production of information used in the performance of the control activity. Because of the technical nature of many IS controls, the auditor generally should obtain assistance from an IS controls auditor in understanding the entity’s use of information system processing and in planning, directing, or performing audit procedures related to assessing IS controls. For example, an IS controls auditor may assist the auditor in identifying and understanding the design of application controls and general controls implemented at the entity-wide, system, and application levels that help ensure the effective operation of the control activities that depend on information system processing. Additionally, an information technology specialist may assist the auditor in understanding technical aspects of information system processing and IS controls.

Based on AU-C 315.30a, the auditor should obtain a sufficient understanding of the design of control activities to determine whether they are likely to achieve the control objectives (i.e., effectively designed to address the risk of material misstatement at the assertion level or effectively designed to support the operation of other control activities), assuming an effective control environment, entity risk assessment, information and communication, monitoring, appropriate segregation of duties, and effective general controls. The purpose of this assumption is for the auditor to identify any deficiencies in the specific control activities of the entity that the auditor should report, as discussed in FAM 580, and recommend that the entity correct. Often only multiple control activities, together with other components of internal control (control environment, entity risk assessment, information and communication, and monitoring), will be sufficient to address a risk.

For accounting estimates, the auditor should identify and obtain an understanding of control activities related to

1. management’s process for making accounting estimates (AU-C 540.12i) and
2. how management reviews the outcomes of previous accounting estimates and responds to the results of that review (AU-C 540.12j).
3. For relationships and transactions with disclosure entities, related parties, and public-private partnerships, the auditor should identify and obtain an understanding of control activities, if any, established to
4. identify, account for, and disclose the relationships and transactions with disclosure entities, related parties, and public-private partnerships;
5. authorize and approve significant transactions and arrangements with disclosure entities, related parties, and public-private partnerships; and
6. authorize and approve significant unusual transactions and arrangements outside the normal course of business (AU-C 550.15).

As part of understanding the controls, the auditor should inquire about any transactions with disclosure entities, related parties, and public-private partnerships

* + that have not been authorized and approved in accordance with the entity’s established policies or procedures regarding the authorization and approval of such transactions and
  + for which exceptions to the entity’s established policies or procedures were granted and the reasons for granting those exceptions (AU-C 550.15).

1. Based on AU-C 315.27, the auditor should identify and obtain an understanding of
   1. control activities over journal entries and other adjustments that address the risk of management override of controls (see FAM 265.54a);
   2. control activities that address a risk that is determined to be a significant risk (see Identify and Respond to Significant Risks section in FAM 265); and
   3. other control activities that based on the auditor’s professional judgment the auditor considers are appropriate to enable the auditor to assess the risks of material misstatement at the assertion level and to design further audit procedures. These may include control activities related to reconciling detailed records to the general ledger and complementary user entity controls, if the entity uses a service organization (AU-C 315.A187).
2. Based on the control activities identified in FAM 340.06, the auditor should identify aspects of the entity’s information technology environment that are subject to risks arising from the use of information technology (AU-C 315.28). For these aspects, the auditor should identify the
3. related risks arising from the use of information technology and
4. entity’s general controls that address such risks (AU-C 315.29).

See Effect of Information Technology on Internal Control section in FAM 260 and Test IS Controls section in FAM 360 for further guidance.

Factors to Consider

When evaluating whether control activities are likely to achieve the control objectives, the factors that the auditor should consider include directness, selectivity, manner of application, and follow-up. In determining whether control objectives are achieved, the auditor should consider both manual and IS controls, if they are likely to be effective (see FAM 270).

1. **Directness** refers to the extent to which a control activity relates to a control objective. The more direct the relationship, the more effective that activity may be in achieving the objective. For example, management reviews of inventory reports that summarize the inventory by storage facility may be less effective in preventing, or detecting and correcting, misstatements in the existence assertion for inventory than a periodic physical inventory, which is more directly related to the existence assertion.
2. **Selectivity** refers to the magnitude of the amount, or the significance of other criteria or distinguishing characteristics, that a specific control activity will identify as an exception condition. Examples of selectivity thresholds are (1) a requirement for additional approvals of all payments to vendors in excess of $25,000 and (2) management reviews of all payments to vendors not on an entity’s approved vendor list. When determining whether a control activity is likely to be effective, the auditor should evaluate the likelihood that items that do not meet the selectivity threshold could, in the aggregate, result in material misstatements of financial statements; material noncompliance with budget authority; material noncompliance with significant provisions of applicable laws, regulations, contracts, and grant agreements; or significant ineffective or inefficient use of resources.

The auditor also should evaluate the appropriateness of the specified criteria used to identify items in a management or exception report. For example, IS input controls (such as the matching of vendor invoices with receiving reports and purchase orders) that require exact matches of data from different sources before a transaction is accepted for processing may be more effective than controls that accept transactions that fall within a broader range of values. On the other hand, controls based on exception reports that are limited to selected information or use more selective criteria may be more effective than lengthy reports that contain excessive information.

1. **Manner of application** refers to the way in which an entity places a specific control activity into operation. The manner of application can influence the effectiveness of a specific control activity. When determining the effectiveness of control activities, the auditor should evaluate the following:

* **Frequency of application.** This refers to the regularity with which control activities are applied. Generally, the more frequently a control activity is applied, the greater the likelihood that it will be effective.
* **Authority and competence of personnel.** This refers to whether the person performing a control activity possesses the necessary authority and competence to perform it effectively (AU-C 330.10a.iii). If the person has less experience and skills or does not have the appropriate authority, it is less likely that the control activity will be effective. Also, the effective application of a control activity is generally adversely affected if the technique (1) is performed by an employee with an excessive volume of work or (2) is not performed carefully.

1. **Follow-up** refers to the procedures performed when a control activity identifies an exception condition. A control activity’s effectiveness depends on the effectiveness of follow-up procedures. To be effective, an entity needs to (1) apply these procedures on a timely basis, (2) determine whether control exceptions represent misstatements, and (3) correct all misstatements noted. For example, as a control, a financial management system may identify and put exception transactions into a suspense file or account. Lack of timely follow-up procedures by the entity to (1) reconcile and review the suspense file or account and (2) correct items in the suspense file or account would render the control ineffective.

When evaluating whether control activities are likely to be effective, the auditor should evaluate whether the activities also are applied effectively to adjustments or corrections made to the financial records. Such adjustments or corrections may occur at the transaction level, or during summarization of the transactions, or may be posted directly to the general ledger accounts. Further, the auditor should also evaluate the design and implementation of control activities applied to the financial statement preparation process.

350 – Determine the Nature, Extent, and Timing of Tests of Controls and Compliance with FFMIA

1. For each control objective, the auditor should

* identify control activities to test (i.e., relevant control activities) (FAM 350.04–.07);[[4]](#footnote-5)
* perform walk-throughs to determine whether relevant control activities have been implemented (FAM 350.08–.10);
* document relevant control activities in the SCE worksheet or equivalent (FAM 350.11); and
* determine the nature, extent, and timing of tests of relevant control activities (FAM 350.13–.26).

1. As noted in FAM 310, according to OMB audit guidance, for those controls that have been suitably designed and implemented, the auditor should perform sufficient tests of such controls to conclude whether the controls are operating effectively (i.e., sufficient tests of controls to support a low level of assessed control risk). Thus, the auditor should not elect to forgo control tests because it is more efficient to extend substantive and compliance audit procedures.
2. For CFO Act agencies, the auditor also should determine the nature, extent, and timing of tests for determining whether the entity’s financial management systems are in substantial compliance with federal financial management systems requirements (these requirements are established by the Department of the Treasury and published in the *Treasury Financial Manual* (TFM), volume 1, chapter 9500); federal accounting standards (U.S. GAAP—see FAM 560); and the USSGL at the transaction level in order to report in accordance with FFMIA (FAM 350.27–.30).

Substantial compliance includes the ability of the financial management systems to routinely provide reliable and timely financial information for managing day-to-day operations as well as to produce reliable financial statements, maintain effective internal control, and comply with legal and regulatory requirements.

Implementing FFMIA’s requirements helps to ensure that agencies use financial management systems that provide reliable, timely, and consistent information. Agencies that can (1) prepare financial statements and other required financial budget reports using information generated by their financial management system(s); (2) provide reliable and timely financial information for managing current operations; (3) account for their assets reliably, so that they can be properly protected from loss, misappropriation, or destruction; and (4) do all three in a way that is consistent with U.S. GAAP and the USSGL are substantially compliant with the three FFMIA requirements. See FAM 701 for further guidance on determining financial management systems’ substantial compliance with FFMIA requirements.

Identify Relevant Control Activities

1. As discussed in FAM 340, the auditor identifies and obtains an understanding of the design of control activities for each control objective identified in FAM 330. Using this understanding, the auditor should determine which control activity, or combination of control activities, to test (i.e., relevant control activities) based on their ability to (1) achieve the control objective and (2) improve the efficiency of control tests. For example, the auditor may have identified several control activities that are equally effective in achieving a control objective. In such a case, the auditor generally should test only those control activities that are necessary to achieve the control objective and are efficient to test, considering such factors as

* the extent to which a control activity achieves several control objectives and thereby reduces the number of control activities that would ordinarily need to be tested;
* the time that will be required to test the control activity; and
* control dependencies, particularly for IS controls (see FAM 340.02).

The auditor may, based on risk, test different control activities from year to year in a recurring audit, but it does not change the auditor’s responsibility to test the control activity, or combination of control activities, in the current-year audit that is necessary to achieve the control objective. See FAM 360 and 450 for guidance on performing tests of control activities.

1. In identifying relevant control activities, the auditor should consider

the assessment of inherent risk and

the tentative determination of the likelihood that IS controls will be effective (see FAM 270).

For example, assertions that have high inherent risk normally require stronger or more extensive controls to prevent, or detect and correct, material misstatements than assertions with low inherent risk.

1. If a control activity is not effectively designed or not likely to operate effectively (based on prior years’ control tests and the auditor’s understanding of the control activity in the current year, including management’s indication that controls have not improved from the prior year), the auditor does not need to test the operating effectiveness of that control activity in the current year.

If, during any phase of the audit, the auditor determines that a relevant control activity is, in fact, ineffective in design, implementation, or operation in achieving the control objective, the auditor may discontinue testing that control activity and should report the identified deficiencies in internal control, as discussed in FAM 580. The auditor should determine whether one or more other control activities are likely to achieve the same objective, and if so, the auditor should test them and update the SCE worksheet accordingly.

1. In addition to identifying relevant control activities, the auditor should identify and test those entity-level controls that are important to the auditor’s conclusion about whether the entity has effective internal control over financial reporting (AU-C 940.22). Testing of entity-level controls as it relates to the other four components of internal control (control environment, entity risk assessment, information and communication, and monitoring) is discussed in FAM 360.19. Per AU-C 940.A35, the auditor’s evaluation of entity-level controls can result in increasing or decreasing the testing that the auditor otherwise would have performed on other controls.

Perform Walk-throughs to Determine Whether Relevant Control Activities Have Been Implemented

The auditor should perform one or more walk-throughs of each relevant control activity identified to determine whether the control activity is functioning in the manner understood by the auditor. These walk-throughs are performed to determine whether relevant control activities have been implemented and differ from those performed to confirm the auditor’s understanding of the information systems (see FAM 320.02). These walk-throughs include a mix of observation, inspection, and inquiry with personnel responsible for applying or maintaining each control activity (see FAM 350.14–.16).

Based on AU-C 315.30b, through these walk-throughs and the system walk-throughs discussed in FAM 320.02, the auditor should determine whether each relevant control activity has, in fact, been implemented. If a relevant control activity has not been implemented, the auditor should consider whether one or more other control activities are likely to achieve the same objective, and if so, the auditor should determine whether such control activity has been implemented. If such other control activities have been implemented, the auditor should update the SCE worksheet accordingly.

In obtaining evidence about whether relevant control activities have been implemented, the auditor should determine whether the entity is using them rather than merely having them written in a manual. This differs from determining operating effectiveness, which is concerned with how the control activity was applied; the consistency with which it was applied; and by whom and by what means it was applied, including, when applicable, whether the person performing the control activity has the necessary authority and competence to perform it effectively.

### Document Relevant Control Activities

The auditor should document relevant control activities and whether they have been implemented in the SCE worksheet or equivalent (see FAM 395 G).[[5]](#footnote-6) The auditor may list (and evaluate) control activities that satisfy more than one control objective only once and refer to these control activities, when applicable, on subsequent occasions. For each relevant control activity, the auditor should determine whether it is an IS control, as discussed in FAM 270 and FAM 295 F. The auditor generally should obtain concurrence from an IS controls auditor on the auditor’s identification of IS controls. See FAM 390.02 for documentation requirements related to all five components of internal control.

Before testing relevant control activities, the auditor may tentatively complete the LIRA form or equivalent, assuming that they are effective.

Determine the Nature of Control Tests

1. To obtain sufficient, appropriate evidence about the effectiveness of relevant control activities as well as the other components of internal control (see FAM 360.19), the auditor should determine the combination of control tests (**observation, inquiry,** or **inspection**) to be performed. No one specific control test is always necessary, applicable, or equally effective in every circumstance. In designing and performing tests of controls, the auditor should do the following:
2. Perform other audit procedures in combination with inquiry to obtain sufficient appropriate audit evidence about the operating effectiveness of controls, including
   * how the controls were applied at relevant times during the period under audit;
   * the consistency with which they were applied; and
   * by whom or by what means they were applied, including, when applicable, whether the person performing the control possesses the necessary authority and competence to perform the control effectively (AU-C 330.10a).
3. To the extent not already addressed, determine whether the controls to be tested depend on other controls and, if so, whether it is necessary to obtain audit evidence supporting the operating effectiveness of those controls (AU-C 330.10b).

For example, the auditor may have identified relevant control activities that depend on information system processing. As discussed in FAM 270, such control activities are often application and user controls. The auditor should identify and test the general controls that help to ensure the effective operation of application and user controls. See FAM 360 for guidance on testing general, application, and user controls.

See FAM 340 for the factors to consider when evaluating whether controls are likely to achieve the control objective. In determining the types of tests to apply, the auditor should determine the tests that are effective and efficient. Specific types of control tests and methods to apply them are discussed in the following paragraphs.

1. **Observation.** The auditor conducts observation tests, which include looking at a process or procedure being performed by others (for example, the auditor’s observation of inventory counting by the entity’s personnel or the performance of control activities) (AU-C 500.A52). Observation generally provides highly reliable evidence that a control activity is properly applied when the auditor is there to observe it. However, it provides no evidence that the control was in operation at any other time. Consequently, the auditor generally should supplement observation tests with corroborative evidence obtained from other tests (such as **inquiry** and **inspection**) about the operation of controls at other times.
2. **Inquiry.** The auditor conducts inquiry tests by seeking information, both financial and nonfinancial, from knowledgeable persons within the entity or outside the entity (AU-C 500.A62). The auditor makes either oral or written inquiries of entity personnel involved in the application of specific control activities to determine what they do or how they perform a specific control activity. Such inquiries are typically open ended. Evidence obtained from inquiry alone is not sufficient. Thus, the auditor should supplement inquiry with other types of control tests—**observation** or **inspection** (which may include reperformance). Combining inquiry with inspection typically provides more assurance than inquiry combined only with observation. The reliability of evidence obtained from inquiry depends on various factors, including the following:

* The competence, experience, knowledge, independence, and integrity of the person of whom the inquiry was made. The reliability of evidence is enhanced when the person possesses these attributes.
* Whether the evidence is general or specific. Evidence that is specific is usually more reliable than evidence that is general.
* The extent of corroborative evidence obtained. Evidence obtained from several entity personnel is usually more reliable than evidence obtained from only one person.
* Whether the evidence was provided orally or in writing. Generally, evidence provided in writing is more reliable than evidence provided orally.

1. **Inspection.** The auditor conducts inspection tests by examining an asset (either by being physically present or using remote observation tools) or examining records or documents, whether internal or external or in paper form, electronic form, or other media (AU-C 500.A51), for evidence (such as the existence of initials or signatures) that a control activity was applied. System documentation, such as operations manuals, flowcharts, and job descriptions, may provide evidence of control design but do not provide evidence that controls are implemented and operating effectively. To use system documentation as part of the evidence of effective control activities, the auditor should obtain additional evidence on how the controls were applied.

Inspection is generally a reliable source of audit evidence, and because evidence of performance is documented, this type of test can be performed at any time. However, since documentary evidence generally does not provide evidence concerning how effectively the control was applied, the auditor generally should supplement inspection tests with observation or inquiry of persons applying the control. For example, the auditor generally should supplement inspection of initials on documents with observation, inquiry, or both of the individual(s) who initialed the documents to understand the procedures they followed before initialing the documents. The auditor may also reperform the control being tested to determine if it was properly applied.

The auditor should select the type of control tests based on (1) the nature of the control to be tested and (2) the timing of the test and period covered by the control.

The **nature of the control** influences the type of evidence that is available. For example, if the control provides documentary evidence, the auditor may inspect the documentation. For other controls, documentation may not be available or relevant. In these circumstances, the auditor may obtain evidence about the effectiveness of the control’s operation through (1) direct observation of the control being applied during the audit period, (2) inquiry of the individual(s) involved about applying the control at other times during the audit period, and (3) review of entity policies and procedures.

The **timing of the control test and the period covered** by the control influence the control test. The auditor should obtain evidence relating to the audit period. Unless it is documentary evidence, the auditor generally should obtain the evidence during the audit period, when sufficient corroborative evidence is most likely to be available. When the evidence relates to only a specific point in time, such as evidence obtained from observation, the auditor should obtain additional evidence that the control activity was effective during the entire audit period. For example, the auditor may observe the control in operation during the audit period and use inquiry and inspection of procedures manuals to determine that the control was in operation during the entire audit period. FAM 380.01 provides guidance concerning situations when new controls are implemented during the year. If the auditor tests controls after the audit period, the auditor should determine if any changes occurred between the end of the audit period and the time of the test. See FAM 350.25 and .26 for further discussion of interim testing of controls.

1. When selecting a particular control test from among equally effective tests, the auditor should select the most efficient test. When statistical sampling is considered necessary, the auditor should consider performing multipurpose testing to enhance audit efficiency (see FAM 430 and FAM 450).

Determine the Extent of Control Tests

1. For each relevant control activity that has been implemented, the auditor should test the control activity to determine whether it is operating effectively to achieve the control objectives. Relevant financial reporting, budget, compliance, and operations controls generally should be tested to the same level of assurance.
2. After determining the nature of control tests to be performed, the auditor should determine the extent of control tests (including IS controls). This determination is based on the

* information gathered in developing an understanding of internal control (including the nature of the control, the nature and availability of evidence, and how frequently the control is performed),
* extent to which audit evidence is obtained from tests of other controls, and
* auditor’s determination of the amount of additional evidence needed.

As the planned level of assurance increases, the auditor should seek more reliable or more extensive audit evidence. The extent of testing is also discussed in FAM 360 and FAM 450.

1. As discussed in FAM 350.18, for controls that do not leave documentary evidence of existence or application, the auditor may test their effectiveness by observation, inquiry, or both. However, the appropriate extent of observation and inquiry is not readily quantifiable and is therefore a matter of the auditor’s judgment.
2. Testing the operating effectiveness of controls is different from obtaining an understanding of and evaluating the design and implementation of controls. However, the same types of audit procedures are used. The auditor may therefore decide it is efficient to test the operating effectiveness of controls at the same time the auditor is evaluating their design and implementation (AU-C 330.A22), such as while performing walk-throughs as discussed in FAM 320.02 and 350.08.

Further, although some risk assessment procedures may not have been specifically designed as tests of controls, they may nevertheless provide audit evidence about the operating effectiveness of the controls and consequently serve as tests of controls. For example, the auditor’s risk assessment procedures may have included inquiries about management’s use of budgets, observing management’s comparison of monthly budgeted and actual expenses, and inspecting reports pertaining to the investigation of variances between budgeted and actual amounts (AU-C 330.A23).

Determine the Timing of Control Tests

The auditor should determine when to perform control tests. For efficiency, the auditor may perform most control testing on an interim basis that covers 9 or 10 months of the audit period and perform a roll-forward and limited testing for the remaining audit period. The auditor should obtain evidence about significant changes to those controls subsequent to the interim period and determine the additional audit evidence to be obtained for the remaining period (AU-C 330.12). If the auditor is providing an opinion on internal control, the auditor should determine the additional evidence needed concerning the operation of the controls as of the end of the year (see FAM 495 C for additional guidance).

Another approach is for the auditor to determine the actual population of transactions for the audit period through an interim date and estimate the transactions for the remaining audit period. A statistical sample can then be drawn that covers the entire audit period, with the bulk of testing completed during the interim period and the remaining items tested immediately after year-end. The auditor generally should overestimate the remaining items in the population so every item will have a chance of selection. An underestimate by the auditor would leave some items out of the population subject to audit sampling, although they may be tested in other ways.

Determine the Nature, Extent, and Timing of Tests of Compliance with FFMIA

For CFO Act agencies, which are subject to FFMIA, the auditor determines whether agency financial management systems comply substantially with the three FFMIA requirements. The auditor should plan and perform audit work in sufficient detail to enable the auditor to determine the degree to which agency financial management systems comply with the FFMIA requirements and whether that degree of compliance is substantial. See FAM 701 for further guidance on determining substantial compliance with FFMIA.

Because of the overlapping scope and nature of FFMIA assessments and financial statement audits, the auditor may use the work performed as part of the financial statement audit in determining substantial compliance with FFMIA. Specifically, many control and substantive tests performed in a financial statement audit may also provide evidence regarding compliance with FFMIA and generally should be performed concurrently (multipurpose testing).

1. The auditor may limit the scope of work performed to support the FFMIA assessment with respect to those requirements for which there is sufficient evidence that the systems do not comply substantially with FFMIA (e.g., continuation of previously reported lack of substantial compliance with FFMIA).
2. When limiting the scope of work performed, the auditor may obtain sufficient information to describe instances of lack of substantial compliance and make recommendations of remedial actions, as required by FFMIA, by (1) gaining an understanding of the design of the systems and controls, (2) performing control and substantive testing as part of the financial statement audit, and (3) reading management-developed documentation about systems’ compliance with FFMIA. However, if the auditor is concerned that it may be difficult to convince management of the systems’ lack of substantial compliance without specific tests, the auditor generally should perform the testing needed for this purpose.

360 – Perform Tests of Controls and Compliance with FFMIA

1. The auditor should test the operating effectiveness of relevant control activities that have been implemented (FAM 360.06–.18). As part of testing control activities, the auditor should also test segregation-of-duties (FAM 360.09–.10) and IS controls (FAM 360.11–.18).
2. The auditor should test the operating effectiveness of controls related to the remaining components of internal control—control environment, entity risk assessment, information and communication, and monitoring—to support the auditor’s assessment of the effectiveness of internal control over financial reporting (FAM 360.19).

The auditor should evaluate the results of control tests performed through the internal control phase (FAM 360.20–.22).

Based on the results of control tests performed through the internal control phase and the results of sampling control tests in the testing phase (see FAM 450), the auditor should evaluate the effectiveness of the entity’s internal control over financial reporting (FAM 360.23).

For CFO Act agencies, the auditor should design and conduct tests of the financial management systems’ substantial compliance with the three FFMIA requirements, if the auditor determines that such tests are necessary (see FAM 350.03 and 350.27–.30). After testing, the auditor may make a preliminary conclusion as to whether the entity’s financial management systems comply substantially with the three FFMIA requirements (see FAM 360.24).

Perform Tests of Controls

When planning control tests, the auditor should select sufficient items for control testing to support a low level of assessed control risk. For controls that do not operate frequently, such as those that operate only once or twice a year (e.g., controls over the year-end closing process), the auditor may determine that it is necessary to test all the items in the population (i.e., all occurrences of the control performance during the audit period). If the auditor does not plan to test all of the items in the population, the auditor generally should use one of two methods to select items for control testing: (1) statistical sampling (intended to be representative of and projected to the population) or (2) nonstatistical selection (not representative of and not projectable to the population).[[6]](#footnote-7) Control tests that involve nonstatistical selection are discussed below and sampling control tests are discussed in FAM 450.

Control Tests That Involve Nonstatistical Selection

1. Performing control tests that involve nonstatistical selection may provide sufficient evidence, along with other sources of evidence, that a control is operating effectively during the year and may be the most efficient way to test. For example, some controls may operate biweekly or weekly, such as controls over payroll processing that operate 26 or 52 times a year. For these controls, statistical sampling may not be efficient or even feasible given the small number of items in the population from which to select the sample. For these less frequently operating controls, the effect of other sources of evidence is often greater than it is for controls that operate more frequently.

Table 360.1 provides guidance on the number of items to select when testing small populations associated with less frequently operating controls (see AICPA’s audit guide, *Audit Sampling*). For larger populations, such as controls that operate daily, the auditor generally should perform statistical sampling to obtain evidence of control effectiveness (see FAM 430 and 450).

**Table 360.1: Testing Small Populations**

|  |  |
| --- | --- |
| Control frequency and population size | Number of items to test |
| Quarterly (4) | 2 |
| Monthly (12) | 2-4 |
| Semimonthly (24) | 3-8 |
| Weekly (52) | 5-9 |

1. In nonstatistical selection, the auditor selects items for control testing based on the auditor’s judgment. The auditor can test the selected items using any type of test or combination of tests (i.e., observation, inquiry, inspection, or a combination of these, although inquiry alone is not sufficient). For example, the auditor may determine that inquiries of entity personnel regarding the specific procedures performed in a control and inspection of documents evidencing performance of those procedures together provide sufficient evidence of the control’s operating effectiveness.

Test Segregation-of-Duties Controls

Segregation-of-duties controls are designed to reduce the opportunities for any person to be in a position both to perpetrate and to conceal misstatements, especially fraud, in the normal course of duties. Typically, an entity achieves adequate segregation of duties by establishing controls (such as segregating asset custody from recordkeeping functions) to prevent any person from having uncontrolled access to both assets and related records.

The auditor should test and document segregation-of-duties controls and may use the following procedures as appropriate:

1. Identify the assets to be controlled through the segregation of duties.
2. Identify the individuals who have authorized access (direct or indirect) to the assets. An individual with direct access is authorized to handle the assets directly (such as during the processing of cash receipts). An individual with indirect access is authorized to prepare documents that cause the release or transfer of assets (such as preparing the necessary forms to request a cash disbursement or transfer of inventory).
3. For each individual with authorized access to assets, determine whether there are sufficient asset access controls. Asset access controls are those controls that are designed to provide assurance that actions taken by individuals with authorized access to assets are reviewed and approved by other individuals. For example, an approval of an invoice for payment generally provides asset access controls (relating to cash) over those individuals authorized to prepare supporting documentation for the transaction. If information systems provide access to assets, the auditor should design tests of IS controls to identify (1) individuals (including information systems personnel) who may use the computer to obtain access and (2) asset access controls over such individuals. See FAM 360.11 through .18 for tests of IS controls.
4. For individuals with authorized access to assets over which asset access controls are insufficient, determine whether such individuals can affect any recording of transactions in the accounting records. If so, segregation of duties is insufficient, unless such access to accounting records is controlled. For example, the person who processes cash receipts may also be able to record entries in the accounting records. Such a person may be in a position to manipulate the accounting records to conceal a shortage in the cash account, unless another individual reviews all accounting entries that the person made (or should have been made).

When information system processing is used, access to assets frequently provides access to records. For example, generation of a check may automatically record a related accounting entry. In such circumstances, a lack of asset access controls would result in inadequate segregation of duties, and the auditor should determine whether other controls would mitigate the effects of this lack of asset access control.

Test IS Controls

As discussed in FAM 350, the auditor documents relevant control activities in the SCE worksheet or equivalent. For each control activity in the SCE worksheet, the auditor should indicate whether it is an IS control. As discussed in FAM 270, such controls are often application and user controls. FAM 295 F provides details on the three types of IS controls—general controls, application controls, and user controls. The effectiveness of user controls typically depends on information system processing or the reliability of information it produces.

The auditor should also identify and understand the design of other IS application and general controls on which the effectiveness of the IS controls in the SCE worksheet depends. As the auditor learns more about the design and implementation of IS controls and identifies those that are likely to achieve control objectives, the auditor may identify other general controls that help ensure their effective operation. As such, the general controls identified during the internal control phase may differ from those identified during the planning phase (see FAM 270).

The auditor should identify and test the general controls and application controls on which the effectiveness of each IS control in the SCE worksheet depends. For example, if the IS control is the review of an exception report, the auditor would identify and test the application controls directly related to the production of the exception report, as well as the general and other application controls on which the reliability of the information in the exception report depends. This testing would include controls over the design and proper functioning of the business processes that generate the exception report and the reliability of the data used to generate the exception report. In addition, the auditor would test the effectiveness of the user control (i.e., management review and follow-up on the items in the exception report).

As discussed in FAM 350.04, the auditor generally should test only the control activities necessary to achieve the objective and that are efficient to test, considering such factors as control dependencies, particularly for IS controls. A control dependency exists when the effectiveness of an internal control depends on the effectiveness of other internal controls. For example, when a dependency on information system processing exists, a control activity cannot reasonably be expected to achieve a specific control objective without effective information system processing—either in the performance of the control activity or in the production of information used in the performance of the control activity.

The auditor should document conclusions on the effectiveness of IS controls during the audit period. Because of the technical nature of many IS controls, the auditor generally should obtain assistance from an IS controls auditor in understanding the entity’s use of information system processing and in planning, directing, or performing audit procedures related to assessing IS controls. Additionally, an information technology specialist may assist the auditor in understanding technical aspects of information system processing and IS controls.

If the auditor identifies IS controls on the SCE worksheet, the auditor should evaluate the effectiveness of related

* general controls at the entity-wide and system levels;
* general controls at the application level; and
* specific application controls, such as business process application controls, interface controls, data management system controls, and user controls, unless the IS controls that achieve the control objectives are general controls.

If controls are not effective, see FAM 350.06.

The auditor should determine whether entity-wide and system-level general controls are designed, implemented, and operating effectively by

* identifying applicable general controls;
* determining how those controls function, and whether they have been implemented; and
* evaluating and testing the effectiveness of the identified controls.

The auditor generally should use knowledge obtained in the planning phase. The auditor should document the understanding of general controls and should conclude on whether such controls are designed, implemented, and operating effectively.

Test General Controls at the Entity-Wide and System Levels

The auditor may test general controls through a combination of procedures, including observation, inquiry, or inspection (which includes a review of documentation on systems and procedures and may include reperformance) using appropriate test software. Although statistical sampling is generally not used to test general controls, the auditor may use statistical sampling to test certain controls, such as those involving approvals.

1. If general controls are not designed, implemented, or operating effectively, the auditor will generally be unable to obtain satisfaction that application controls are effective.[[7]](#footnote-8) In such instances, the auditor should (1) determine and document the nature and extent of risks resulting from ineffective general controls, (2) identify and test any manual controls that achieve the control objectives that the IS controls in the SCE worksheet or equivalent document were unable to achieve, and (3) see FAM 580 for classifying and reporting control deficiencies.

If manual controls do not achieve the control objectives, the auditor should determine whether any specific IS controls are **designed** to achieve the objectives. If not, the auditor should develop appropriate findings principally to provide recommendations to improve internal control. If specific IS controls are designed to achieve the objectives, but are in fact ineffective because of poor general controls, testing would typically not be necessary, except to support findings.

Test General Controls at the Application Level

If the auditor reaches a favorable conclusion on general controls at the entity-wide and system levels, the auditor should evaluate and test the effectiveness of general controls for those software programs, or applications, within which application controls or user controls are to be tested. Because of the technical nature of many IS controls, the auditor generally should obtain assistance from an IS controls auditor in assessing these controls.

1. If general controls are not operating effectively within the application, application controls and user controls generally will be ineffective.[[8]](#footnote-9) In such instances, the engagement team should discuss the nature and extent of risks resulting from ineffective general controls. The auditor should determine whether to proceed with the evaluation of application controls and user controls.

Test Application Controls and User Controls

The auditor, generally with IS controls auditor assistance, should perform tests of those application controls and user controls necessary to achieve the control objectives where the entity-wide, system, and application-level general controls were determined to be effective.

Perform Tests of the Components of Internal Control

Based on AU-C 940.22, the auditor should test the operating effectiveness of entity-level controls related to the control environment, entity risk assessment, information and communication, and monitoring components that are important to the auditor’s conclusion about whether these components are operating effectively to support effective internal control over financial reporting. Per AU-C 940.A35, the auditor’s evaluation of entity-level controls can result in increasing or decreasing the testing that the auditor otherwise would have performed on other controls.

In the planning phase, the auditor assessed the design and implementation of the control environment, entity risk assessment, information and communication, and monitoring components (FAM 260). In the internal control phase, the auditor should test the operating effectiveness of entity-level controls related to these components, generally by a combination of observation, inquiry, and inspection (see FAM 350.13–.20). Controls within these four components that directly address risks of material misstatement at the assertion level are considered equivalent to control activities in the FAM and should be included in the SCE worksheet (see AU-C 315.A5).

The auditor’s assessment of the design and implementation of control activities and information systems (part of the information and communication component) is discussed in FAM 340, 350, and 320, respectively. The auditor’s tests of operating effectiveness of control activities and information systems are discussed in FAM 360.06 through 360.18.

Evaluate the Results of Control Tests

The auditor should investigate and understand the reasons for any deviations from controls noted during control tests completed through the internal control phase. The auditor may find, for example, that significant subpopulations were not subject to controls or that controls were not applied during a specific period during the year. In such instances, the auditor may determine whether controls are effective for at least some parts of the population. For example, an otherwise effective control may not have been applied effectively in 1 month because of personnel turnover. For all but that month, the auditor may assess controls as effective and reduce related substantive testing. For the 1 month that controls were not effective, the auditor may increase substantive testing, if these tests are sufficient to reduce detection risk. The auditor also should determine whether other controls achieve the related control objective(s). Additionally, the auditor should gather sufficient evidence to report the control deficiency, as discussed in FAM 580.

The auditor should evaluate whether the entity’s controls sufficiently address identified risks of material misstatement due to fraud and the risk of management override of other controls (AU-C 940.16). For example, the use of a lockbox (a control activity) may reduce the risk of material misstatement associated with the completeness of cash receipts.

The auditor should consider whether controls tested in the internal control phase and planned control tests in the testing phase (FAM 450) are likely to provide sufficient evidence about whether controls are operating effectively. For example, performing control tests that involve nonstatistical selection may provide sufficient evidence that a control is operating effectively for the items tested. However, since the auditor cannot project the results of nonstatistical selection to the population, the auditor should evaluate the results of the nonstatistical selection in conjunction with other sources of evidence to form an overall conclusion on the effectiveness of the controls tested. Other sources of evidence may include

* an understanding of the entity and its environment (FAM 220),
* inherent risk assessments (FAM 265),
* walk-throughs performed to confirm an understanding of information systems (FAM 320.02) and determine whether relevant control activities have been implemented (FAM 350.08),
* competence of entity personnel,
* the auditor’s past experience,
* knowledge about other balances, and
* information obtained during interim substantive testing (FAM 420 and FAM 470).

If, after evaluating the results of control tests and other sources of evidence, the auditor concludes that sufficient evidence has not been obtained regarding the effectiveness of the controls tested, the auditor should perform additional control testing, for example, by selecting additional items to test or by performing sampling control tests (see FAM 430 and 450).

Evaluate the Effectiveness of the Entity’s Internal Control over Financial Reporting

1. Based on the results of control tests performed through the internal control phase and sampling control tests performed in the testing phase (see FAM 450), the auditor should evaluate the effectiveness of the entity’s internal control over financial reporting and determine whether (1) each of the five components of internal control is designed, implemented, and operating effectively and (2) the five components are operating together in an integrated manner to achieve the entity’s financial reporting objectives (AU‑C 940.23). The auditor assesses the five components and underlying principles in the Green Book. In general, all components and principles are relevant for establishing an effective internal control system. See FAM 260 for discussion of the five components and underlying principles of internal control. In rare circumstances, there may be an operating or regulatory situation in which management has determined that a principle is not relevant for the entity to achieve its objectives and address related risks. If management determines that a principle is not relevant, management should support that determination with documentation that includes the rationale of how, in the absence of that principle, the associated component could be designed, implemented, and operating effectively.

Perform Tests of Compliance with FFMIA

The auditor may make preliminary conclusions as to whether the entity’s financial management systems comply substantially with federal financial management systems requirements, federal accounting standards (U.S. GAAP), and the USSGL at the transaction level. However, the auditor should not form a final conclusion as to compliance, especially with accounting standards, until the auditor completes substantive procedures (see FAM 470).

370 – Assess Internal Control on a Preliminary Basis

1. Based on the evaluation of the design and implementation of internal control, and the results of control tests completed through the internal control phase, the auditor should preliminarily assess the effectiveness of internal control during the period (for a report on internal control and for determining the risk of material misstatement used to determine the nature, extent, and timing of further audit procedures) and as of the end of the period (if the auditor is expressing an opinion on internal control as of that point in time). Assessing the effectiveness of IS controls is discussed in FAM 370.03 through .05. Assessing the effectiveness of each type of control—financial reporting (including safeguarding assets and segregation of duties), budget, compliance, and operations—is discussed in FAM 370.06 through .14.

To assess the effectiveness of internal control, the auditor determines whether internal control provides reasonable assurance that control objectives are achieved. Internal control only provides reasonable assurance that misstatements, losses, or noncompliance, material in relation to the financial statements, would be prevented, or detected and corrected, during the period under audit. For each control objective that is not achieved, the auditor should obtain sufficient (1) information to determine whether the deficiency is a material weakness, significant deficiency, or other control deficiency and to report any deficiencies in the auditor’s report or separate report to management (see FAM 580) and (2) evidence to support the preliminary assessment of the effectiveness of internal control and the risk of material misstatement.

Information System Controls

Because of the technical nature of many IS controls, the auditor generally should obtain assistance from an IS controls auditor in assessing these controls. Based on the procedures performed, the auditor and IS controls auditor should discuss conclusions on the effectiveness of IS controls and reach agreement. The auditor should (1) incorporate the conclusions into the audit documentation for each IS control tested and (2) perform tests on the manual aspects of application controls (e.g., manual follow-up on items in an exception report).

If the auditor determines that IS controls are effective, the auditor may also ask the IS controls auditor to identify any IS controls within the software programs, or applications, tested that the auditor did not previously identify using the above procedures. For example, such IS controls might achieve control objectives not otherwise achieved through manual controls or might be more efficient or effective to test than manual controls.

The IS controls auditor may assist the auditor in determining the efficiency and effectiveness of searching for and testing additional IS controls. The auditor should document these decisions, including a description of the expected nature, extent, and timing of the IS controls auditor’s work.

The auditor and IS controls auditor should work together to document the procedures for evaluating and testing the effectiveness of IS controls and the results of this work.

### Financial Reporting Controls

1. Based on audit procedures performed but before sampling control tests,[[9]](#footnote-10) if any, the auditor generally should form a preliminary conclusion about

the effectiveness of financial reporting controls as of the end of the period (when the auditor is providing an opinion on internal control) and

the assessed level of control risk and the risk of material misstatement (i.e., combined assessment of inherent risk and control risk) during the period for each identified risk of material misstatement at the assertion level for which inherent risk is more than remote, for each material line item, account, note disclosure, and class of transactions.

1. **Preliminary assessment of control risk.** Based on AU-C 315.38 and .A257, for each identified risk of material misstatement at the assertion level for which inherent risk is more than remote, for each material line item, account, note disclosure, and class of transactions, the auditor should assess control riskat one of three levels:

* **Low:** The auditor believes that controls **will likely** prevent, or detect and correct, on a timely basis any aggregate misstatements in excess of performance materiality that could occur in the assertion.
* **Moderate:** The auditor believes that controls **will less than likely but more than unlikely** prevent, or detect and correct, on a timely basis any aggregate misstatements in excess of performance materiality that could occur in the assertion.
* **High:** The auditor believes that controls **will unlikely** prevent, or detect and correct, on a timely basis any aggregate misstatements in excess of performance materiality that could occur in the assertion.

1. **Preliminary assessment of the risk of material misstatement.** In assessing the risk of material misstatement, the auditor should evaluate the likelihood that a material misstatement would occur (inherent risk) (see FAM 265) and not be prevented or detected on a timely basis by the entity’s internal control (control risk). The auditor should base this preliminary assessment of the risk of material misstatement on the auditor’s assessment of inherent risk and control risk. Based on AU-C 315.38, if controls are not effective, the auditor should assess control risk at the maximum level. This results in the assessment of the risk of material misstatement being the same as the assessment of inherent risk.
2. For each identified risk of material misstatement at the assertion level for which inherent risk is more than remote, for each material line item, account, note disclosure, and class of transactions, the auditor should assess the risk of material misstatement at one of three levels:

* **Low:** Based on the evaluation of inherent risk and control risk, but prior to the application of substantive audit procedures, the auditor believes that it is **unlikely** that any aggregate misstatements in the assertion exceed performance materiality.
* **Moderate:** Based on the evaluation of inherent risk and control risk, but prior to the application of substantive audit procedures, the auditor believes that it is **more than unlikely but less than likely** that any aggregate misstatements in the assertion exceed performance materiality.
* **High:** Based on the evaluation of inherent risk and control risk, but prior to the application of substantive audit procedures, the auditor believes that it is **likely** that any aggregate misstatements in the assertion exceed performance materiality. As a result, the auditor should obtain most, if not all, audit evidence from substantive procedures.

As discussed in FAM 265, the auditor should evaluate whether the audit evidence obtained from the risk assessment procedures provides an appropriate basis for the identification and assessment of the risks of material misstatement. If not, the auditor should perform additional risk assessment procedures until audit evidence has been obtained to provide an appropriate basis. In identifying and assessing the risks of material misstatement, the auditor should take into account all audit evidence obtained from the risk assessment procedures, whether corroborative or contradictory to assertions made by management.

The minimum substantive assurance from substantive procedures varies directly with the risk of material misstatement. In other words, as the risk of material misstatement increases, so does the minimum substantive assurance level. FAM 470 discusses the assurance level in more detail. The auditor should document the preliminary assessment of control risk in the SCE worksheet and on the LIRA form, or equivalents. The auditor should also document the preliminary assessment of the risk of material misstatement on the LIRA form or equivalent.

Budget Controls

When forming conclusions on the effectiveness of internal control related to budget execution, the auditor should evaluate the impact of any uncorrected misstatements noted in the proprietary accounts and should determine any impact on the budgetary amounts. If the budgetary amounts are also misstated, the auditor should determine whether these misstatements indicate deficiencies in internal control related to budget execution. If audit evidence indicates that internal control might not provide reasonable assurance that the entity executed transactions in accordance with budget authority, the auditor should discuss the legal implications with the Office of the General Counsel (OGC) and document the conclusions.

Compliance Controls

Based on the results of compliance control tests and other audit procedures, the auditor should

1. conclude whether the entity’s internal control provides reasonable assurance that the entity complied with the significant provisions of applicable laws, regulations, contracts, and grant agreements, noncompliance with which could have a material effect on the financial statements, and
2. report deficiencies in compliance controls that come to the auditor’s attention (see FAM 580).

If compliance controls are effective in preventing, or detecting and correcting, noncompliance with significant provisions of applicable laws, regulations, contracts, and grant agreements during the period, the extent of compliance testing can be less than if such controls were not effective, as discussed in FAM 460.

Operations Controls

If the results of control tests indicate that operations controls were not effective during the period, the auditor should not place reliance on those controls when designing other audit procedures. See FAM 580 regarding reporting deficiencies.

Reevaluation of Control Risk and the Risk of Material Misstatement

After completing the testing phase, discussed in FAM 400, the auditor should reevaluate the preliminary assessment of control risk and the risk of material misstatement for financial reporting controls and control effectiveness for budget, compliance, and operations controls. If the auditor obtains new information that is inconsistent with the audit evidence on which the auditor originally based the identification or assessments of the risks of material misstatement, the auditor should revise the identification or assessment (AU-C 315.41). For example, if the test results are contrary to the preliminary assessment (e.g., control risk assessed at low, but the controls being tested were not operating effectively), the auditor should reevaluate the adequacy of the audit procedures performed and perform additional procedures as necessary. See FAM 470.01 and 530 for guidance on reassessing the risks of material misstatement.

380 – Other Considerations

Partial-Year Controls

1. Management may implement changes to the entity’s controls to make them more effective or efficient or to address deficiencies prior to the period-end. The auditor generally should test the operating effectiveness of both new and superseded controls, if they were effectively designed and implemented, to assess control risk for the entire period under audit (see FAM 350 and 360). If the auditor is providing an opinion on internal control, the auditor’s tests of operating effectiveness of new controls should be sufficient to support the opinion on internal control over financial reporting as of the period-end date.

Planned Changes in Controls

The auditor may become aware of an entity’s plans to implement new systems or controls after the audit period ends. Even though new systems or controls are planned, the auditor should evaluate controls over the systems in operation to conclude on whether they are designed, implemented, and operating effectively through the end of the audit period to

* assess the risk of material misstatement;
* determine the nature, extent, and timing of further audit procedures;
* provide support for the report or opinion on internal controls; and
* recommend any improvements to the current system that should be considered in designing the new systems or controls.

During the current audit, the auditor may review controls designed into the new system and generally should bring any identified deficiencies to the attention of entity management.

390 – Documentation

1. In addition to preparing an audit plan with control testing audit procedures and other documentation relevant to the internal control phase, the auditor should prepare the documents described in this section or their equivalent.

The auditor should document the understanding of the operating effectiveness of each component of internal control (see FAM 360.19).

The auditor should document the walk-throughs performed, including their dates, the information systems and control activities they encompassed, and key entity personnel who participated. The auditor should incorporate relevant information obtained from the walk-throughs into the applicable cycle memorandums and flowcharts, as discussed below.

The auditor should document the results of the audit procedures performed and the audit evidence obtained.

As the audit work is performed, the auditor may become aware of possible significant deficiencies or other matters that should be communicated to the entity, including those charged with governance. The auditor should document and communicate these as described in FAM 290, 580, and 590.

Cycle Memorandums and Flowcharts

For each material line item, account, note disclosure, and class of transactions, or cycle (if the auditor groups related items by cycle), the auditor should prepare a cycle memorandum or equivalent that

* identifies the material line items, accounts, note disclosures, and classes of transactions included in the cycle and the significant financial management systems that support them (see FAM 235);
* documents the auditor’s understanding of information system processing affecting the cycle (see FAM 320 and 340);
* describes relationships with other cycles;
* describes the operating policies and procedures affecting the cycle (see FAM 320); and
* describes the relevant control activities documented in the SCE worksheet (see FAM 350), including those
  + related to accounting estimates (AU-C 540.38a) and
  + that address the risks of material misstatement due to fraud (AU-C 240.43c).

For CFO Act agencies, the auditor may include in the cycle memorandum information on FFMIA requirements considered to this point, such as systems requirements and the USSGL.

The auditor may also prepare **flowcharts** tocomplement the cycle memorandum and summarize the significant transaction flows in terms of

* input and report documents,
* processing steps,
* files used,
* organizational units involved,
* information systems, and
* interfaces with other cycles.

Flowcharts provide a good mechanism for documenting the process and the flow of transactions through the system. However, the auditor generally should avoid extreme detail, which makes the charts confusing and hard to follow. Complex systems, particularly those involving information technology, may be difficult to understand without a flowchart. Although the auditor may have gathered information on control activities when preparing flowcharts, the auditor should document these control activities in the SCE worksheet or equivalent.

The auditor should document the understanding of relevant compliance and operations control systems in a memorandum and may prepare related flowcharts (see FAM 320).

SCE Worksheet

Based on AU-C 315.42c, the auditor should document the evaluation of relevant control activities in the SCE worksheet or equivalent (see FAM 395 G). The auditor should document control tests in the control test audit plan and in accompanying documents. The auditor should also document any IS control tests, as discussed in FAM 370.05.

LIRA Form

1. Based on the results of audit procedures performed through the internal control phase and the auditor’s preliminary assessment of control risk and the risk of material misstatement, the auditor should complete the internal control phase columns of the LIRA form or equivalent (see FAM 395 H). If the auditor tentatively completed the internal control phase columns before testing control activities, the auditor should update the LIRA form as necessary.

395 A – Typical Relationships of Classes of Transactions to Line Items or Accounts

This section illustrates the typical relationships between classes of transactions and line items or accounts. For example, sources of significant accounting entries to the cash line item typically include the cash receipts and cash disbursements classes of transactions. The cash line item is also affected by the cash balance class of transactions, which includes reconciliations and maintenance of detailed records that support the period-end cash balance.

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | Line Items / Accounts | | | | | | | |
| Cash or FBWT | Accounts Receivable | Inventory | Property | Liabilities | Revenue | Expenses | Obligations |
| Classes of transactions | | | | | | | | |
| **Transaction related** |  |  |  |  |  |  |  |  |
| Billing |  | X |  |  |  | X |  |  |
| Cash Receipts | X | X |  |  |  | X |  |  |
| Purchasing |  |  | X | X | X |  | X | X |
| Cash Disbursements | X |  | X | X | X |  | X | X |
| Payroll Accruals |  |  |  |  | X |  | X | X |
| **Line item/account related** |  |  |  |  |  |  |  |  |
| Cash Balance | X |  |  |  |  |  |  |  |
| Accounts Receivable Balance |  | X |  |  |  |  |  |  |
| Property Balance |  |  |  | X |  |  |  |  |

395 B – Assertions, Potential Misstatements, and Control Objectives

This section lists potential misstatements that could occur in each assertion, together with related control objectives. As discussed in FAM 265, the auditor tailors the potential misstatements illustrated in this section to the specific circumstances of the entity. These potential misstatements represent identified risks of material misstatement at the assertion level. The assertions and identified risks of material misstatement are used to prepare the first and second columns of the LIRA form at FAM 395 H and the SCE worksheet at FAM 395 G. The auditor also tailors the control objectives illustrated in this section, as appropriate, which may include supplementing them with additional objectives or subobjectives. These control objectives are used to prepare the sixth column of the SCE worksheet. However, this section is provided as a reference and does **not** require completion as a form.

| Assertion | Potential misstatement | Control objective |
| --- | --- | --- |
| Existence or occurrence | Transaction related | |
| Occurrence/validity: |  |
|  | 1. Recorded transactions and events did not actually occur or do not pertain to the entity. | 1a. Recorded transactions, events, and related processing procedures are authorized by federal laws, regulations, contracts, grant agreements, and management policy. |
|  | 1b. Appropriate individuals approve recorded transactions and events in accordance with management’s general or specific criteria. |
|  |  | 1c. Recorded transactions and events actually occurred and pertain to the entity.  1d. Transactions and events are recorded in the proper accounts. |
|  | Cutoff: |  |
|  | 2. Transactions and events are recorded in the current period but occurred in a different period. | 2. Transactions and events recorded in the current period actually occurred in the current period. |
|  | Summarization: |  |
|  | 3. Transactions are summarized improperly, resulting in an overstated total. | 3. The summarization of recorded transactions is not overstated. |
| Existence or occurrence | Line item/account related | |
| Existence: |  |
|  | 4. Recorded assets, liabilities, net position, and budgetary balances do not exist at a given date. Projected revenues or expenditures in the sustainability financial statements are not valid. | 4a. Recorded assets, liabilities, net position, and budgetary balances exist at a given date.  4b. Assets, liabilities, net position, and budgetary balances are recorded in the proper accounts. |
| 4c. Recorded assets, liabilities, net position, and budgetary balances of the entity, at a given date, are supported by appropriate detailed records that are accurately summarized and reconciled to the account balance.  4d. Projected revenues and expenditures in the sustainability financial statements are valid. |
|  |  | 4e. Access to assets, critical forms, records, and processing and storage areas is permitted only in accordance with laws, regulations, and management policy. |
| Completeness | Transaction related | |
|  | Transaction completeness: |  |
| 5. Valid transactions and events are not recorded or are recorded in the incorrect accounts. | 5. All valid transactions and events are recorded in the proper accounts. |
| Cutoff: |  |
| 6. Transactions and events occurred in the current period but are recorded in a different period. | 6. All transactions and events that occurred in the current period are recorded in the current period. |
| Summarization: |  |
| 7. Transactions are summarized improperly, resulting in an understated total. | 7. The summarization of recorded transactions is not understated. |
| Line item/account related | |
| Account completeness: |  |
| 8. Assets, liabilities, net position, and budgetary balances of the entity exist but are not recorded in the proper period or accounts or are omitted from the financial statements. Projections in the sustainability financial statements do not include all estimated future revenues and expenditures at present value that should have been included. | 8a. All assets, liabilities, net position, and budgetary balances that should have been recorded have been recorded in the proper period and accounts and are properly included in the financial statements.  8b. Projections in the sustainability financial statements include all estimated future revenues and expenditures at present value that should have been included. |
| Accuracy, valuation, and allocation | Transaction related | |
| Accuracy: |  |
| 9. Amounts and other data[[10]](#footnote-11) relating to recorded transactions or events have not been appropriately recorded. | 9. Amounts and other data relating to recorded transactions and events have been appropriately recorded. |
| Line item/account related | |
| Accuracy, Valuation, and Allocation: |  |
| 10. Assets, liabilities, net position, budgetary balances, or projections in the sustainability financial statements have been included in the financial statements at inappropriate amounts. Resulting valuation or allocation adjustments have not been appropriately recorded. | 10. Assets, liabilities, net position, budgetary balances, and projections in the sustainability financial statements have been included in the financial statements at appropriate amounts, and any resulting valuation or allocation adjustments have been appropriately recorded. |
|  | Measurement: |  |
|  | 11. Revenues, expenses, and budgetary activity included in the financial statements are measured improperly. | 11. Revenues, expenses, and budgetary activity included in the financial statements are measured properly. |
| Rights and obligations | Line item/account related | |
| Ownership: |  |
|  | 12. Recorded assets are owned by others because of sale, consignment, or other contractual arrangements. | 12. The entity owns (i.e., has valid title to) recorded assets. |
| Rights: |  |
| 13. The entity does not hold or control the rights to recorded assets or budgetary resources because of liens, pledges, or other restrictions. | 13. The entity holds or controls the rights to recorded assets and budgetary resources at a given date. |
|  | Obligations: |  |
|  | 14. The entity does not have an obligation for recorded liabilities at a given date.  Budgetary obligations do not pertain to the entity. | 14a. Liabilities are the entity’s obligations at a given date.    14b. Budgetary obligations pertain to the entity. |
| **Presentation and disclosure** | Transaction and line item/account related | |
| Presentation: |  |
| 15. Financial or other information in the financial statements is not appropriately aggregated or disaggregated or is not clearly described. | 15. Financial and other information in the financial statements is appropriately aggregated or disaggregated and is clearly described. |
| Consistency: |  |
| 16. The current period financial statement components are based on accounting principles different from those used in the prior periods presented. | 16. The financial statement components are based on accounting principles that are applied consistently from period to period. |
| Disclosure: |  |
| 17. Note disclosures are not appropriately measured or described or are not relevant and understandable in the context of the requirements of U.S. GAAP. Not all note disclosures that should have been included in the financial statements have been included. Disclosed transactions and events did not actually occur or pertain to the entity. | 17. Note disclosures are appropriately measured and described and are relevant and understandable in the context of the requirements of U.S. GAAP. All note disclosures that should have been included in the financial statements have been included. Disclosed transactions and events have occurred and pertain to the entity. |
|  | Transaction and line item/account related | |
|  | Segregation of duties:[[11]](#footnote-12) |  |
|  | 18. The entity is exposed to loss of assets and various potential misstatements, including certain of those above, as the result of inadequate segregation of duties. | 18. Persons do not have uncontrolled access to both assets and records; they are not assigned duties to put them in a position that would allow them to both commit and conceal errors or fraud. |

395 C – Typical Control Activities

Authorization

1. Authorization controls are designed to provide reasonable assurance that (1) transactions, (2) events from which they arise, and (3) procedures under which they are processed are authorized in accordance with laws, regulations, contracts, grant agreements, and management policy. Typical authorization controls include

* documented policies establishing events or transactions that the entity is authorized to engage in by law, regulation, contract, grant agreement, or management policy;
* documented policies and procedures for processing transactions in accordance with laws, regulations, contracts, grant agreements, or management policy; and
* master files that include only authorized employees, customers, or suppliers.

Approval

Approval controls are designed to provide reasonable assurance that appropriate individuals approve recorded transactions and events in accordance with management’s general or specific criteria. Typical approval controls occur when the following occurs:

* Transactions and events are approved by persons having the authority to do so (such as the specific approval of purchases by the procurement officer or other designated individual with procurement authority) in accordance with established policies and procedures.
* Transactions are compared with predetermined expectations (invoice terms are compared with agreed-upon prices, input is checked for valid data type for a particular field, etc.), and exceptions are reviewed by someone authorized to approve them.
* Transactions are compared with approved master files (such as approved customer credit limits or approved vendors) before approval or acceptance, and exceptions are reviewed by someone authorized to approve them or correct the situation.
* Key records are matched before a transaction or event is approved (such as the matching of purchase order, receiving report, and vendor invoice records before an invoice is approved for payment).
* Before acceptance, changes to data in existing files are independently approved, evidenced by either documentary or online approval of input before processing.

Segregation of Duties

Segregation-of-duties controls are designed to reduce the opportunities for someone to both cause and conceal errors or fraud. Typically, an entity achieves adequate segregation of duties by establishing controls (such as segregating asset custody from recordkeeping functions) to prevent any person from having uncontrolled access to both assets and records. See FAM 330.08 and 360.09 through .10 for additional discussions of segregation-of-duties controls.

Design and Use of Documents and Records

Controls over the design and use of records help provide reasonable assurance that transactions and events are recorded. Such controls typically include the following:

* Prenumbered forms are used to record all of an entity’s transactions, and accountability is maintained for the sequence of all numbers used. (For example, prenumbered billing documents, vouchers, purchase orders, etc., are accounted for in numerical sequence when they are used, and any numbers missing from the sequence are investigated.)
* Receiving reports, inspection documents, purchase orders, and other information are matched with billing notices, such as vendor invoices, or other documents used to record delivered orders and related liabilities to provide assurance that all and only valid transactions are recorded.
* Transaction documents (such as vendor invoices or shipping documents) are stamped with the date and tracked (through periodic supervisory reviews) to provide assurance that transactions are recorded.
* Source documents are canceled after processing (for example, invoices are stamped, perforated, or written on after they are paid) to provide assurance that the same documents will not be reused and will not result in the entity recording transactions more than once. Also, only original documents are used to process transactions.

Safeguards over Access to and Use of Assets and Records

1. Access controls are designed to protect assets and records against physical harm, theft, loss, misuse, or unauthorized alteration. These controls restrict **unauthorized** access to assets and records. The auditor should determine whether to evaluate segregation of duties of persons who have **authorized** access to assets and records based on FAM 330.08. Typical access controls include the following:

* Cash receipt totals are recorded before cash is deposited.
* Secured facilities (locked rooms, fenced areas, vaults, etc.) are used. Access to critical forms and equipment (such as check-signing machines and signature stamps) is limited to authorized personnel.
* Access to information system programs and data files is restricted to authorized personnel. (For example, manual records, computer terminals, and backup files are kept in secured areas to which only authorized persons can gain access. Access is restricted by logical access controls.)
* Assets and records are protected against physical harm. (For example, intruder alarms, security guards, fire walls, a sprinkler system, etc., are used to prevent intentional or accidental destruction of assets and records.)
* Incoming and outgoing assets are counted, inspected, and received or disposed/transferred/sold only based on proper authorization (such as a purchase order, contract, or shipping order) in accordance with established procedures.
* Procedures provide reasonable assurance that current files can be recovered in the event of a computer failure. (For example, the entity has implemented a backup and recovery plan, such as using on-premises or off-premises file backup, off-site storage of duplicate programs and operating procedures, and standby arrangements to use a second processing facility if the entire data center is destroyed.)
* Access to critical forms and records is restricted. (For example, secured conditions are established and maintained for manual records and media used to access assets, such as blank checks or forms for the release of inventory.)

Independent Checks

Controls are designed to provide independent checks of the validity, accuracy, and completeness of processed data. Procedures that are typical of this category of controls include the following:

* Calculations, extensions, additions, and accounting classifications are independently reviewed. (For example, arithmetic on vouchers is independently recalculated—either manually or by computerized systems—and transactions and accounting classifications are subsequently reviewed.)
* Assets on hand are periodically inspected and counted, and the results are compared with asset records. (For example, inventories are inspected and physically counted at the end of each year and compared with inventory records.)
* Subsidiary ledgers and records are reconciled to general ledgers.
* The entity promptly follows up on complaints from vendors, customers, employees, and others.
* Management reviews performance reports. (For example, the warehouse manager reviews performance reports on the accuracy and timeliness of fulfilling shipping orders and recording them in the sales processing system.)
* Data from different sources are compared for accuracy and completeness. (For example, the cash journal entry is compared with the authenticated bank deposit slip and with the detailed listing of cash receipts prepared independently when mail was opened, and units billed are compared with units shipped.)
* Actual operating results (such as personnel cost or capital expenditures for a particular organizational component or an entity as a whole) are compared with approved budgets, and variances are explained.

Valuation Controls of Recorded Amounts

Controls in this category are designed to provide reasonable assurance that assets, liabilities, net position, budgetary resources, and projections in the sustainability financial statements are included in the financial statements at appropriate amounts. Typical valuation controls are as follows:

* The condition and marketability of assets is periodically evaluated. (For example, inventory is periodically reviewed for physical damage, deterioration, or obsolescence, or receivables are evaluated for collectability.)
* Recorded data are compared with information from an independent third party. (For example, recorded cash is reconciled to bank statements, and suppliers’ accounts are reconciled to monthly statements from suppliers.)
* Assessed values (such as independent appraisals of assets) are compared with the accounting records.
* Budgetary balances are reconciled to audited proprietary balances. (For example, the receipt of goods or services, recorded as expenses in proprietary accounts, decreases undelivered orders balances in budgetary accounts.)
* Methodologies, assumptions, and data used in deriving the sustainability financial statements are reviewed for reasonableness.

Summarization of Accounting Data

Controls in this category are designed to provide reasonable assurance that transactions are accurately summarized and that any adjustments are valid. Typical controls in this category include the following:

* The sources of summarized data (such as ledgers, journals, and other records) are compared with the underlying subsidiary records, documents, or both before the data are accepted for inclusion in summarized records and reports. (For example, when Fund Balance with Treasury (FBWT) in the general ledger is reconciled to the balance from Treasury, any necessary journal entries are compared to source documents, and the summaries of journal entries are compared to the individual journal entries before the summarized entries are posted to the general ledger.)
* Procedures are followed to check the completeness and accuracy of data summarization, and exceptions are reviewed and resolved by authorized persons. (For example, batch totals are compared with appropriate journals, hash totals are compared at the beginning and end of processing, and totals passed from one system or software program/application to another are compared.)

Rights and Obligations Controls

Controls in this category are designed to provide reasonable assurance that (1) the entity owns recorded assets, with the ownership supported by appropriate documentation; (2) the entity holds or controls the rights to its assets and budgetary resources at a given date; (3) recorded liabilities reflect the entity’s obligations at a given date; and (4) budgetary obligations pertain to the entity at a given date. Procedures that are typical of this category of controls include the following:

* Policies and procedures are documented (such as policy, procedures, and training manuals, together with organization charts) for initiating transactions and for identifying and monitoring those transactions and accounts warranting attention with respect to ownership.
* Policies and procedures are documented for initiating and monitoring transactions and accounts related to obligations.
* Significant transactions require the approval of senior management.
* Reported results and balances are compared with plans and authorizations.

Presentation and Disclosure Controls

Controls in this category are designed to provide reasonable assurance that (1) financial and other information in the financial statements is appropriately aggregated or disaggregated and is clearly described, (2) financial statement components are based on accounting principles that are applied consistently from period to period, (3) note disclosures are appropriately measured and described and are relevant and understandable in the context of the requirements of U.S. GAAP, (4) all note disclosures that should have been included in the financial statements have been included, and (5) disclosed transactions and events have occurred and pertain to the entity. Procedures that are typical of this category of controls include the following:

* Policies and procedures are documented for the accumulating and disclosing of financial information in the financial statements by appropriate personnel. Responsibility is assigned to specific individuals.
* Policies and procedures are documented for the preparation of financial statements by authorized personnel having sufficient experience and expertise to comply with U.S. GAAP.
* Policies and procedures are documented (such as policy and procedures manuals, together with organization charts) for properly classifying and clearly describing financial information in the financial statements.
* Reports are periodically compared with underlying documents and evaluated by supervisory personnel. Procedures are implemented to detect and correct misstatements and to evaluate recorded balances.
* A written chart of accounts containing a description of each account is used, such as the USSGL. Journal entries are prepared, reviewed, compared with supporting details where necessary, and approved each accounting period, including year-end closing.
* Appropriate processing procedures are used, including control totals, batch totals, edit checks, or other computerized controls. Written cutoff and closing schedules are also used.
* The same chart of accounts is used for both budgeting and reporting, and variances between actual and planned results are analyzed.

395 D – Selected Statutes Relevant to Budget Execution

1. **Antideficiency Act:** This statute places limitations on the obligation and expenditure of government funds. Expenditures and obligations may not exceed the amounts available in the related appropriation or fund accounts. Unless expressly allowed by law, amounts may not be obligated before they are appropriated. Additionally, the amount of obligations and expenditures may not exceed the amount of the apportionments received. (See 31 U.S.C. §§ 1341-1342, 1351, and 1517 for further information.) Also, see FAM 803.
2. **Purpose statute:** This statute states that appropriations may be obligated and expended only for the purposes stated in the appropriation. (See 31 U.S.C. § 1301 for further information.)
3. **Time statute:** This statute states that appropriations may be obligated or expended only during the period of availability specified by law. (See 31 U.S.C. §1502 for further information.)

One-year (annual) or multiple-year (multiyear) appropriations often are referred to as **fixed accounts**. These accounts are available for obligation for a definite period of time. Multiple-year appropriations may also cover periods different than the fiscal year, such as July 1 of one fiscal year through September 30 of the next fiscal year—a period of 15 months. This type of multiple-year authority is sometimes referred to as **forward funding**.

**No-year** authority or accounts are budgetary resources that are available for obligation for an indefinite period of time, usually until the purposes for which they were provided are carried out. A no-year appropriation is usually identified by words of futurity such as “to remain available until expended.”

1. **Appropriation acts:** The entity’s appropriations may contain other budgetary restrictions on the appropriations provided.

395 E – Budget Execution Process

1. The steps of a simplified budget process are illustrated in the following table.

|  |  |  |
| --- | --- | --- |
| General phases | Events | Accounting recognition |
| Formulation | Budget submission | None |
| Approval | Granting budget authority | Appropriations |
| Execution | Delegation of authority | Apportionment |
| Allotment |
| Use of authority | Commitment |
| Obligation |
| Expended authority |
| Outlay |
|  |  | Expiration |
|  |  | Cancellation |

1. The design of the budget execution process is of interest to the auditor when testing the statement of budgetary resources and reconciliation of net cost to net outlays and when evaluating an entity’s internal control relating to budget execution.[[12]](#footnote-13)
2. Congress provides an entity with an **appropriation (or other budget authority)**, which is authority provided by law to enter into obligations that result in immediate or future outlays (2 U.S.C. § 622(2)).

The Secretary of the Treasury issues **warrants**, which establish the amount of moneys authorized to be withdrawn from the central accounts that Treasury maintains.

1. OMB makes an **apportionment**, which is a distribution of amounts available for obligation. Apportionments divide amounts available for obligation by specific periods (usually quarters), activities, projects, objects, or a combination thereof. The amounts apportioned limit the amount of obligations that may be incurred.
2. The entity head (or other authorized employee) makes an **allotment**, which is an authorization to subordinates to incur obligations within a specified amount. The total amount allotted by an entity may not exceed the amount apportioned by OMB. The entity, through its fund control regulations, establishes allotments at a legally binding level for complying with the Antideficiency Act. Suballotments and allowances are further administrative divisions of funds, usually at a more detailed level (i.e., suballotments are divisions of allotments established as needed).
3. The entity may make a **commitment**, which is an administrative reservation of an allotment or of other funds in anticipation of their obligation. Commitments are not required by law or regulation nor are they formal/official uses of budget authority. Rather, entities use commitments for financial planning and control over obligations and the use of budget authority.
4. The entity incurs an **obligation**. An obligation, as defined in OMB Circular No. A-11, is a binding agreement that will result in outlays, immediately or in the future. GAO’s Federal Budget Glossary[[13]](#footnote-14) defines obligation as a definite commitment that creates a legal liability of the government for the payment of goods and services ordered or received, or a legal duty on the part of the United States that could mature into a legal liability by virtue of actions on the part of the other party beyond the control of the United States. Payment may be made immediately or in the future. An agency incurs an obligation, for example, when it places an order, signs a contract, awards a grant, purchases a service, or takes other actions that require the government to make payments to the public or from one government account to another. The entity should comply with legal requirements before recording obligations against appropriation accounts (title 7 of *GAO’s Policy and Procedures Manual for Guidance of Federal Agencies*). These legal requirements include determining whether the purpose, the amount, and the timing of when the obligation was incurred are in accordance with the appropriation. Additionally, there are legal requirements concerning the documentary evidence necessary for recording an obligation.

The reconciliation of net cost to net outlays reconciles the budgetary resources obligated for an entity’s programs and operations, which are shown on the statement of budgetary resources and determined using budgetary accounting with the net cost of operations shown on the statement of net cost, which is determined using proprietary accounting.

1. The entity records **expended authority** when the budget authority has been used, such as by the receipt and acceptance of goods or services ordered.[[14]](#footnote-15)
2. The entity records an **outlay**, which, as used in the President’s budget, congressional budget documents, and the statement of budgetary resources, refers to payments (cash disbursements) made to liquidate obligations. The statement of budgetary resources reconciles obligations incurred net of offsetting collections to net outlays.
3. The entity records a **deobligation**, which is the entity’s cancellation or downward adjustment (i.e., reduction) of previously incurred obligations. Theentity should not cancel or reduce an obligation until it has made a formal decision to do so, supported by any necessary documentation that has been fully executed (e.g., SF-30 for contract amendments). There may be specific statutory or other requirements concerning deobligation. For example, transactions authorized by the Economy Act are limited by the statutory requirement that the amount obligated by the ordering appropriation is required to be deobligated to the extent that the agency or unit filling the order has not incurred obligations before the end of the period of availability of the ordering appropriation. Additionally, there are stewardship reasons for timely deobligating funds.
4. When appropriations are deobligated before the expiration of the period of availability, the deobligated amountis available for incurring new obligations for an authorized use. This means that annual appropriated funds may be reobligated in the fiscal year in which the funds were appropriated, while multiyear or no-year appropriated funds may be reobligated in the same or subsequent fiscal years. When appropriations are deobligated after the expiration of the period of availability, the deobligated amount is not available to incur a new obligation unless specifically authorized; however, the deobligated amount is available to cover appropriate adjustments to obligations in the expired account. Deobligated no-year funds are generally available for obligation on the same basis as if they had never been obligated.
5. The appropriation account **expires** when, according to time restrictions contained in the appropriation, the appropriation is no longer available for new obligations.[[15]](#footnote-16) Adjustments may be made for valid obligations that were either (1) recorded at an estimated amount that differs from the actual amount[[16]](#footnote-17) or (2) incurred before the authority expired but not recorded. Adjustments may be recorded for 5 years after the appropriation expires. For both expired accounts and closed accounts, the entity’s obligations and expenditures may not exceed the related budget authority. See OMB Circular No. A-11, part 4, for additional guidance on these types of adjustments and transactions.

Examples of valid adjustments to expired accounts within the 5-year period include adjustments for

* canceled orders or orders for which delivery is no longer likely,
* refunds received in the current period that relate to recovery of erroneous payments or accounting errors,
* legal and valid obligations that were previously unrecorded, and
* differences between the estimated and actual obligation amounts.

1. After the 5-year period, the budget authority for the expired accounts is **canceled** and the expired accounts are **closed**.[[17]](#footnote-18) No further adjustments or outlays may be made in those closed accounts. Payments for any unliquidated obligations in closed accounts may be made from unexpired appropriations that have the same general purpose (but are limited in aggregate to 1 percent of the current-year appropriation). For both expired accounts and closed accounts, the entity’s obligations and expenditures may not exceed the related budget authority. See OMB Circular No. A-11, part 4, for additional guidance on these types of adjustments and transactions.

395 F – Budget Control Objectives

1. This section lists budget control objectives by steps in the budget process. The auditor may use these control objectives for the audit of the statement of budgetary resources and the reconciliation of net cost to net outlays, the evaluation of financial reporting controls, or the evaluation of compliance controls. The auditor may evaluate the design of many of these controls when evaluating the design of controls over expenses, disbursements, and liabilities. When testing control effectiveness, the auditor may test these controls at the same time, which is referred to as multipurpose testing.
2. **Appropriations (or other forms of budget authority).** The recorded appropriation (or other form of budget authority) is the same as that made available in the appropriation or other appropriate statutes, including restrictions on amount, purpose, and timing.
3. **Apportionments.** The recorded apportionments agree with the OMB apportionments (as indicated on the apportionment schedules), and the total amount apportioned does not exceed the total amount appropriated.[[18]](#footnote-19)
4. **Allotments/suballotments.** The total amount allotted does not exceed the total amount apportioned.
5. **Commitments.** The auditor may not be concerned with controls over budgetary commitments because commitments are not required by law or regulation nor are they formal/official uses of budget authority. Controls over budgetary commitments are a type of operations control.

The auditor generally should evaluate the design of controls over commitments if the entity relies on controls over commitments to achieve the control objectives relating to obligations. If the auditor evaluates the design of controls over commitments, the auditor generally should use the same control objectives as used for obligations and expenditures, as discussed below. The auditor should test the operation of those controls that are designed and implemented effectively.

1. **Obligation transactions.** The control objectives relating to obligation transactions are as follows:

* **Validity/occurrence.** Obligations recorded are valid. An obligation is valid only if it meets these criteria:
  + The obligation has been incurred and represents a valid obligation. This is usually evidenced by appropriate supporting documentation, such as a purchase order or contract.

The auditor may look for instances of “block obligating” or “block dumping,” which occur when an entity records obligations to “reserve” funds even though the goods or services have not been ordered. This is most likely to occur near the expiration of an appropriation and usually occurs in large dollar services and equipment contracts. The auditor may look for such signs as large, even-amount obligations near the end of the fiscal year for annual appropriations or during the last year of a multiyear appropriation account.

* + The purpose of the obligation is one for which the appropriation was made.
  + The obligation was incurred within the time that the appropriation was made available for new obligations.
  + The obligation did not exceed the amount allotted or appropriated by statute nor was it incurred before the appropriation became law, unless otherwise provided by law.
  + The obligation complies with any other legally binding restrictions, such as obligation ceilings or earmarks, identified in the planning phase.
  + The obligation has not subsequently been deobligated or canceled. The entity should not cancel or reduce an obligation until it has made a formal decision to do so, supported by any necessary documentation that has been fully executed (e.g., SF-30 for contract amendments). There may be specific statutory or other requirements concerning deobligation. For example, transactions authorized by the Economy Act are limited by the statutory requirement that the amount obligated by the ordering appropriation is required to be deobligated to the extent that the agency or unit filling the order has not incurred obligations before the end of the period of availability of the ordering appropriation.
  + For adjustments to obligations in expired accounts, objectives are as follows:
    1. If the adjustment represents a “contract change,” as defined in OMB Circular No. A-11, refer to the entity’s reporting and approval requirements in that circular.
    2. The adjustment represents a valid increase or decrease to the entity’s budgetary obligation, supported by any necessary documentation that has been fully executed (e.g., SF-30 for contract amendments).
    3. The adjustment does not cause the entity to exceed the amount allotted or appropriated by statute.
    4. The adjustment is recorded during the period when the account is available for adjustments (5 years) and was made for a valid obligation incurred before the authority expired.
    5. New obligations are not to be recorded in expired accounts.
* **Completeness.** All obligation transactions are recorded.
* **Accuracy.** Obligations are accurately recorded based on the entity’s budgetary obligation for the payment of goods and services ordered or received and other unliquidated obligations.[[19]](#footnote-20) The entity’s budgetary obligation is not the same as an entity’s accounting liability, which is a probable future outflow or other sacrifice of resources as a result of past transactions or events (e.g., receipt of goods or services). The entity’s budgetary obligation is reported on the statement of budgetary resources, whereas its accounting liability is reported on the balance sheet.
* **Cutoff.** Obligations are recorded in the proper period.
* **Classification.** Obligations are recorded in the proper appropriation or fund accounts (also by program and by object, if applicable), including the proper appropriation year if the account is multiyear. Examples of programmatic account classifications are school lunch program and nutrition education and training. Examples of object account classifications are salaries, rent, and travel.

1. **Expended authority transactions.** Control objectives relating to expended authority transactions, as defined in FAM 395 E, are generally the same as those for obligation transactions.

* **Validity/occurrence.** For all expended authority transactions, recorded expended authority transactions have occurred. This occurrence is usually evidenced by appropriate supporting documentation, such as invoices and receiving reports. Accrual of liabilities based on incurred but unbilled contractor costs alone is not sufficient evidence of validity (i.e., it may not meet the purpose, time, and amount provisions of an appropriation). For expended authority transactions (or adjustments to expended authority transactions) in expired accounts, the entity objectives are that
  + the expended authority transaction does not cause the entity to exceed the amount appropriated by statute,
  + the expended authority transaction is recorded during the period when the account is available for adjustments (5 years), and
  + the expenditure is not made from a closed account.
* **Completeness.** All expended authority transactions and adjustments are recorded.
* **Accuracy and valuation.** Expended authority transactions and adjustments are recorded at the correct amount.
* **Cutoff.** Expended authority transactions and adjustments are recorded in the proper period.
* **Classification.** Expended authority transactions and adjustments are recorded in the proper appropriation or fund accounts (also by program and by object, if applicable), including the proper appropriation year if the account is multiyear.

1. **Outlay transactions.** Control objectives that relate to outlay transactions and may be tested while auditing cash disbursements are as follows:

* **Validity/occurrence.** Outlays are supported by evidence such as contractor invoices, receiving reports, and intragovernmental payment and collection reports. The outlay is recorded against an obligation made during the period of availability of the appropriation (not made out of a closed account). The outlay is also for a purpose for which the appropriation was provided and in an amount not exceeding the obligation, as adjusted, authorizing the outlay. Use of “first-in, first-out” or other arbitrary means to liquidate obligations based on outlays is not generally acceptable unless supporting evidence demonstrates that in fact these estimating techniques reasonably represent the manner in which costs are incurred. (Note: Internal control over outlays and related liquidation of obligations may provide safeguards against improper payments, such as erroneous, duplicative, or fraudulent contractor billings.)
* **Completeness.** All outlays and adjustments are recorded.
* **Accuracy and valuation.** Outlays and adjustments are recorded at the correct amounts.
* **Classification.** Outlays are recorded in the proper accounts (both by program and by object, if applicable), including the proper appropriation year if the account is multiyear. This is evidenced by “matching” the outlay to the underlying obligation.
* **Cutoff.** Outlays and adjustments are recorded in the proper period.

1. **Obligation and expended authority balances.** Control objectives relating to obligation and expended authority balances as of a point in time are as follows:

* **Summarization.** Recorded balances of obligation and expended authority accounts as of a given date are supported by appropriate detailed records that are accurately summarized and reconciled to the appropriation or fund account balance, by year, for each account.
* **Existence.** Recorded account balances exist and are supported by valid obligations and expended authority transactions.
* **Compliance.** Total undelivered orders (i.e., the value of goods and services ordered and obligated that have not been received) and other unliquidated obligations plus total expended authority transactions do not exceed the amount of the appropriation or other statutory limitations (such as obligation ceilings or earmarks) that may exist by appropriation period. These other statutory limitations may limit the amount of obligations that can be incurred by program or object classification.

In addition, total payments of unliquidated obligations that relate to closed accounts do not exceed the limits described in OMB Circular No. A-11 (for annual accounts, 1 percent of the account’s current year appropriation; for multiyear accounts, 1 percent of all appropriations that are available for obligation for the same purpose, which is a single, cumulative limit).

1. **Appropriation account balances.** The control objective relating to appropriation account balances as of a point in time is as follows:

* **Cutoff/completeness/existence.** Fixed appropriation accounts are identified by fiscal year after the end of the period in which they are available for obligation until they are closed (31 U.S.C. § 1553(a)).

Fixed appropriation accounts are closed on September 30 of the fifth fiscal year after the end of the period that they are available for obligation. Any remaining balance (whether obligated or unobligated) in the account is canceled and is no longer available for obligation or expenditure for any purpose (31 U.S.C. § 1552(a)). For example, at the end of fiscal year 2017, the entity has accounts only for fixed appropriations that expired at the end of fiscal years 2013, 2014, 2015, 2016, and 2017. Accounts for all fixed appropriations that expired prior to these dates have been closed, and their remaining balances have been canceled as of the end of fiscal year 2017.

Appropriation accounts that are available for obligation for an indefinite period are closed if (1) the entity head or the President determines that the purposes for which the appropriation was made have been carried out and (2) no disbursement has been made against the appropriation for 2 consecutive fiscal years (31 U.S.C. § 1555).

1. **Outlay account balances.** Control objectives relating to outlay account balances appearing in the statement of budgetary resources for the fiscal year are as follows:

* **Summarization.** Recorded balances of outlay accounts for the fiscal year are supported by appropriate detailed records that are accurately summarized for each account.
* **Existence.** Recorded account balances exist and are supported by valid outlay transactions.

1. **Recording of cash receipts related to closed appropriation accounts.** This control is to be evaluated only if these amounts are expected to exceed performance materiality. The control objective is as follows:

* **Compliance.** Collections authorized or required to be credited to an appropriation account but not received before the account is closed are deposited in the Treasury as miscellaneous receipts (31 U.S.C. § 1552(b)).

Budget Control Objectives under the Federal Credit Reform Act

1. The Federal Credit Reform Act (FCRA) contains provisions regarding the recording and reporting of activity related to direct loans, loan guarantees, and modifications of these items for budget accounting purposes. Definitions of these and other FCRA terms are provided in paragraph .03 below. For transactions and account balances related to these types of activities, the auditor generally should use the budget control objectives listed in FAM 395 F and supplement them with the following budget control objectives related to FCRA. Additional guidance on FCRA accounting for budget purposes is included in OMB Circular No. A-11. Also, see Federal Financial Accounting and Auditing Technical Releases No. 3, *Auditing Estimates for Direct Loan and Loan Guarantee Subsidies Under the Federal Credit Reform Act* (as amended), and No. 6, *Preparing Estimates for Direct Loan and Loan Guarantee Subsidies Under the Federal Credit Reform Act*.
2. **Obligation transactions.** Obligation transactions include direct loan obligations, loan guarantee commitments, and modifications that change the cost of an outstanding direct loan or loan guarantee (modifications do not include changes to outstanding direct loans or loan guarantees that are within the terms of existing contracts or through other existing authorities). The supplemental control objective relating to obligation transactions under FCRA is as follows:

* **Valuation.** When funds are obligated for a direct loan or loan guarantee, the estimated cost shall be based on the “current” assumptions,[[20]](#footnote-21) adjusted to incorporate the terms of the loan contract, for the fiscal year in which the funds are obligated.
  + - * The cost of a direct loan is recorded at the net present value, at the time when the loan is disbursed, of estimated cash flows for
    1. loan disbursements;
    2. principal repayments;
    3. interest payments; and
    4. other payments by or to the government over the life of the loan, including fees, penalties, and other recoveries, as well as adjustments for estimated prepayments, delinquencies, and defaults.

These estimated cash flows include the effects of the timing and are discounted using the appropriate rate as described below. Administrative costs and any incidental effects on governmental receipts and outlays are not included in the cost of the direct loan (2 U.S.C. § 661a(5)(A), (B)).

* + - * The cost of a loan guarantee is recorded at the net present value, at the time when the related guaranteed loan is disbursed, of the cash flows for
    1. estimated amounts and timing of payments by the government for defaults, delinquencies, interest subsidies, or other payments, excluding administrative costs, and
    2. estimated amounts and timing of payments to the government for origination and other fees, penalties, and recoveries.

These estimated cash flows are discounted using the appropriate rate as described below. Administrative costs and any incidental effects on governmental receipts and outlays are excluded (2 U.S.C. § 661a(5)(A), (C)).

* + - * The cost of a modification is recorded at the difference between the current estimated net present value of the remaining cash flows under the existing direct loan or guarantee contract and the estimated net present value of the remaining cash flows under the modified contract. The cash flows for each of these calculations are discounted at the rate for modifications described below (2 U.S.C. § 661a(5)(D)).
      * The discount rate used to estimate the net present values described above is the average interest rate on marketable Treasury securities of similar maturity to the cash flows of the direct loan or loan guarantee for which the estimate is being made (2 U.S.C. § 661a(5)(E)).

1. **Expended authority transactions.** Expended authority transactions include transactions that occur when loans are disbursed. Supplemental control objectives relating to expended authority transactions under FCRA are as follows:

* **Valuation.** Expended authority transactions are recorded at the proper amount. The same specific criteria for the amounts of FCRA obligations are also applicable to expended authority transactions.
* **Cutoff.** Expended authority transactions are recorded in the proper period. Expended authority transactions for the cost of loans or guarantees are recorded in the fiscal year in which the direct or guaranteed loan is disbursed or when a modification occurs (2 U.S.C. § 661c(d)(2)).
* **Classification/presentation and disclosure.** Amounts are recorded in the proper account and reported appropriately for:
  + Differences in subsequent years between original estimated costs and reestimated costs are recorded in a separately identified subaccount in the credit program account and shown as a change in program costs and a change in net interest (2 U.S.C. § 661c(f)).
  + Funding for the administrative costs of a direct loan or loan guarantee program is recorded in separately identified subaccounts within the same budget account as the program’s cost (2 U.S.C. § 661c(g)).
  + Cash disbursements for direct loan obligations or loan guarantee commitments made on or after October 1, 1991, are made out of the financing account (2 U.S.C. § 661a(7)).

1. **Obligation and expended authority balances.** The supplemental control objective relating to obligation and expended authority balances under FCRA as of a point in time is as follows:

* **Limitation.** Total obligations and total expended authority transactions do not exceed the appropriation amount or other statutory limitations that may exist by appropriation period. Specifically, see the following:
  + Direct loan obligations made on or after October 1, 1991, do not exceed the available appropriation or other budget authority.
  + Modifications made to direct loan obligations or direct loans do not exceed the available appropriation or other budget authority. (Note: Prior to performing any control or compliance tests, the auditor should discuss with OGC the applicability of this budget restriction to direct loans and direct loan obligations that were outstanding prior to October 1, 1991.)
  + Obligations for new loan guarantee commitments made on or after October 1, 1991, do not exceed the available appropriation or other budget authority.
  + Modifications made to loan guarantee commitments or outstanding loan guarantees do not exceed the available appropriation or other budget authority. (Note: Prior to performing any control or compliance tests, the auditor should discuss with OGC the applicability of this budget restriction to loan guarantees or loan guarantee commitments that existed prior to October 1, 1991.)

1. **Cash receipts.** The control objective for cash receipts under FCRA is as follows:

* **Classification.** Cash receipts are recorded in the proper account for:
  + Cash receipts related to direct loans obligated or loan guarantees committed prior to October 1, 1991, are recorded in the liquidating accounts (2 U.S.C. § 661f(b)).
  + Cash receipts related to direct loan obligated or loan guarantees committed on or after October 1, 1991, are recorded in the financing account (2 U.S.C. § 661a(7)).

Definitions used in FCRA are as follows:

1. **Direct loans** are disbursements of funds by the government to nonfederal borrowers under contracts that require the repayment of such funds with or without interest. Direct loans also include the purchase of, or participation in, loans made by other lenders. Direct loans do not include the acquisition of federally guaranteed loans in satisfaction of default claims or the price support loans of the Commodity Credit Corporation (2 U.S.C. § 661a(1)).
2. **Direct loan obligations** are binding agreements by a federal agency to make direct loans when specified conditions are fulfilled by the borrowers (2 U.S.C. § 661a(2)).
3. **Loan guarantees** are any guarantees, insurance, or other pledges with respect to the payment of all or a part of the principal or interest on any debt obligations of nonfederal borrowers to nonfederal lenders, but do not include the insurance of deposits, shares, or other withdrawable accounts in financial institutions (2 U.S.C. § 661a(3)).
4. **Loan guarantee commitments** are binding agreements by a federal agency to make loan guarantees when specified conditions are fulfilled by borrowers, lenders, or any parties to guarantee agreements (2 U.S.C. § 661a(4)).
5. **Cost** is defined as the estimated long-term cost to the government of a direct loan or loan guarantee, calculated on a net present value basis, or modification thereof, excluding administrative costs and any incidental effects on governmental receipts or outlays (2 U.S.C. § 661a(5)). These calculations are described in further detail under the valuation control objective for obligations in FAM 395 F.
6. **Credit program accounts** are the budget accounts associated with each program account into which appropriations to cover the costs of direct loans or loan guarantee programs are made and from which such costs are disbursed to the financing accounts (2 U.S.C. § 661a(6)).
7. **Financing accounts** are the nonbudget accounts associated with each credit program account that hold balances, receive the cost payment from the credit program account, and include all other cash flows to and from the government resulting from direct loan obligations or loan guarantee commitments made on or after October 1, 1991 (2 U.S.C. § 661a(7)).
8. **Liquidating accounts** are the budget accounts that include all cash flows to and from the government resulting from direct loan obligations or loan guarantee commitments made prior to October 1, 1991. These accounts are shown on a cash basis (2 U.S.C. § 661a(8)).
9. **Modifications** are government actions that alter the estimated cost of an outstanding direct loan (or direct loan obligation) or loan guarantee (or loan guarantee commitment) from the current estimate of cash flows (2 U.S.C. § 661c(9)). These include the sale of loan assets, with or without recourse, and the purchase of guaranteed loans. They also include the actions resulting from new statutes, or from the exercise of administrative discretion under existing law, that directly or indirectly alter the estimated cost of outstanding direct loans (or direct loan obligations) or loan guarantees (or loan guarantee commitments).

For example, a policy change affecting the repayment period or interest rate for a group of existing loans would be a modification. Changes within the terms of existing contracts or through other existing authorities are not modifications under FCRA. In addition, “work outs” of individual loans, such as a change in the amount or timing of payments to be made, are not modifications. The effects of these changes are included in the annual reestimates of the estimated net present value of the obligations.

Reestimates are generally made annually to adjust the net present value of direct loans and loan guarantee obligations for changes in the estimated amounts of items such as defaults and in the timing of payments. Permanent indefinite authority has been provided for reestimates.

395 G – Specific Control Evaluation Worksheet

1. For each identified risk of material misstatement at the assertion level (identified risk) for which inherent risk is more than remote, for each material line item, account, note disclosure, and class of transactions, the auditor should use the SCE worksheet or equivalent to document the assessment of control risk. When preparing the LIRA form at FAM 395 H or equivalent, the auditor will use this assessment of control risk, along with the assessment of inherent risk, to assess the risk of material misstatement, which provides an appropriate basis for the design of further audit procedures.

For each identified risk for which inherent risk is more than remote, the SCE worksheet or equivalent should include the following information:

* + control objectives that address the risk;
  + evaluation of the design, implementation, and operating effectiveness of the relevant control activities necessary to achieve each control objective; and
  + assessment of control risk.

As discussed in FAM 330, each line item, account, and note disclosure is affected by input from one or more classes of transactions. As such, the risks that affect a class of transactions will also affect the related line items, accounts, and note disclosures. To avoid duplication in documentation, the auditor may use one SCE worksheet to document the control risk assessment for a material class of transactions and all the material line items, accounts, and note disclosures it affects. If a class of transactions, such as journal vouchers, is not directly related to a specific line item, account, or note disclosure, the auditor may prepare an SCE worksheet for that class of transactions only.

The auditor may prepare the SCE worksheet as follows:

* In the header, identify the material class of transactions. If the SCE worksheet covers multiple classes of transactions, such as those within a cycle, list all the classes of transactions. The auditor will list the related line items in column 3, as explained below.
* In column 1, list each assertion that is applicable to the class of transactions and all the material line items, accounts, and note disclosures it affects. The auditor obtains this information from the LIRA form(s) or equivalent for the class of transactions (see FAM 395 H). If an assertion is not applicable, the auditor does not need to list it in column 1. While all five assertions described in FAM 235 are applicable to line item/account-related classes of transactions that support balances that exist at period-end (e.g., asset, liability, net position, or budgetary balances), only the existence or occurrence; completeness; accuracy, valuation, and allocation; and presentation and disclosure assertions are applicable to transaction-related classes of transactions (e.g., billing, purchasing, cash receipts, and cash disbursements), as illustrated in FAM 395 B.
* In columns 2 and 3, for each assertion identified in column 1, list the material line items that the class of transactions affects and the identified risks, which are obtained from the LIRA form(s) or equivalent (see FAM 395 H). For example, identified risks for the cash receipts class of transactions would typically be documented in the cash, accounts receivable, and revenue LIRA forms (see FAM 395 A for typical relationships of classes of transactions to line items or accounts).

Also indicate in column 3 the assertion affected for each line item listed and reference the LIRA form that addresses it. For example, a misstatement in the occurrence assertion for the cash receipts class of transactions would affect the existence assertion for the cash line item. It would also affect the occurrence assertion for the revenue line item or the completeness assertion for the accounts receivable line item.

* In columns 4 and 5, list the inherent risk assessment and significant risk determination for each identified risk. The auditor obtains this information from the LIRA form(s) or equivalent (i.e., where the inherent risk assessment and significant risk determination are performed and documented). The auditor should consider this assessment and determination in identifying relevant control activities in column 7 (see FAM 350.05).

The following columns should be completed for each identified risk for which inherent risk is more than remote. If inherent risk is remote, enter N/A for columns 6 through 14. As discussed in FAM 310.09, in rare circumstances in which the auditor assessed all identified risks at remote for a material line item, account, note disclosure, or class of transactions, the auditor should perform control tests, as appropriate, if the auditor is providing an opinion on internal control.

* In column 6, identify the related internal control objectives for each identified risk. See FAM 330 and 395 B for guidance on identifying control objectives.
* In column 7, list internal control activities selected for testing that achieve each internal control objective identified (i.e., relevant control activities). In the FAM, control activities include controls in the control environment, entity risk assessment, information and communication, and monitoring components that directly address risks of material misstatement at the assertion level (see FAM 360.19). FAM 395 C illustrates typical control activities to achieve financial reporting control objectives.[[21]](#footnote-22)
* In column 8, indicate whether each control activity is either (a) an IS control, (b) a manual control, or (c) both an IS control and a manual control. As noted in FAM 350.11, the auditor generally should obtain concurrence from an IS controls auditor on the auditor’s identification of IS controls. IS controls consist of those internal controls that depend on information system processing and include general controls, application controls, and user controls.

A user control can be either (a) a manual control or (b) both an IS control and a manual control. A user control is considered both an IS control and a manual control if it depends on information system processing. Conversely, a user control is considered a manual control if it does not depend on information system processing. Manual controls do not depend on information system processing—either in the performance of the control activity or in the production of information used to perform the control activity. See FAM 295 F for additional information on the types of IS controls.

* In column 9, based on procedures performed in the internal control phase, conclude as to whether the control activity is effectively designed and implemented. As noted in FAM 360.11, the auditor should also identify and assess the design and implementation of other IS controls (application and general controls) on which the effectiveness of the IS controls in the SCE worksheet depends. An IS controls auditor will often need to assist the auditor in assessing the design and implementation of IS controls.
* In column 10, reference the audit documentation supporting the conclusion on whether the control activity is effectively designed and implemented.
* In column 11, based on the results of the internal control and testing phase audit procedures, enter a conclusion regarding the operating effectiveness of each control activity. As part of this assessment, the auditor assesses the operating effectiveness of other IS controls on which the effectiveness of the IS controls included in the SCE worksheet depends. An IS controls auditor will often need to assist the auditor in assessing the operating effectiveness of IS controls.
* In column 12, reference the audit procedures in the detailed control testing audit plan that were designed to test each control determined to be effectively designed and implemented.
* In column 13, conclude on whether each internal control objective has been achieved. This conclusion will need to consider the impact of results for each internal control activity related to the internal control objective. For example, one of the four control activities for achieving a control objective may have been ineffective; however, the combination of all control activities achieved the control objective.
* In column 14, assess control risk as either low, moderate, or high based on the effectiveness of related control activities and whether control objectives are achieved as indicated in columns 11 and 13, respectively (see FAM 370.07).

In the internal control phase, the auditor should document on the LIRA form at FAM 395 H or equivalent the preliminary assessments of the effectiveness of financial reporting controls and control risk from the SCE worksheets, based on the results of audit procedures performed through the internal control phase (e.g., walk-throughs and control tests that involve nonstatistical selection). Based on the results of audit procedures performed in the testing phase (e.g., sampling control tests), the auditor should determine if the preliminary assessments remain appropriate and should update them if necessary. The auditor should also note on the LIRA form any control deficiencies identified during testing of the control activities in the SCE worksheet.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Note: The auditor should tailor the risks in column 2 to the specific entity. For illustrative purposes, some columns contain example text. The auditor should complete all columns as applicable. | | | | | | | | | | | | | | | | | | | | | | | | | | |
| **ENTITY:** | |  | |  | | | | **SPECIFIC CONTROL EVALUATION** | | | | | | | | | |  | |  |  | | | |  |  |
| **DATE OF FINANCIAL STATEMENTS:** | | | |  | | | |  | |  |  |  | **INTERNAL CONTROL PHASE SIGN-OFFS** | | | | | | |  | **TESTING PHASE SIGN-OFFS** | | | |  |  |
| **CLASS OF TRANSACTIONS:** | | | |  | | |  |  | |  |  |  | Preparer & Date: | | |  | | | |  |  | | | | |  |
| [e.g., Cash Receipts] | | | |  | |  |  | Primary Reviewer & Date: | | | |  | | | |  |  | | | | |  |
|  | | | |  | | |  |  | |  |  |  | | | |  | | | |  |  | | | | |  |
| **IDENTIFIED RISKS OF  MATERIAL MISSTATEMENT  AT THE ASSERTION LEVEL** | | | **INHERENT RISK ASSESSMENT** (from LIRA) | | | | | |  | **CONTROL OBJECTIVES AND ACTIVITIES** | | | | | | | **DESIGN AND IMPLEMENTATION OF CONTROL ACTIVITIES** | | **CONTROL RISK ASSESSMENT** | | | | | | | |
| **Assertions** | **Identified Risks of Material Misstatement** | | **Related  Line Items, Assertions, and LIRA References** | | **Inherent Risk Assessment[[22]](#footnote-23)** (remote, low, moderate, high) | **Significant Risk?** (yes, no, N/A) | | |  | **Internal Control Objectives (ICO)**  (for each identified risk of material misstatement for  which inherent risk is  more than remote) | | | | **Internal Control Activities (ICA)** | **Type of ICA:  IS,  Manual (M), or Both IS and Manual (B)** | | **Is the ICA Effectively Designed and Implemented?** | **Audit Doc. Ref.** | **Is the ICA Operating Effectively?** | | | **Audit Plan Testing  Step** | **Is the ICO Achieved?** | **Control Risk Assessment** (low, moderate, high, N/A) | | |
| 1 | 2 | | 3 | | 4 | 5 | | | 6 | 6 | | | | 7 | 8 | | 9 | 10 | 11 | | | 12 | 13 | 14 | | |
| Existence or Occurrence | **Transaction related** | | | | | | | |  |  | | | |  |  | |  |  |  | | |  |  |  | | |
| Occurrence/validity: 1. Recorded transactions and events did not actually occur or do not pertain to the entity. | | [e.g., cash - existence, LIRA.1] | |  |  | | |  | 1a. Recorded transactions, events, and related processing procedures are authorized by federal laws, regulations, contracts, grant agreements, and management policy. | | | |  |  | |  |  |  | | |  |  |  | | |
|  | |  |  |  | |  |  |  | | |  |
| [e.g., revenue - occurrence, LIRA.2] | |  |  | | |  | 1b. Appropriate individuals approve recorded transactions and events in accordance with management’s general or specific criteria. | | | |  |  | |  |  |  | | |  |  |
|  | 1c. Recorded transactions and events actually occurred and pertain to the entity. | | | |  |  | |  |  |  | | |  |  |
|  | 1d. Transactions and events are recorded in the proper accounts. | | | |  |  | |  |  |  | | |  |  |
| Cutoff: 2. Transactions and events are recorded in the current period but occurred in a different period. | |  | |  |  | | |  | 2. Transactions and events recorded in the current period actually occurred in the current period. | | | |  |  | |  |  |  | | |  |  |  | | |
|  | |  |  | | |  |  |  | |  |  |  | | |  |
| Summarization: 3. Transactions are summarized improperly, resulting in an overstated total. | |  | |  |  | | |  | 3. The summarization of recorded transactions is not overstated. | | | |  |  | |  |  |  | | |  |  |  | | |
|  | |  |  | | |  |  |  | |  |  |  | | |  |  |
| **Line item/account related** | | | | | | | | | | | | | | | | |  |  | | |  |  |  | | |
| Existence: 4. Recorded assets, liabilities, net position, and budgetary balances do not exist at a given date. Projected revenues or expenditures in the sustainability statements are not valid. | | N/A | |  |  | | |  | 4a. Recorded assets, liabilities, net position, and budgetary balances exist at a given date. | | | |  |  | |  |  |  | | |  |  |  | | |
|  | |  | 4b. Assets, liabilities, net position, and budgetary balances are recorded in the proper accounts. | | | |  |  | |  |  |  | | |  |  |
|  | |  | 4c. Recorded assets, liabilities, net position, and budgetary balances of the entity, at a given date, are supported by appropriate detailed records that are accurately summarized and reconciled to the account balance. | | | |  |  | |  |  |  | | |  |  |
|  | |  | 4d. Projected revenues and expenditures in the sustainability statements are valid. | | | |  |  | |  |  |  | | |  |  |
|  | |  | 4e. Access to assets, critical forms, records, and processing and storage areas is permitted only in accordance with laws, regulations, and management policy. | | | |  |  | |  |  |  | | |  |  |
| Completeness | **Transaction related** | | | | | | | | | | | | | | | | |  |  | | |  |  |  | | |
| Transaction completeness: 5. Valid transactions and events are not recorded or are recorded in the incorrect accounts. | |  | |  |  | | |  | 5. All valid transactions and events are recorded in the proper accounts. | | | |  |  | |  |  |  | | |  |  |  | | |
|  | |  |  | | |  |  |  | |  |  |  | | |  |  |
| Cutoff: 6. Transactions and events occurred in the current period but are recorded in a different period. | |  | |  |  | | |  | 6. All transactions and events that occurred in the current period are recorded in the current period. | | | |  |  | |  |  |  | | |  |  |  | | |
|  | |  |  | | |  |  |  | |  |  |  | | |  |  |
| Summarization: 7. Transactions are summarized improperly, resulting in an understated total. | |  | |  |  | | |  | 7. The summarization of recorded transactions is not understated. | | | |  |  | |  |  |  | | |  |  |  | | |
|  | |  |  | | |  |  |  | |  |  |  | | |  |  |
| **Line item/account related** | | | | | | | | | | | | | | | | |  |  | | |  |  |  | | |
| Account completeness: 8. Assets, liabilities, net position, and budgetary balances of the entity exist but are not recorded in the proper period or accounts or are omitted from the financial statements. Projections in the sustainability statements do not include all estimated future revenues and expenditures at present value that should have been included. | |  | |  |  | | |  | 8a. All assets, liabilities, net position, and budgetary balances that should have been recorded have been recorded in the proper period and accounts and are properly included in the financial statements. | | | |  |  | |  |  |  | | |  |  |  | | |
|  | |  | 8b. Projections in the sustainability statements include all estimated future revenues and expenditures at present value that should have been included. | | | |  |  | |  |  |  | | |  |  |
| Accuracy,  Valuation, and Allocation | **Transaction related** | | | | | | | | | | | | | | | | |  |  | | |  |  |  | | |
| Accuracy: 9. Amounts and other data relating to recorded transactions or events have not been appropriately recorded. | |  | |  |  | | |  | 9. Amounts and other data relating to recorded transactions and events have been appropriately recorded. | | | |  |  | |  |  |  | | |  |  |  | | |
|  | |  |  | | |  |  |  | |  |  |  | | |  |  |
| **Line item/account related** | | | | | | | | | | | | | | | | |  |  | | |  |  |  | | |
| Accuracy, valuation, and allocation: 10. Assets, liabilities, net position, budgetary balances, or projections in the sustainability statements have been included in the financial statements at inappropriate amounts. Resulting valuation or allocation adjustments have not been appropriately recorded. | |  | |  |  | | |  | 10. Assets, liabilities, net position, budgetary balances, and projections in the sustainability statements have been included in the financial statements at appropriate amounts, and any resulting valuation or allocation adjustments have been appropriately recorded. | | | |  |  | |  |  |  | | |  |  |  | | |
| Measurement: 11. Revenues, expenses, and budgetary activity included in the financial statements are measured improperly. | |  | |  |  | | |  | 11. Revenues, expenses, and budgetary activity included in the financial statements are measured properly. | | | |  |  | |  |  |  | | |  |  |  | | |
| Rights and Obligations | **Line item/account related** | | | | | | | | | | | | | | | | |  |  | | |  |  |  | | |
| Ownership: 12. Recorded assets are owned by others because of sale, consignment, or other contractual arrangements. | |  | |  |  | | |  | 12. The entity owns (i.e., has valid title to) recorded assets. | | | |  |  | |  |  |  | | |  |  |  | | |
| Rights: 13. The entity does not hold or control the rights to recorded assets or budgetary resources because of liens, pledges, or other restrictions. | |  | |  |  | | |  | 13. The entity holds or controls the rights to recorded assets and budgetary resources at a given date | | | |  |  | |  |  |  | | |  |  |  | | |
| Obligations: 14. The entity does not have an obligation for recorded liabilities at a given date. Budgetary obligations do not pertain to the entity. | |  | |  |  | | |  | 14a. Liabilities are the entity’s obligations at a given date. | | | |  |  | |  |  |  | | |  |  |  | | |
|  | |  | 14b. Budgetary obligations pertain to the entity. | | | |  |  | |  |  |  | | |  |  |
| Presentation and Disclosure | **Transaction and line item/account related** | | | | | | | | | | | | | | | | |  |  | | |  |  |  | | |
| Presentation: 15. Financial or other information in the financial statements is not appropriately aggregated or disaggregated or is not clearly described. | |  | |  |  | | |  | 15. Financial and other information in the financial statements is appropriately aggregated or disaggregated and is clearly described. | | | |  |  | |  |  |  | | |  |  |  | | |
|  | |  |  | | |  |  |  | |  |  |  | | |  |  |
| Consistency: 16. The current period financial statement components are based on accounting principles different from those used in the prior periods presented. | |  | |  |  | | |  | 16. The financial statement components are based on accounting principles that are applied consistently from period to period. | | | |  |  | |  |  |  | | |  |  |  | | |
|  | |  |  | | |  |  |  | |  |  |  | | |  |  |
| Disclosure: 17. Note disclosures are not appropriately measured or described or are not relevant and understandable in the context of the requirements of U.S. GAAP. Not all note disclosures that should have been included in the financial statements have been included. Disclosed transactions and events did not actually occur or pertain to the entity. | |  | |  |  | | |  | 17. Note disclosures are appropriately measured and described and are relevant and understandable in the context of the requirements of U.S. GAAP. All note disclosures that should have been included in the financial statements have been included. Disclosed transactions and events have occurred and pertain to the entity. | | | |  |  | |  |  |  | | |  |  |  | | |
|  | |  |  | | |  |  |  | |  |  |  | | |  |  |
|  | Segregation of duties:[[23]](#footnote-24)  18. The entity is exposed to loss of assets and various potential misstatements, including certain of those above, as the result of inadequate segregation of duties. | | N/A | | | | | |  | 18. Persons do not have uncontrolled access to both assets and records; they are not assigned duties to put them in a position that would allow them to both commit and conceal errors or fraud. | | | |  |  | |  |  |  | | |  |  | [Reference the control risk assess-ments above for which segregation of duties procedures were performed.] | | |
|  |  |  | |  |  |  | | |  |  |
|  | Laws, regulations, contracts, and grant agreements[[24]](#footnote-25) | | [Reference the inherent risk assessments above to which compliance with laws, regulations, contracts, and grant agreements is relevant.] | | | | | |  |  | | | |  |  | |  |  |  | | |  |  | [Reference the control risk assess-ments above to which compliance is relevant.] | | |

395 H – Line Item Risk Analysis Form

1. The auditor should use the LIRA form or equivalent to document the auditor’s identification and assessment of risks of material misstatement at the assertion level for material line items, accounts, note disclosures, and the related classes of transactions (see FAM 235 and 265). For each identified risk of material misstatement at the assertion level (identified risk), the LIRA form or equivalent should document the assessed level of inherent risk. For each identified risk for which inherent risk is more than remote, the LIRA form or equivalent should include the following information:

* the determination of whether the risk is a significant risk;
* the assessed level of control risk;
* the assessed level of risk of material misstatement (i.e., combined inherent risk and control risk); and
* the planned nature, extent, and timing of substantive audit procedures to address the risk.

1. For purposes of preparing the LIRA form, the auditor may group related line items, accounts, and note disclosures, as appropriate. Typically, the auditor will use one LIRA form to document identified risks for a material line item and all the material accounts, note disclosures, and classes of transactions related to it. If a class of transactions, such as journal vouchers, or a note disclosure, such as fiduciary activities, is not directly related to a line item (e.g., it affects many line items), the auditor may prepare a LIRA form for that class of transactions or note disclosure only.
2. The auditor may prepare the LIRA form as follows:

* In the header, identify the material line item and enter the line item total. Also list the accounts and balances that make up the line item and the related note disclosures. Immaterial accounts may be listed following material accounts. This would allow the auditor to demonstrate that all accounts making up the line item total have been considered. If the line item consists of many accounts, the auditor may list the accounts or additional accounts in an addendum to the LIRA form. The auditor will list the related classes of transactions in column 3, as explained below. However, if the LIRA form is prepared for a class of transactions or note disclosure only, the auditor should replace the header information with the class of transactions or note disclosure.

**Planning Phase:**

* In column 1, list each of the five assertions discussed in FAM 235. If an assertion is not applicable to the line item or any of its related accounts, note disclosures, or classes of transactions, the auditor may exclude the assertion from the LIRA form. For example, the auditor may exclude the rights and obligations assertion from the LIRA form for net cost line items. For balance sheet line items, the auditor should include all five assertions.
* In column 2, list the identified risks for the line item and its related accounts, note disclosures, and classes of transactions (classes of transactions are identified in column 3). The auditor tailors the potential misstatements in FAM 395 B to the specific circumstances of the entity. The auditor may identify multiple types of potential misstatements in an assertion (see FAM 330).

Misstatements are classified as transaction related or line item/account related. For line items that reflect the accumulation of activities and events that occurred during the period under audit (e.g., revenues, expenses, and budgetary activity), the auditor typically considers transaction-related misstatements. For line items that reflect balances at period-end (e.g., asset, liability, net position, or ending budgetary balances), the auditor typically considers both transaction-related and line item/account-related misstatements. For example, for the cash line item, the auditor would identify potential misstatements in existence but also in occurrence/validity because cash is affected by the cash receipt and disbursement transactions that occurred during the year. Some types of potential misstatements may affect only a portion or component of a line item. Additionally, some potential misstatements may not be applicable for a given line item or its related accounts, note disclosures, and classes of transactions. For example, the potential misstatements related to existence, ownership, rights, and obligations in FAM 395 B are not applicable to net cost line items.

These potential misstatements represent identified risks of material misstatement at the **assertion level**. Risks of material misstatement identified at the **financial statement level** are documented in the audit strategy and do not need to be included on the LIRA form unless they also affect the assessment of risks at the assertion level (see FAM 290.07m).

* In column 3, for each identified risk, list the classes of transactions that contribute to the risk and reference the SCE worksheets that address them. For example, on the cash LIRA form, the auditor would typically identify a risk related to occurrence (i.e., recorded transactions did not actually occur). For this risk, the auditor would typically list cash receipts and cash disbursements as the classes of transactions that contribute to the risk. Other risks for which the auditor might list cash receipts and cash disbursements include those related to transaction completeness, cutoff, summarization, accuracy, presentation, consistency, and disclosure.

On the cash LIRA form, the auditor would typically also identify a risk related to existence (e.g., recorded cash does not exist at a given date). For this risk, the auditor would typically list the cash balance class of transactions, which consists of activities that support the period-end cash balance. Other risks for which the auditor might list the cash balance class of transactions include those related to account completeness, accuracy, ownership, rights, presentation, consistency, and disclosure. See FAM table 330.1 and FAM 395 A for additional guidance on the relationships between classes of transactions and line items. If the LIRA form is prepared for a class of transactions only, the auditor may enter N/A in this column and include a reference to the related SCE worksheet in the header of column 3.

The following columns should be completed for each class of transactions that contributes to each identified risk.

* In column 4, summarize the inherent risk considerations, including fraud risk and noncompliance considerations, that support the assessment of inherent risk in column 5 (see FAM 220). For example, the auditor may assess inherent risk at high for an identified risk in the valuation of the net receivables line item due to (1) the materiality of the receivables and potential allowance, (2) the subjectivity of management’s judgment related to the loss allowance, or (3) management’s history of aggressively challenging any proposed adjustments to the valuation of the receivables.

The auditor’s considerations for a class of transactions may be documented on multiple LIRA forms. In these cases, the considerations should be consistent among the multiple LIRA forms. For example, the auditor may identify cash receipts as a class of transactions that contributes to a risk related to occurrence/validity on the cash LIRA form. Since the receipt of cash usually result in a debit to cash and a credit to revenue or accounts receivable, the auditor’s considerations for cash receipts on the cash LIRA form should be consistent with those documented for cash receipts on the revenue LIRA form or accounts receivable LIRA form.

* In column 5, indicate whether the assessment of inherent risk is remote, low, moderate, or high (see FAM 265.23). As in column 4, this may be based on and should be consistent with the inherent risk assessments for other line items affected by the same class of transactions. If the auditor assesses inherent risk at remote, the auditor does not need to perform further audit procedures to address the risk. In these cases, the auditor should enter N/A in columns 6 through 10. The auditor should continue to complete the LIRA form for the identified risks for which inherent risk is assessed at low, moderate, or high. As discussed in FAM 265.26, in rare circumstances in which the auditor assessed all identified risks at remote for a material line item, account, note disclosure, or class of transactions, the auditor should nonetheless perform substantive procedures for that line item, account, note disclosure, or class of transactions. Additionally, the auditor should perform control tests, as appropriate, if the auditor is providing an opinion on internal control.
* In column 6, indicate whether the identified risk is a significant risk. As in column 4, this should be consistent with the significant risk identification for other line items affected by the same class of transactions. A significant risk is an identified risk of material misstatement (1) for which the assessment of inherent risk is high; (2) due to fraud, for which inherent risk is more than remote; or (3) arising from transactions with disclosure entities, related parties, and public-private partnerships that are also significant unusual transactions, for which inherent risk is more than remote. Significant risks require special audit considerations and are discussed throughout the FAM. See FAM 265 for additional guidance on identifying and responding to significant risks.

**Internal Control Phase:**

The following columns should be completed for each class of transactions that contributes to each identified risk for which inherent risk is more than remote.

* In column 7, indicate the assessment of control risk, which is obtained from the SCE worksheet that addresses the class of transactions contributing to the identified risk.
* In column 8, assess the risk of material misstatement as either low, moderate, or high (see FAM 370.09). This is a combined assessment of inherent risk (column 5) and control risk (column 7). In making this assessment, consider the extent to which control risk mitigates inherent risk. If control risk is high, the assessment of risk of material misstatement would be the same as the assessment of inherent risk.

As in column 4, this should be consistent with the risk assessment for other line items affected by the same class of transactions.

Testing Phase:

The following columns should be completed for each class of transactions that contributes to each identified risk for which inherent risk is more than remote.

* In column 9, summarize the nature, extent, and timing of planned substantive audit procedures that address the risk (see FAM 420).
* In column 10, provide a reference to the related audit procedure step number(s) in the testing audit plan.

If the audit procedures for a class of transactions is already documented on another LIRA form, the auditor may refer to the other LIRA form in columns 9 and 10.

1. If the results of audit procedures in the testing phase (e.g., sampling control tests and substantive procedures, see FAM 400) indicate that the assessment of inherent risk, control risk, and the risk of material misstatement at the assertion level was not appropriate, the auditor should document the revised assessment and the factors contributing to the revised assessment in the LIRA form or other document, such as the audit summary memo.

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Note: The auditor should tailor the risks in column 2 to the specific entity. For illustrative purposes, some columns contain example text. The auditor should complete all columns as applicable. | | | | | | | | | |
| **ENTITY:** |  |  | |  |  |  |  |  |  |
| **DATE OF FINANCIAL STATEMENTS:** | |  | | **LINE ITEM RISK ANALYSIS** | | |  |  |  |
| **LINE ITEM & TOTAL:** | | [e.g., Cash | $100,000,000] |  |  |  | |  |  |
| **ACCOUNTS & BALANCES:** | |  |  |  |  | **Preparer and Date:** | |  |  |
| **NOTE DISCLOSURES:** | |  |  |  |  | **Primary Reviewer and Date:** | |  |  |
|  | | | | | | | | | |
| **PLANNING PHASE** | | | | | | **INTERNAL CONTROL PHASE** | | **TESTING PHASE** | |
| **IDENTIFIED RISKS OF MATERIAL MISSTATEMENT  AT THE ASSERTION LEVEL** | | | **INHERENT RISK ASSESSMENT** | | | **CONTROL RISK ASSESSMENT** from SCEs  (low, moderate, high, N/A) | **RISK OF MATERIAL MISSTATEMENT ASSESSMENT** Combined Inherent Risk and  Control Risk (low, moderate, high, N/A) | **SUBSTANTIVE AUDIT PROCEDURES** | |
| **Assertions** | **Identified Risks of Material Misstatement** | **Classes of Transactions & SCE References** | **Inherent Risk Considerations** (including fraud risk and noncompliance considerations) | **Inherent Risk Assessment**  (remote, low, moderate, high)[[25]](#footnote-26) | **Significant Risk?** (yes, no, N/A) | **Nature, Extent, & Timing** (interim/year-end) | **Audit Plan  Testing Step** |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
| Existence or Occurrence | **Transaction related** | |  |  |  |  |  |  |  |
| Occurrence/validity 1. Recorded transactions and events did not actually occur or do not pertain to the entity. | [e.g., cash receipts, SCE.1] | [columns 4 - 8 should be consistent with the Revenue LIRA related to cash receipts] |  |  |  |  | [e.g., see Revenue LIRA] |  |
| [e.g., cash disbursements, SCE.2] | [columns 4 - 8 should be consistent with the Net Cost LIRA related to cash disbursements] |  |  |  |  | [e.g., see Net Cost LIRA] |  |
| Cutoff: 2. Transactions and events are recorded in the current period but occurred in a different period. |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
| Summarization: 3. Transactions are summarized improperly, resulting in an overstated total. |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
| **Line item/account related** | | | | | | | | |
| Existence: 4. Recorded assets, liabilities, net position, and budgetary balances do not exist at a given date. Projected revenues or expenditures in the sustainability statements are not valid. | [e.g., cash balance, SCE.3] |  |  |  |  |  |  |  |
| Completeness | **Transaction related** | | | | | | | | |
| Transaction completeness: 5. Valid transactions and events are not recorded or are recorded in the incorrect accounts. |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
| Cutoff: 6. Transactions and events occurred in the current period but are recorded in a different period. |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
| Summarization: 7. Transactions are summarized improperly, resulting in an understated total. |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
| **Line item/account related** | | | | | | | | |
| Account completeness: 8. Assets, liabilities, net position, and budgetary balances of the entity exist but are not recorded in the proper period or accounts or are omitted from the financial statements. Projections in the sustainability statements do not include all estimated future revenues and expenditures at present value that should have been included. |  |  |  |  |  |  |  |  |
| Accuracy, Valuation, and Allocation | **Transaction related** | | | | | | | | |
| Accuracy: 9. Amounts and other data relating to recorded transactions or events have not been appropriately recorded. |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
| **Line item/account related** | | | | | | | | |
| Accuracy, valuation, and allocation: 10. Assets, liabilities, net position, budgetary balances, or projections in the sustainability statements have been included in the financial statements at inappropriate amounts. Resulting valuation or allocation adjustments have not been appropriately recorded. |  |  |  |  |  |  |  |  |
| Measurement: 11. Revenues, expenses, and budgetary activity included in the financial statements are measured improperly. | [e.g., N/A] |  |  |  |  |  |  |  |
| Rights and Obligations | **Line item/account related** | | | | | | | | |
| Ownership: 12. Recorded assets are owned by others because of sale, consignment, or other contractual arrangements. |  |  |  |  |  |  |  |  |
| Rights: 13. The entity does not hold or control the rights to recorded assets or budgetary resources because of liens, pledges, or other restrictions. |  |  |  |  |  |  |  |  |
| Obligations: 14. The entity does not have an obligation for recorded liabilities at a given date. Budgetary obligations do not pertain to the entity. | [e.g., N/A] |  |  |  |  |  |  |  |
| Presentation and Disclosure | **Transaction and line item/account related** | | | | | | | | |
| Presentation: 15. Financial or other information in the financial statements is not appropriately aggregated or disaggregated or is not clearly described. | [e.g., cash receipts, SCE.1] |  |  |  |  |  |  |  |
| [e.g., cash disbursements SCE.2] |  |  |  |  |  |  |  |
| [e.g., cash balance, SCE.3] |  |  |  |  |  |  |  |
| Consistency: 16. The current period financial statement components are based on accounting principles different from those used in the prior periods presented. |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
| Disclosure: 17. Note disclosures are not appropriately measured or described or are not relevant and understandable in the context of the requirements of U.S. GAAP. Not all note disclosures that should have been included in the financial statements have been included. Disclosed transactions and events did not actually occur or pertain to the entity. |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |

1. In this paragraph, “auditor” refers to the user auditor and “entity” refers to the user entity, as defined in AU-C 402, *Audit Considerations Relating to an Entity Using a Service Organization*. AU-C 402 defines (1) user entity as an entity that uses a service organization and whose financial statements are being audited and (2) user auditor as an auditor who audits and reports on the financial statements of a user entity. [↑](#footnote-ref-2)
2. As indicated in FAM 260, the Federal Managers’ Financial Integrity Act report and its supporting documentation may be used as a starting point for understanding and evaluating internal control. The auditor may use management’s documentation of systems and internal control, including OMB Circular No. A-123 work, where appropriate. The auditor may use management’s tests of controls as part of the auditor’s tests of controls if such tests were executed by competent individuals independent of the controls. (See FAM 640 and FAM 645 for further information.) [↑](#footnote-ref-3)
3. 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-4)
4. “Relevant control activities” as used in the FAM are referred to as identified controls or controls that address the risks of material misstatement at the assertion level in AU-C 315. FAM 395 C presents a list of typical control activities that an entity may establish to help prevent, or detect and correct, misstatements in assertions. [↑](#footnote-ref-5)
5. In the FAM, control activities include controls within the control environment, entity risk assessment, information and communication, and monitoring components that directly address risks of material misstatement at the assertion level (see FAM 360.19). [↑](#footnote-ref-6)
6. Nonstatistical sampling is generally not used in tests of controls. [↑](#footnote-ref-7)
7. See GAO, *Federal Information System Controls Audit Manual* (FISCAM), [GAO-09-232G](https://www.gao.gov/products/gao-09-232g) (Washington, D.C.: February 2009), for further information. [↑](#footnote-ref-8)
8. Refer to FISCAM for further information. [↑](#footnote-ref-9)
9. The auditor may assess the risk of material misstatement on a preliminary basis at an earlier point in the audit, if preferred. This may be particularly appropriate for a recurring audit where the auditor understands the design of the control environment, entity risk assessment, information and communication, and monitoring components of internal control. [↑](#footnote-ref-10)
10. Other data includes information that is recorded along with the transaction amount and is necessary for the proper recording of the transaction, such as transaction description, transaction date, trading partner, cost center, fund code, and other accounting codes that the entity uses. [↑](#footnote-ref-11)
11. Segregation-of-duties controls are a type of safeguarding control and are designed to reduce the opportunities for any person to be in a position to both perpetrate and conceal misstatements, especially fraud, in the normal course of duties. Typically, an entity achieves adequate segregation of duties by establishing controls (such as segregating asset custody from recordkeeping functions) to prevent any person from having uncontrolled access to both assets and related records. The lack of segregation-of-duties controls may be pervasive and affect several assertions. The auditor should test segregation-of-duties controls as discussed in FAM 360.09 through .10. [↑](#footnote-ref-12)
12. For additional information on budget execution, see part 4 of OMB Circular No. A-11, *Preparation, Submission, and Execution of the Budget*, issued on August 11, 2023*.* OMB circulars are updated periodically, and the current version can be found on the OMB website at <https://www.whitehouse.gov/omb/information-for-agencies/circulars/> (accessed June 3, 2024). Another useful document is GAO, *A Glossary of Terms Used in the Federal Budget Process*, GAO-05-734SP (Washington, D.C.: September 2005). The USSGL and related accounting in the TFM can be found at <https://tfx.treasury.gov> (accessed June 3, 2024). [↑](#footnote-ref-13)
13. GAO, *A Glossary of Terms Used in the Federal Budget Process,* [GAO-05-734SP](https://www.gao.gov/products/gao-05-734sp) (Washington, D.C.: September 2005). [↑](#footnote-ref-14)
14. In the normal flow of business, when obligations are incurred, a credit to “undelivered orders” or “unexpended obligations - unpaid” is recorded (USSGL account 4801) with a debit to commitments (USSGL account 4700 or 4720). When the budget authority has been used, such as by the receipt of goods or services ordered, the obligation is debited (USSGL account 4801) with a credit to “delivered orders-unpaid” or “expended authority - unpaid” (USSGL account 4901). At this time, a proprietary accounting entry is also made to debit expenditures (usually USSGL account 6100) with a credit to accounts payable (USSGL account 2110). When the obligation is paid and the outlay is made, the transaction is credited to “delivered orders - paid” or “expended authority - paid” (USSGL account 4902). At this time, a proprietary accounting entry is also made to debit accounts payable (USSGL account 2110) with a credit to FBWT (USSGL account 1010). For additional transaction details, see TFM’s U.S. Standard General Ledger Accounting Transactions supplement. [↑](#footnote-ref-15)
15. Unobligated amounts are debited and moved to “allotments – expired authority” with a credit to USSGL account 4650. For no-year appropriations (i.e., those available for obligation for an indefinite period), the appropriation account does not expire. Consistent with 31 U.S. C. § 1555, the appropriation account is closed, and any remaining balance (whether obligated or unobligated) in that account is canceled (and thus no longer available for obligation or expenditure for any purpose) if (1) the entity head or the President determines that the purposes for which the appropriation was made has been carried out and (2) no disbursement has been made against the appropriation for 2 consecutive fiscal years. [↑](#footnote-ref-16)
16. Amounts of commitments, obligations, and expended authority may differ for a particular item acquired. Commitments are made at “initial” estimates, obligations at “later” estimates, and expended authority at “actual” amounts. [↑](#footnote-ref-17)
17. Expired authority (USSGL account 4650) is debited and moved to “canceled authority” by a credit to USSGL account 4350. At this time, a proprietary entry is made to debit and reduce “unexpended appropriations” (USSGL account 3106) and to credit and reduce FBWT (USSGL account 1010). [↑](#footnote-ref-18)
18. OMB apportionments may, as a result of impoundments (rescissions or deferrals), be less than the amount of the apportionments requested by the entity. The auditor generally should notify OGC of any impoundments that come to the auditor’s attention. OMB may also approve different amounts available than those requested by time period, activity, project, or object class. [↑](#footnote-ref-19)
19. Other unliquidated obligations include legal duties on the part of the United States that could mature into legal liabilities by virtue of actions on the part of the other party beyond the control of the United States. For example, in a GAO legal decision, an entity that, at the time of grant award, accepted a legal duty to cover the benefits of new participants at the time of a grant award was required to record its maximum amount of liability because the amount of payment was under the control of the grantee. See*Obligational Practices of the Corporation for National and Community Service*, B-300480, Apr. 9, 2003*; Corporation for National and Community Service: Amount of Obligations,*B-300480.2, June 6, 2003. [↑](#footnote-ref-20)
20. The term current has the same meaning as in section 250(c)(9) of the Balanced Budget and Emergency Deficit Control Act of 1985. [↑](#footnote-ref-21)
21. The auditor may (1) commingle the documentation of compliance (including budget), operations, and safeguarding controls with that of financial reporting controls to the extent appropriate on an SCE worksheet; (2) list these controls in a separate section(s) within the SCE worksheet; or (3) present each type of control in a separate SCE worksheet. [↑](#footnote-ref-22)
22. If inherent risk is assessed at remote, enter N/A in columns 5 through 14. If the auditor is providing an opinion on internal control, the auditor should perform control tests for all material line items, accounts, note disclosures, and classes of transactions. [↑](#footnote-ref-23)
23. Segregation of duties involves segregating work responsibilities so that one individual does not control all critical stages of a process, allowing that person to both cause and conceal misstatements whether due to error or fraud. In assessing control risk for the identified risks of material misstatements listed above, the auditor considers the risk that inadequate segregation of duties could result in material misstatements to the financial statements. Segregation of duties procedures as discussed in FAM 360 should be documented, and the conclusions should be summarized here. [↑](#footnote-ref-24)
24. In assessing inherent risk and control risk for the identified risks of material misstatement listed above, the auditor considers the risk that noncompliance with laws, regulations, contracts, and grant agreements could result in material misstatements to the financial statements. The auditor may commingle compliance controls (including budget) with financial reporting controls as appropriate, list them in a separate section of this SCE worksheet, or include them in a separate SCE worksheet. See FAM 800 for examples of compliance SCE worksheets for laws and regulations. [↑](#footnote-ref-25)
25. If inherent risk is assessed at remote, enter N/A for columns 6 through 10. If inherent risk is remote for all identified risks of material misstatement, see FAM 395 H.03 for instructions. [↑](#footnote-ref-26)