SECTION 500

Reporting Phase

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510 – Overview of the Reporting Phase

Based on the work in the preceding phases, the auditor decides how to report on (as applicable)

* the financial statements taken as a whole;
* required supplementary information (RSI) (including management’s discussion and analysis (MD&A)) and other information presented with the financial statements;
* the entity’s internal control over financial reporting;
* the financial management systems’ substantial compliance with the three Federal Financial Management Improvement Act of 1996 (FFMIA) requirements (for Chief Financial Officers (CFO) Act agencies); and
* the entity’s compliance with applicable laws, regulations, contracts, and grant agreements.

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

520 – Perform Overall Analytical Procedures

Purposes of Overall Analytical Procedures

1. As the audit nears completion, the auditor should design and perform overall analytical procedures, as discussed in the American Institute of Certified Public Accountants’ (AICPA) Clarified Statements on Auditing Standards (AU-C) 520. The purposes of these procedures are

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

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

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

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

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

The auditor generally should coordinate overall analytical procedures with the evaluation of the MD&A, including forming conclusions about the information in the MD&A. See FAM 280.05 for performing procedures over RSI.

### Performance of Overall Analytical Procedures

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

1. Assessing expectations: The auditor should determine if expectations previously developed during preliminary analytical procedures in FAM 225.03 (a) are still appropriate or should be revised.
2. Comparing current-year amounts with expectations: This information may be on a summarized level, such as the level of financial statements, or a more detailed level, as discussed in FAM 520.03.
3. Identifying significant or unusual fluctuations from expectations that have not already been identified and resolved: The auditor should determine whether previously established parameters for determining whether a fluctuation is significant are still appropriate. Parameters are usually based on performance materiality. Unusual fluctuations include inappropriate accounting balances (such as debit balances in liability accounts), balances with either no current-year or no prior-year comparison, and decreases in property accounts that would normally occur only by disposition (instead of by misstatements) or inconsistencies with other relevant information obtained during the audit (AU-C 520.08c). Fluctuations identified are a matter of the auditor’s professional judgment. The auditor should also evaluate the absence of expected fluctuations when identifying significant fluctuations (such as lower foreclosure rates on home loans despite higher default rates).
4. Understanding identified fluctuations from expectations: The auditor should understand all significant fluctuations identified, obtain audit evidence corroborating the causes, and document the causes. The documentation may be a brief description with a reference to corroborating audit evidence. If the auditor does not understand the cause of a fluctuation or if the understanding is not consistent with the audit evidence, the auditor should perform procedures to obtain an understanding or to resolve any inconsistencies.
5. Evaluating the results of overall analytical procedures: The auditor should evaluate these results to determine if the auditor obtained an adequate understanding of significant fluctuations from expectations and if the financial statements are consistent with the auditor’s understanding of the entity. If the auditor identifies a previously unrecognized risk of material misstatement, the auditor should revise the auditor’s assessment of the risks of material misstatement and modify the audit procedures accordingly (AU-C 520.A26).

530 – Reassess Materiality and Risks of Material Misstatement (AU-C 450.10)

1. In the planning phase, the auditor determined materiality for the financial statements taken as a whole based on preliminary information. Based on this materiality, the auditor determined performance materiality and tolerable misstatement, which affected the extent of audit testing. Also in planning, the auditor assessed the risks of material misstatement by assertion. During the audit, the auditor may have revised these determinations and assessments if better information became available.

Before the end of the audit, prior to evaluating the effect of uncorrected misstatements, the auditor should reassess materiality for the financial statements taken as a whole to confirm whether it remains appropriate in the context of the entity’s actual (final) financial statements (AU-C 450.10). If the reassessment of materiality results in a lower amount (or amounts), then the auditor should reconsider performance materiality and the appropriateness of the nature, timing, and extent of the further audit procedures in order to obtain sufficient appropriate audit evidence on which to base the audit opinion.

Before the conclusion of the audit, the auditor should also reassess, based on the audit procedures performed and the audit evidence obtained, whether the assessments of the risks of material misstatement at the relevant assertion level remain appropriate (AU-C 330.27). The auditor should determine whether the overall audit strategy and audit plan need to be revised

* if the aggregate of misstatements accumulated during the audit approaches materiality for the financial statements taken as a whole (determined in accordance with AU-C 320) (AU-C 450.06.b) or
* if the nature of the identified misstatements and the circumstances of their occurrence indicate that other misstatements may exist that when aggregated with misstatements accumulated during the audit, could be material (AU-C 450.06a).

See FAM 540 for evaluating accumulated misstatements.

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

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

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

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

Based on these reassessments, the auditor should determine whether the nature, extent, and timing of substantive audit procedures were sufficient, such as the appropriateness of sample sizes for detail tests and the limit for investigation of differences during substantive analytical procedures. When the auditor has questions regarding the adequacy of work performed or sufficiency of audit evidence, the auditor should consult with the reviewer to determine the need for additional procedures.

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

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

1. The auditor might detect misstatements during substantive tests or other procedures. The auditor should accumulate misstatements identified during the audit, other than those that are clearly trivial (AU-C 450.05), and evaluate misstatements individually and in the aggregate in both quantitative and qualitative terms. Based on the evaluation of all misstatements, the auditor should determine whether the overall audit strategy and audit plan need to be revised (AU-C 450.06), as discussed in FAM 530. See FAM 595 C for additional details. Additionally, the auditor should determine the effects of accumulated misstatements on the financial statements and the auditor’s conclusions and reports.

As discussed in AU-C 330, the auditor should not assume that an instance of fraud or error is an isolated occurrence and therefore should evaluate how the detection of the misstatement affects the assessed risks of material misstatement, including (1) the related nature, extent, and timing of substantive audit procedures and (2) the audit evidence of the operating effectiveness of relevant controls, including the entity’s risk assessment and monitoring process. In addition to evaluating the effects of misstatements on the financial statements, the auditor should evaluate the effects of misstatements on the following:

1. The auditor’s conclusions on internal control (see FAM 580.43 through .72).

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

1. The consideration of the risks of material misstatement due to fraud (see FAM 540.18 through .21).

The auditor should determine whether to change the risk of material misstatement due to fraud determined during planning, based on the accumulated results of audit procedures.

1. The auditor’s evaluation of the financial management systems’ substantial compliance with the three FFMIA requirements, if applicable (see FAM 580.74 through .78).

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

1. The entity’s compliance with significant provisions of applicable laws, regulations, contracts, and grant agreements (see FAM 580.79 through .86).

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

1. Budget formulation and execution.

The auditor should evaluate the effects the misstatements have on budget-related matters for purposes of reporting budget control deficiencies, reporting on the statement of budgetary resources and reconciliation of net cost to budget note disclosure, and reporting on compliance with applicable budget-related provisions of laws and regulations.

1. Other reports.

The auditor should evaluate whether the misstatements include effects of related control deficiencies in FAM 580 affect other reports prepared by the entity that are (1) used for management decision-making or (2) distributed outside the entity.

FAM 475 (substantive analytical procedures) and FAM 480 (substantive detail tests) discuss the evaluation of individual misstatements from a quantitative standpoint.

Note: The auditor should accumulate all misstatements above clearly trivial (even those adjustments identified by the auditor and already corrected by management during the audit). If the auditor judges an individual misstatement to be material, the auditor generally should not offset other misstatements against it.[[1]](#footnote-1) Following that guidance, the auditor should quantify the effects of the misstatement. (See AU-C 450.11.)

To assist in evaluating the effects of misstatements accumulated during the audit and in communicating misstatements to management and those charged with governance, the auditor generally should use the following categories to classify each misstatement as either of the following:

* Factual misstatements: The amount of misstatement about which there is no doubt.
* **Judgmental misstatements:** Differences arising from the judgments of management concerning accounting estimates that the auditor considers unreasonable or the selection or application of accounting policies that the auditor considers inappropriate.
* **Projected misstatements**: The auditor’s best estimate of the amount of the misstatements in populations, involving the projection of misstatements identified in audit samples to the entire population from which the samples were drawn. (AU-C 450.A3)

The auditor should also accumulate all corrected misstatements throughout the audit period. The auditor should evaluate the corrected misstatements and consider whether the misstatements indicate (1) an increased risk in internal control over financial reporting, (2) an increased risk of material misstatement, or (3) the potential existence of further undetected misstatements.

### Accumulate Misstatements

To evaluate the aggregate effects of misstatements on the financial statements, the auditor should accumulate misstatements identified during the audit, other than those that are clearly trivial (AU-C 450.05), and generally should classify each misstatement as factual, judgmental, or projected on a Schedule of Uncorrected Misstatements (before discussion with management), an example of which is illustrated at FAM 595 C, Example 1. (Note: This includes any misstatements that the entity brings to the auditor’s attention that have not been corrected in the financial statements.)

The auditor should quantify and evaluate misstatements under both the rollover and iron curtain approaches, including consideration of the effects on the current-period financial statements of any misstatements related to prior periods on the relevant classes of transactions, accounts, balances, or disclosures and the financial statements taken as a whole (AU-C 450.11.b). Subsequently, the auditor generally should propose an adjusting entry when either approach results in quantifying a misstatement that is above clearly trivial, after considering all relevant quantitative and qualitative factors. One approach quantifies a misstatement based on the amount of the misstatement originating in the current-year statement of net cost (i.e., rollover approach). Thus, this approach ignores the effects of correcting the portion of the current-year balance sheet misstatement that originated in prior years. Misstatements originating in the current year, as quantified in the rollover approach, consist of 1) misstatements arising in the current year (for example, an understatement of current year payroll expenses identified in the testing of current year payroll expenses) and 2) misstatements arising in prior periods that affect the current year (for example, an understatement of current year non-payroll expenses from a cutoff error in the prior year). The other approach quantifies a misstatement based on the effects of correcting the misstatement existing in the balance sheet at the end of the current year, irrespective of the misstatement’s year of origination (i.e., iron curtain approach). (See additional discussion and examples in Securities and Exchange Commission Staff Accounting Bulletin No. 108.) The rollover and iron curtain approaches quantify the effects of misstatements arising in the current year identically; however, the approaches quantify misstatements arising in prior periods differently (also, see FAM 540.16).

For example, the auditor identifies an expense cutoff error in which $200 of expenses related to the following year were recorded in the current year, thereby overstating other liabilities by $200 at the end of the current year. In addition, a similar cutoff error existed at the end of the prior year, in which $300 of expenses related to the current year were included in the prior year. Under the rollover approach, the auditor would only consider the effect of the misstatement on the current year Statement of Net Cost. Therefore, in this example, the auditor would quantify (1) the effect of the $200 overstatement of expenses arising in the current year, offset by (2) the effect of the reversal of the $300 understatement of expenses included in the prior year that should have been incurred in the current year. Under the iron curtain approach, the auditor instead quantifies the misstatement based on correcting the misstatement in the balance sheet at the end of the current year. Therefore, in this example, the auditor would quantify the effect of only the $200 misstatement to other liabilities as of the end of the current year. See FAM 595 C for an illustration of these approaches.

The financial statements usually include various accounting estimates made by management, such as the recoverability of assets (through allowances for doubtful accounts receivable or loans) and liabilities for loan guarantees. The auditor should evaluate whether the estimates are either reasonable or are misstated. If the recorded amount falls outside a range of amounts that the auditor determines is reasonable, the auditor generally should include at least the difference between the recorded amount and the closest end of the auditor’s range as a judgmental misstatement in the Schedule of Uncorrected Misstatements (AU-C 540.18 and .A122).

Review Misstatements with Management

After accumulating and summarizing the misstatements on a Schedule of Uncorrected Misstatements (an example of which is at FAM 595 C, Example 1) (AU-C 450.12b) the auditor **should**, on a timely basis, take the following actions:

* Communicate all these misstatements accumulated during the audit with appropriate entity management. This includes communicating factual, judgmental, and projected misstatements (AU-C 450.07).
* Request that entity management to adjust the entity’s financial statements and underlying records to correct all misstatements accumulated during the audit (AU-C 450.07).
* For misstatements that are material either individually or when aggregated with other misstatements, request that entity management examine the classes of transactions, account balances, or disclosures to identify and quantify the entity’s own amount of related misstatements. This may also help determine the cause of the misstatements. The auditor should then test management’s procedures and the amount of the proposed adjustment to determine the reasonableness of the amount. The auditor should perform additional audit procedures if needed (AU-C 450.07 and .08). Entity management may establish valuation allowances for projected misstatements, net of factual misstatements (since the projected misstatement represents the best estimate of the total correction needed).[[2]](#footnote-2)

For judgmental misstatements involving differences in estimates, the auditor may share the assumptions and methods used to develop the estimate with management so that management can revise its estimate.

* Communicate all misstatements accumulated during the audit with those charged with governance, including the following information:
* The effect that the misstatements, individually or in the aggregate, may have on the opinion in the auditor’s report. The auditor’s communication should identify material uncorrected misstatements individually. The auditor should request that uncorrected misstatements be corrected.
* The effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances, or disclosures and the financial statements taken as a whole (AU-C 260.13).
* Material, corrected misstatements that were brought to the attention of management as a result of audit procedures (AU-C 260.14).

In presenting the misstatements to management, the auditor generally should remind management that AU-C 580 requires the entity to indicate in the management representation letter that the uncorrected misstatements aggregated by the auditor, both individually and in the aggregate, are not material to the financial statements taken as a whole. AU-C 580 also requires that a summary of the uncorrected misstatements be attached to the representation letter. Attaching this summary is further discussed in FAM 1001 and presented in the example representation letter at FAM 1001 A. Thus, management may consider some of the same factors presented in FAM 540.09 through .17.

Consider the Effects of Uncorrected Misstatements on the Financial Statements

If management does not correct the financial statements, the auditor should obtain an understanding of management’s reasons for not making the corrections and whether the uncorrected misstatements are considered material. The auditor should take that understanding into account when evaluating whether the financial statements as a whole are free from material misstatement (AU-C 450.09). The auditor should update the Schedule of Uncorrected Misstatements to reflect the uncorrected misstatements after discussions with management (FAM 595 C, Example 2) (AU-C 450.12b).

If entity management declines to record adjustments for any identified misstatements, the auditor should determine the effects of these uncorrected misstatements, individually and in the aggregate, on the financial statements, including the effect on individual line items (even if the amount is netted in the line item). The auditor should also consider the effect on the financial statement audit opinion in both quantitative and qualitative terms.

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

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

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

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

If the total of uncorrected misstatements is material, the auditor should modify the opinion on the financial statements (see FAM 580.09). Deciding how to modify the opinion based on the materiality of total uncorrected misstatements involves significant auditor’s judgment. The decision and the basis for it should be documented. The audit director should be involved in the decision and review the documentation related to it. Also, the reviewer should review and approve the documentation of the decision.

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

Qualitative Considerations

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

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

These circumstances are only examples—not all are likely to be present in all audits nor is the list necessarily complete. The existence of any circumstances such as these does not necessarily lead to a conclusion that a misstatement is material. See AU-C 450.A23 for further examples.

When determining whether uncorrected misstatements are material, either individually or in the aggregate, to the financial statements, the auditor should consider the size and nature of the misstatements, both in relation to particular classes of transactions, account balances, or disclosures in the financial statements and in relation to the financial statements taken as a whole, and the particular circumstances of their occurrence (AU-C 450.11a).

If the auditor provides assurance on any combining statements and supplemental schedules in relation to the financial statements taken as a whole, the auditor should determine whether these statements and schedules are materially misstated due to uncorrected misstatements.

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

Treatment of Misstatements That Arose in Prior Periods but Were Detected in the Current Period

If, during the audit of the current period, the auditor detects a misstatement that arose in a prior period but was not previously detected, the auditor should include the misstatement in the Schedule of Uncorrected Misstatements and bring it to management’s attention. The auditor should determine if the misstatement, together with other uncorrected misstatements, is material to the prior-period and/or current-period financial statements. The auditor should gather sufficient information to evaluate the cumulative effects, as well as the current-year change, related to the misstatement on beginning and ending balances, such as those for balance sheet accounts, as well as the related impact on the current year’s activity, such as that shown on the statement of net cost (AU-C 450.11.b). Also, see FAM 580.91 regarding financial statement restatements.

If the misstatement is material, the auditor should consult with the reviewer to determine the effect on the current-period statements and the auditor’s report. Also, see FAM 580.91 regarding financial statement restatements.

Evaluate Whether Identified Misstatements Indicate Fraud

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

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

If the auditor has identified or suspects a fraud, the auditor should determine whether the auditor has a responsibility to report the occurrence or suspicion to a party outside the entity. Although the auditor’s professional duty to maintain the confidentiality of client information may preclude such reporting, the auditor’s legal responsibilities may override the duty of confidentiality in some circumstances (AU-C 240.42). In some circumstances, the auditor may be required by law or regulation to report directly to outside parties about fraud (or significant abuse). However, the auditor should limit public reporting to matters that would not compromise any related investigative or legal proceedings (see *Government Auditing Standards* (2011), paragraphs 4.27).

If a misstatement is or might be the result of fraud and the effect is not material to the financial statements, the auditor should evaluate the implications, especially those regarding the organizational position and responsibilities of the individual involved. If the matter involves a relatively low-level employee who is not responsible for significant activities (for example, a misappropriation from a small petty cash fund by a nonmanagement employee), the auditor may conclude that the matter has little significance to the audit. However, if the auditor identifies a misstatement, whether material or not, and the auditor has reason to believe that it is, or may be, the result of fraud and that management (in particular, senior management) is involved, the auditor should reevaluate the assessment of the risks of material misstatement due to fraud and its resulting effect on the nature, timing, and extent of audit procedures to respond to the assessed risks (AU-C 240.36). The auditor should evaluate whether (1) the misstatement is qualitatively material and (2) it might indicate a more pervasive problem.

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

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

* attempt to obtain additional evidential matter to determine whether material fraud has occurred or is likely to have occurred and its effect on the financial statements and the related audit report;
* evaluate the implications for other aspects of the audit, including reevaluating the assessment of risks and the resulting effects on testing, as described in the preceding paragraph (AU-C 240.20);
* discuss the matter and the approach for further investigation with at least the next higher level of entity management and with senior management and those charged with governance; and
* determine whether to advise entity management to consult with its legal counsel.

The auditor should discuss in the audit report any fraud that causes a material misstatement of the financial statements. In addition, depending on circumstances, fraud (material or immaterial) could affect the reports on the financial statements; internal control over financial reporting; and compliance with applicable laws, regulations, contracts, and grant agreements and the quality of management representations. The auditor should consult with the audit director and the reviewer and should report the matter to those charged with governance.

545 – Audit Exposure (Further Evaluation of Audit Risk)

1. At the beginning of the audit, performance materiality(which, as defined, is one or more amounts) was set to reduce to an appropriately low level the probability that the aggregate of uncorrected and potential undetected misstatements in the financial statements exceeds materiality for the financial statements as a whole (AU-C 320.09). Before the conclusion of the audit, the auditor should consider any potential further misstatement to the financial statements taken as a whole by accumulating the total of uncorrected misstatements plus an overall allowance for undetected misstatements. If the aggregate of misstatements accumulated during the audit approaches materiality, a greater than acceptably low level of risk may exist that possible undetected misstatements, when taken with the aggregate of uncorrected misstatements accumulated during the audit, could exceed materiality (AU-C 450.A5). It is important to evaluate the potential further misstatement amount in relation to materiality for the financial statements as a whole (see FAM 230.05) and the relative importance of the misstated items to readers of the financial statements (qualitative and mitigating aspects). Therefore, the auditor should determine whether its audit exposure (audit exposure is the combination of detected misstatements, possible undetected misstatements, and qualitative aspects) is material to the financial statements.

Evaluation

The auditor may or may not detect misstatements during substantive tests or other procedures performed during the audit (see FAM 540). However, the auditor should evaluate the risk of potential undetected misstatement, which is due to the imprecision of audit procedures, as discussed in FAM 230.12. This risk includes such things as (1) unaudited amounts/accounts that were considered to be individually immaterial and were not tested on that basis (untested amounts); (2) the sampling precision associated with statistical samples selected for substantive tests of financial statement balances (or, if no statistical samples are selected, including an allowance equal to performance materiality);[[3]](#footnote-3) and (3) an allowance for the imprecision of substantive analytical procedures on which the auditor placed complete reliance. For example, all untested amounts are considered to be 100 percent overstated for this evaluation.

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

1. The auditor may also consider any other aspects that may increase the risk of potential undetected misstatements and also consider any mitigating factors that may lower the risk of misstatement.
2. See FAM 545 A for a template that the auditor can use to conduct this analysis.

545 A – Further Evaluation of Audit Risk Template

1. This template is a tool that the auditor can use to conduct the analysis described in FAM 545. The template consists of three sections: (1) Conclusions, (2) Consideration of Quantitative Factors, and (3) Consideration of Other Factors.

Consideration of Quantitative Factors

Overall

1. Amounts that do not affect the materiality (benchmark) will be entered to column C for each financial statement in the tables below.
2. Untested amounts and limits related to analytical tests upon which we placed 100 percent substantive reliance (see FAM 475.06) will be entered at absolute value (simple addition with no +/- signs).
3. Uncorrected misstatements that do not affect the benchmark will first be netted for each line item, and then the amount for all the line items will be accumulated at absolute value and the total entered to column C.
4. Sampling precision associated with statistical samples selected to test balances that do not affect the benchmark will be statistically combined with the assistance of the audit sampling specialist, and the result entered to column C. For any financial statement on which the benchmark does not appear, all amounts will be entered to column C. Hence in such cases, column D will not be needed, and “N/A” can be entered in each row. Amounts related to balances that do affect the benchmark will be entered in column D. In these cases, untested amounts, limits related to analytical tests upon which we placed 100 percent substantive reliance, and uncorrected misstatements will all be added or netted, as appropriate, to determine their actual effect on the benchmark and the results entered in column D. Combined sampling precision calculations related to balances that do affect the benchmark will be done the same way as for those balances that do not affect the benchmark (above), except that they will be entered in column D. So on any financial statement that includes the benchmark, and also reports a mixture of balances that do, and do not, affect the benchmark (and were subject to statistical sampling), two separate sample combination calculations will be needed—one for column C and one for column D. To illustrate some of these principles:

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

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

Evaluation of Uncorrected Misstatements

1. For each line item of each financial statement, calculate the net effect (debits less credits) of uncorrected misstatements, if any. Include only the misstatements from nonstatistical selections or other nonstatistical tests (factual and judgmental). The estimated effect of the outcome of statistical tests will be included in the sampling precision calculations, below.
2. For those uncorrected misstatements that do not affect the materiality benchmark, calculate the absolute value of the amounts calculated in No. 1, above for each financial statement (i.e., once you have calculated the net effect on each line item, remove the +/- signs for the totals and add them up). Enter the result in the space indicated, column C for each financial statement.
3. For those uncorrected misstatements that do affect the materiality benchmark, calculate the net effect upon the materiality benchmark of all uncorrected misstatements (net the debits and the credits). Enter the result to the appropriate space in column D for each financial statement.

Evaluation of the Potential Undetected Misstatement

Untested Amounts

1. For untested amounts related to line items that do not affect the materiality benchmark, calculate the absolute value of the untested amounts, and enter the result to the appropriate space in column C for each financial statement.
2. For untested amounts related to line items that do affect the materiality benchmark, calculate the absolute value affect upon the materiality benchmark, and enter the result to the appropriate space in column D for each financial statement.

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

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

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

Analytical Procedures upon Which Complete Substantive Reliance Was Placed

1. If we have identified a sound, reasonable, defensible basis upon which to estimate the ending balance of a line item, the auditor can consider complete (sole) reliance on an analytical procedure as an option for obtaining substantive assurance. However, this option is only available IF such a basis can be identified. If not, the balance will either need to be substantively tested through alternate means, or treated as an untested amount. FAM 475.06 provides guidance for establishing the limit in any case where the auditor elects to completely rely upon an analytical test for substantive assurance (i.e., there are no other tests of the balance during the same period such as sampling at an interim point, confirmations, reconciliations, or other analytical tests. If there were any other substantive tests, reliance is only partial), and defines the term “limit” in this context.
2. Identify analytical procedures upon which complete substantive reliance was placed, if any.

For each financial statement, identify any analytical procedures in which (a) the limit set was not exceeded by the observed differences between the expected and actual outcome, and (b) the differences identified were either not investigated, explained, and supported, or were only partially explained and supported (Do not include limits related to differences that were adequately explained/supported.) Examples:

* Example (a): We projected a final balance of $1 million, and set a limit of $200,000. The reported balance was actually $900,000. Since the difference between the reported balance and our projected balance ($100,000) is within the limit we set ($200,000), we did not investigate. The amount in this case would be $100,000, which is the difference we did not investigate between the reported balance ($900,000) and the projected balance ($1 million).
* Example (b): We set the limit at $50,000, the projected balance is $900,000, and the reported balance is $1,100,000. The difference between the reported balance ($1,100,000) and our projected balance ($900,000) is $200,000, which exceeds our limit ($50,000) so we investigated, but without success. We would propose an audit adjustment $150,000, which is the extent to which the unexplained difference exceeds the limit. If the agency does accept and post the audit adjustment, the potential undetected misstatement would be $50,000, which is the remaining portion of the unexplained difference we did not investigate and they did not correct. If the agency does not accept and post the proposed audit adjustment, audit amount would be $200,000. Of this total, $50,000 would be treated as a potential undetected misstatement due to complete reliance on a substantive analytical procedure, and $150,000 (the rejected adjustment) would be treated as an uncorrected misstatement.
* Example (c): The same facts as (a), above, except that we elect to investigate even though it’s not necessary in the circumstances, and we obtain a reasonable, supported explanation. In this case, there would be no further amount to consider.

1. For limits related to any such analytical procedures affecting line items that do not affect the materiality benchmark, calculate the absolute value of all limits identified under (2), above, for each financial statement, and enter the result in the space indicated in column C.
2. For any such analytical procedures affecting line items that do affect the materiality benchmark, calculate the net effect of all limits identified under (2), above, for each financial statement, and enter the result in the space indicated in column D.

For consideration of the implications of any analytical procedures upon which we placed only partial substantive reliance, see Section 3, Consideration of Other Factors.

**Conclusions**

|  |
| --- |
| **Purpose**  To determine if our audit exposure (audit exposure is the combination of detected misstatements, possible undetected misstatements, and qualitative aspects) is material for our financial statement audit. |
| **Approach**  We analyzed quantitative and qualitative factors potentially affecting our audit risk. The calculated measurable quantitative amounts for each financial statement **(Section II)** represents the total value of (1) the net amount of correcting audit adjustments that were not accepted and booked by XYZ agency, (2) amounts that were considered to be individually immaterial and were not tested on that basis (untested amounts), (3) the sampling precision associated with statistical samples selected for the purposes of performing substantive tests of financial statement balances (or, if no statistical samples selected including an allowance equal to performance materiality), (4) an amount for when no sampling has occurred, and (5) an allowance for the imprecision of substantive analytical procedures on which we placed total reliance. Our analysis was designed to provide a conservative estimate of the risk represented by these conditions, and therefore used conservative assumptions. For example, all untested amounts were considered to be 100% overstated. All statistical calculations were performed by or in consultation with an Audit Sampling Specialist.   We also considered whether other factors were relevant and potentially significant to our evaluation of audit risk. This includes factors that may affect risk, but whose actual dollar effect cannot be measured with any degree of precision (nonmeasurable quantitative factors). We also considered any mitigating factors that may lower the risk. These are documented in **Section III.** |
| **Materiality Benchmark(s)**  Complete as per instructions. Example: We determined that the materiality benchmark was total gross costs because, based upon our judgment, we concluded that it is the most significant element of XXX’s financial statements to users (FAM 230.08). During the planning phase of the audit, we used XXX’s reported $300 million in total gross costs for fiscal year 2015 to compute our performance materiality and tolerable misstatement thresholds. As XXX’s actual total program costs of $315 million for fiscal year 2016 exceeded the prior year amount used in the planning phase calculations, we believe that the performance materiality and tolerable misstatement thresholds used are adequate. Additionally, we assessed the adequacy of our determination to apply the materiality benchmark to each financial statement given the effect of identified misstatements on the various financial statements and line items; we determined that the application of the benchmark was valid. |
| **Sources**  As indexed in Sections II and III. |
| **Conclusions**  Based on considerations of both the quantitative and qualitative aspects of the audit exposure in this analysis, including the effect of amounts not directly affecting the materiality benchmark, we believe that the audit exposure is immaterial. |

|  |  |  |  |
| --- | --- | --- | --- |
| **BALANCE SHEET** | | | |
| **A** | **B** | **C** | **D** |
| **Risk of Material Misstatement (Quantitative)** | **Doc. Ref.** | **Estimated Amounts** | |
| Absolute Value Effect of Factors Not Directly Affecting the Materiality Benchmark | Net Effect of Factors Directly Affecting the Materiality Benchmark, Upon the Materiality Benchmark |
|
| Factual Uncorrected Misstatements:1 |  | $0 | $0 |
| Judgmental Uncorrected Misstatements: |  | 0 | 0 |
| **Subtotal: Factual and Judgmental Uncorrected Misstatements** | | **$0** | **$0** |
| **Estimate of Potential Undetected Misstatements:** |  |  |  |
| Untested Amounts |  | 0 | 0 |
| Combined Sampling Precision; Non-MUS Sample(s) |  | 0 | 0 |
| Combined Sampling Precision; MUS Sample(s) |  | 0 | 0 |
| **[Include Performance Materiality amount if no sampling was performed (and therefore, no global upper error limit amount was included in the 2 rows above)]** |  | 0 | 0 |
| Limits Related to Analytical Procedures Relied Upon as the Only Substantive Test (Complete Reliance) |  | 0 | 0 |
| Other2 |  | 0 | 0 |
| **Subtotal: Estimated Quantitatively Measurable Undetected Misstatements** | | **$0** | **$0** |
| **Total Estimated Quantitatively Measurable Misstatements** | | **$0** | **$0** |
| **Materiality Benchmark ($ amount and benchmark used)** | | **[Add $ amount of benchmark used here]** | **[Describe benchmark used (total assets, total cost, etc.)]** |
| **Total Estimated Quantitatively Measurable Misstatements as a Percentage of Materiality Benchmark** | | **0.0%** | **0.0%** |
| **[Add auditor's note regarding the auditor’s assessment of the percentage.]** | | | |

|  |  |  |  |
| --- | --- | --- | --- |
| **STATEMENT OF NET COST** | | | |
| **A** | **B** | **C** | **D** |
| **Risk of Material Misstatement (Quantitative)** | **Doc. Ref.** | **Estimated Amounts** | |
| Absolute Value Effect of Factors Not Directly Affecting the Materiality Benchmark | Net Effect of Factors Directly Affecting the Materiality Benchmark, Upon the Materiality Benchmark |
|
| Factual Uncorrected Misstatements:1 |  | $0 | $0 |
| Judgmental Uncorrected Misstatements: |  | 0 | 0 |
| **Subtotal: Factual and Judgmental Uncorrected Misstatements** | | **$0** | **$0** |
| **Estimate of Potential Undetected Misstatements:** |  |  |  |
| Untested Amounts |  | 0 | 0 |
| Combined Sampling Precision; Non-MUS Sample(s) |  | 0 | 0 |
| Combined Sampling Precision; MUS Sample(s) |  | 0 | 0 |
| **[Include Performance Materiality amount if no sampling was performed (and therefore, no global upper error limit amount was included in the 2 rows above)]** |  | 0 | 0 |
| Limits Related to Analytical Procedures Relied Upon as the Only Substantive Test (Complete Reliance) |  | 0 | 0 |
| Other2 |  | 0 | 0 |
| **Subtotal: Estimated Quantitatively Measurable Undetected Misstatements** | | **$0** | **$0** |
| **Total Estimated Quantitatively Measurable Misstatements** | | **$0** | **$0** |
| **Materiality Benchmark ($ amount and benchmark used)** | | **[Add $ amount of benchmark used here]** | **[Describe benchmark used (total assets, total cost, etc.)]** |
| **Total Estimated Quantitatively Measurable Misstatements as a Percentage of Materiality Benchmark** | | **0.0%** | **0.0%** |
| **[Add auditor's note regarding the auditor’s assessment of the percentage.]** | | | |

|  |  |  |  |
| --- | --- | --- | --- |
| **STATEMENT OF CHANGES IN NET POSITION** | | | |
| **A** | **B** | **C** | **D** |
| **Risk of Material Misstatement (Quantitative)** | **Doc. Ref.** | **Estimated Amounts** | |
| Absolute Value Effect of Factors Not Directly Affecting the Materiality Benchmark | Net Effect of Factors Directly Affecting the Materiality Benchmark, Upon the Materiality Benchmark |
|
| Factual Uncorrected Misstatements:1 |  | $0 | $0 |
| Judgmental Uncorrected Misstatements: |  | 0 | 0 |
| **Subtotal: Factual and Judgmental Uncorrected Misstatements** | | **$0** | **$0** |
| **Estimate of Potential Undetected Misstatements:** |  |  |  |
| Untested Amounts |  | 0 | 0 |
| Combined Sampling Precision; Non-MUS Sample(s) |  | 0 | 0 |
| Combined Sampling Precision; MUS Sample(s) |  | 0 | 0 |
| **[Include Performance Materiality amount if no sampling was performed (and therefore, no global upper error limit amount was included in the 2 rows above)]** |  | 0 | 0 |
| Limits Related to Analytical Procedures Relied Upon as the Only Substantive Test (Complete Reliance) |  | 0 | 0 |
| Other2 |  | 0 | 0 |
| **Subtotal: Estimated Quantitatively Measurable Undetected Misstatements** | | **$0** | **$0** |
| **Total Estimated Quantitatively Measurable Misstatements** | | **$0** | **$0** |
| **Materiality Benchmark ($ amount and benchmark used)** | | **[Add $ amount of benchmark used here]** | **[Describe benchmark used (total assets, total cost, etc.)]** |
| **Total Estimated Quantitatively Measurable Misstatements as a Percentage of Materiality Benchmark** | | **0.0%** | **0.0%** |
| **[Add auditor's note regarding the auditor’s assessment of the percentage.]** | | | |

|  |  |  |  |
| --- | --- | --- | --- |
| **STATEMENT OF BUDGETARY RESOURCES – TOTAL BUDGETARY RESOURCES (SOURCES)** | | | |
| **A** | **B** | **C** | **D** |
| **Risk of Material Misstatement (Quantitative)** | **Doc. Ref.** | **Estimated Amounts** | |
| Absolute Value Effect of Factors Not Directly Affecting the Materiality Benchmark | Net Effect of Factors Directly Affecting the Materiality Benchmark, Upon the Materiality Benchmark |
|
| Factual Uncorrected Misstatements:1 |  | $0 | $0 |
| Judgmental Uncorrected Misstatements: |  | 0 | 0 |
| **Subtotal: Factual and Judgmental Uncorrected Misstatements** | | **$0** | **$0** |
| **Estimate of Potential Undetected Misstatements:** |  |  |  |
| Untested Amounts |  | 0 | 0 |
| Combined Sampling Precision; Non-MUS Sample(s) |  | 0 | 0 |
| Combined Sampling Precision; MUS Sample(s) |  | 0 | 0 |
| **[Include Performance Materiality amount if no sampling was performed (and therefore, no global upper error limit amount was included in the 2 rows above)]** |  | 0 | 0 |
| Limits Related to Analytical Procedures Relied Upon as the Only Substantive Test (Complete Reliance) |  | 0 | 0 |
| Other2 |  | 0 | 0 |
| **Subtotal: Estimated Quantitatively Measurable Undetected Misstatements** | | **$0** | **$0** |
| **Total Estimated Quantitatively Measurable Misstatements** | | **$0** | **$0** |
| **Materiality Benchmark ($ amount and benchmark used)** | | **[Add $ amount of benchmark used here]** | **[Describe benchmark used (total assets, total cost, etc.)]** |
| **Total Estimated Quantitatively Measurable Misstatements as a Percentage of Materiality Benchmark** | | **0.0%** | **0.0%** |
| **[Add auditor's note regarding the auditor’s assessment of the percentage.]** | | | |

|  |  |  |  |
| --- | --- | --- | --- |
| **STATEMENT OF BUDGETARY RESOURCES – STATUS OF BUDGETARY RESOURCES** | | | |
| **A** | **B** | **C** | **D** |
| **Risk of Material Misstatement (Quantitative)** | **Doc. Ref.** | **Estimated Amounts** | |
| Absolute Value Effect of Factors Not Directly Affecting the Materiality Benchmark | Net Effect of Factors Directly Affecting the Materiality Benchmark, Upon the Materiality Benchmark |
|
| Factual Uncorrected Misstatements:1 |  | $0 | $0 |
| Judgmental Uncorrected Misstatements: |  | 0 | 0 |
| **Subtotal: Factual and Judgmental Uncorrected Misstatements** | | **$0** | **$0** |
| **Estimate of Potential Undetected Misstatements:** |  |  |  |
| Untested Amounts |  | 0 | 0 |
| Combined Sampling Precision; Non-MUS Sample(s) |  | 0 | 0 |
| Combined Sampling Precision; MUS Sample(s) |  | 0 | 0 |
| **[Include Performance Materiality amount if no sampling was performed (and therefore, no global upper error limit amount was included in the 2 rows above)]** |  | 0 | 0 |
| Limits Related to Analytical Procedures Relied Upon as the Only Substantive Test (Complete Reliance) |  | 0 | 0 |
| Other2 |  | 0 | 0 |
| **Subtotal: Estimated Quantitatively Measurable Undetected Misstatements** | | **$0** | **$0** |
| **Total Estimated Quantitatively Measurable Misstatements** | | **$0** | **$0** |
| **Materiality Benchmark ($ amount and benchmark used)** | | **[Add $ amount of benchmark used here]** | **[Describe benchmark used (total assets, total cost, etc.)]** |
| **Total Estimated Quantitatively Measurable Misstatements as a Percentage of Materiality Benchmark** | | **0.0%** | **0.0%** |
| **[Add auditor's note regarding the auditor’s assessment of the percentage.]** | | | |

|  |  |  |  |
| --- | --- | --- | --- |
| **STATEMENT OF BUDGETARY RESOURCES – CHANGES IN OBLIGATIONS** | | | |
| **A** | **B** | **C** | **D** |
| **Risk of Material Misstatement (Quantitative)** | **Doc. Ref.** | **Estimated Amounts** | |
| Absolute Value Effect of Factors Not Directly Affecting the Materiality Benchmark | Net Effect of Factors Directly Affecting the Materiality Benchmark, Upon the Materiality Benchmark |
|
| Factual Uncorrected Misstatements:1 |  | $0 | $0 |
| Judgmental Uncorrected Misstatements: |  | 0 | 0 |
| **Subtotal: Factual and Judgmental Uncorrected Misstatements** | | **$0** | **$0** |
| **Estimate of Potential Undetected Misstatements:** |  |  |  |
| Untested Amounts |  | 0 | 0 |
| Combined Sampling Precision; Non-MUS Sample(s) |  | 0 | 0 |
| Combined Sampling Precision; MUS Sample(s) |  | 0 | 0 |
| **[Include Performance Materiality amount if no sampling was performed (and therefore, no global upper error limit amount was included in the 2 rows above)]** |  | 0 | 0 |
| Limits Related to Analytical Procedures Relied Upon as the Only Substantive Test (Complete Reliance) |  | 0 | 0 |
| Other2 |  | 0 | 0 |
| **Subtotal: Estimated Quantitatively Measurable Undetected Misstatements** | | **$0** | **$0** |
| **Total Estimated Quantitatively Measurable Misstatements** | | **$0** | **$0** |
| **Materiality Benchmark ($ amount and benchmark used)** | | **[Add $ amount of benchmark used here]** | **[Describe benchmark used (total assets, total cost, etc.)]** |
| **Total Estimated Quantitatively Measurable Misstatements as a Percentage of Materiality Benchmark** | | **0.0%** | **0.0%** |
| **[Add auditor's note regarding the auditor’s assessment of the percentage.]** | | | |

|  |  |  |  |
| --- | --- | --- | --- |
| **STATEMENT OF BUDGETARY RESOURCES – BUDGET AUTHORITY AND OUTLAYS** | | | |
| **A** | **B** | **C** | **D** |
| **Risk of Material Misstatement (Quantitative)** | **Doc. Ref.** | **Estimated Amounts** | |
| Absolute Value Effect of Factors Not Directly Affecting the Materiality Benchmark | Net Effect of Factors Directly Affecting the Materiality Benchmark, Upon the Materiality Benchmark |
|
| Factual Uncorrected Misstatements:1 |  | $0 | $0 |
| Judgmental Uncorrected Misstatements: |  | 0 | 0 |
| **Subtotal: Factual and Judgmental Uncorrected Misstatements** | | **$0** | **$0** |
| **Estimate of Potential Undetected Misstatements:** |  |  |  |
| Untested Amounts |  | 0 | 0 |
| Combined Sampling Precision; Non-MUS Sample(s) |  | 0 | 0 |
| Combined Sampling Precision; MUS Sample(s) |  | 0 | 0 |
| **[Include Performance Materiality amount if no sampling was performed (and therefore, no global upper error limit amount was included in the 2 rows above)]** |  | 0 | 0 |
| Limits Related to Analytical Procedures Relied Upon as the Only Substantive Test (Complete Reliance) |  | 0 | 0 |
| Other2 |  | 0 | 0 |
| **Subtotal: Estimated Quantitatively Measurable Undetected Misstatements** | | **$0** | **$0** |
| **Total Estimated Quantitatively Measurable Misstatements** | | **$0** | **$0** |
| **Materiality Benchmark ($ amount and benchmark used)** | | **[Add $ amount of benchmark used here]** | **[Describe benchmark used (total assets, total cost, etc.)]** |
| **Total Estimated Quantitatively Measurable Misstatements as a Percentage of Materiality Benchmark** | | **0.0%** | **0.0%** |
| **[Add auditor's note regarding the auditor’s assessment of the percentage.]** | | | |

|  |  |  |  |
| --- | --- | --- | --- |
| **STATEMENT OF BUDGETARY RESOURCES – AGENCY OUTLAYS, NET** | | | |
| **A** | **B** | **C** | **D** |
| **Risk of Material Misstatement (Quantitative)** | **Doc. Ref.** | **Estimated Amounts** | |
| Absolute Value Effect of Factors Not Directly Affecting the Materiality Benchmark | Net Effect of Factors Directly Affecting the Materiality Benchmark, Upon the Materiality Benchmark |
|
| Factual Uncorrected Misstatements:1 |  | $0 | $0 |
| Judgmental Uncorrected Misstatements: |  | 0 | 0 |
| **Subtotal: Factual and Judgmental Uncorrected Misstatements** | | **$0** | **$0** |
| **Estimate of Potential Undetected Misstatements:** |  |  |  |
| Untested Amounts |  | 0 | 0 |
| Combined Sampling Precision; Non-MUS Sample(s) |  | 0 | 0 |
| Combined Sampling Precision; MUS Sample(s) |  | 0 | 0 |
| **[Include Performance Materiality amount if no sampling was performed (and therefore, no global upper error limit amount was included in the 2 rows above)]** |  | 0 | 0 |
| Limits Related to Analytical Procedures Relied Upon as the Only Substantive Test (Complete Reliance) |  | 0 | 0 |
| Other2 |  | 0 | 0 |
| **Subtotal: Estimated Quantitatively Measurable Undetected Misstatements** | | **$0** | **$0** |
| **Total Estimated Quantitatively Measurable Misstatements** | | **$0** | **$0** |
| **Materiality Benchmark ($ amount and benchmark used)** | | **[Add $ amount of benchmark used here]** | **[Describe benchmark used (total assets, total cost, etc.)]** |
| **Total Estimated Quantitatively Measurable Misstatements as a Percentage of Materiality Benchmark** | | **0.0%** | **0.0%** |
| **[Add auditor's note regarding the auditor’s assessment of the percentage.]** | | | |

|  |  |  |  |
| --- | --- | --- | --- |
| **STATEMENT OF {NAME OF STATEMENT}** | | | |
| **A** | **B** | **C** | **D** |
| **Risk of Material Misstatement (Quantitative)** | **Doc. Ref.** | **Estimated Amounts** | |
| Absolute Value Effect of Factors Not Directly Affecting the Materiality Benchmark | Net Effect of Factors Directly Affecting the Materiality Benchmark, Upon the Materiality Benchmark |
|
| Factual Uncorrected Misstatements:1 |  | $0 | $0 |
| Judgmental Uncorrected Misstatements: |  | 0 | 0 |
| **Subtotal: Factual and Judgmental Uncorrected Misstatements** | | **$0** | **$0** |
| **Estimate of Potential Undetected Misstatements:** |  |  |  |
| Untested Amounts |  | 0 | 0 |
| Combined Sampling Precision; Non-MUS Sample(s) |  | 0 | 0 |
| Combined Sampling Precision; MUS Sample(s) |  | 0 | 0 |
| **[Include Performance Materiality amount if no sampling was performed (and therefore, no global upper error limit amount was included in the 2 rows above)]** |  | 0 | 0 |
| Limits Related to Analytical Procedures Relied Upon as the Only Substantive Test (Complete Reliance) |  | 0 | 0 |
| Other2 |  | 0 | 0 |
| **Subtotal: Estimated Quantitatively Measurable Undetected Misstatements** | | **$0** | **$0** |
| **Total Estimated Quantitatively Measurable Misstatements** | | **$0** | **$0** |
| **Materiality Benchmark ($ amount and benchmark used)** | | **[Add $ amount of benchmark used here]** | **[Describe benchmark used (total assets, total cost, etc.)]** |
| **Total Estimated Quantitatively Measurable Misstatements as a Percentage of Materiality Benchmark** | | **0.0%** | **0.0%** |
| **[Add auditor's note regarding the auditor’s assessment of the percentage.]** | | | |

|  |
| --- |
| **Explanatory Comments2** |
|  |
|  |
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|  |
|  |
|  |
|  |
|  |
| 1Include only the identified factual misstatements due to errors arising from nonstatistical selections or other nonstatistical tests. The full estimated effect of the outcome of statistical tests (projected misstatement) will be included in the combined sampling precision calculations, including the related factual amount. |
| 2Describe in "Explanatory Comments" section, any factor that does not fall into one of the listed categories. |
|  |

Consideration of Other Factors

1. Consider the (1) risk of undetected material misstatement arising from analytical procedures upon which we placed only partial reliance, (2) risk of material understatement, and (3) risk of material misstatement affecting amounts on the financial statements which do not affect the materiality benchmark when considered in relation to the total of the amounts they do affect.
2. There may also be conditions which reduce the risk of material misstatement, in terms of (1) reducing the risk that a misstatement has occurred, and/or (2) reducing the risk that users will perceive a misstatement to be material if it has occurred. On Tab III, list and assess any mitigating factors that are relevant to the uncorrected misstatements and undetected misstatements listed on Tab II. Index to appropriate support.
3. In each section, blank rows may be used and if needed, more rows added for additional factors specific to any given audit.

|  | **Description** | **Explanatory Comments** |
| --- | --- | --- |
| **Other Nonquantitative Factors** | | |
| **1** | Imprecision of analytical procedures upon which only partial reliance was placed |  |
| **2** | Risk of material understatement |  |
| **3** | Risk of material misstatement affecting balances and financial statements that do not affect the materiality benchmark (Tab II, Column C), when considered in relation to the total of the amounts they do directly affect (1) |  |
| **4** | Consideration of all corrected misstatements identified |  |
| **5** | *{insert other factors - reconsider factors noted in FAM 540.10}* |  |
| **Consideration of Mitigating Factors (2)** | | |
| **1** | *{example}* Conclusion that internal control was effective, particularly if there is convincing evidence that the entity monitors internal control over financial reporting in a manner sufficiently effective to further reduce the risk of material misstatement |  |
| **2** | *{example}* Final, overall analytical procedures did not identify any material changes that were not adequately explained and supported |  |
| **3** | *{insert other mitigating factors}* |  |
|  | **Notes:** | |
|  | 1For example, if the materiality benchmark is total assets; exposure affecting liability amounts on the balance sheet would not directly affect the benchmark and would therefore be entered to column C on Tab II. As a qualitative factor, the auditor should assess whether the quantifiably measurable exposure affecting liability amounts, when considered in relation to total liabilities, was relevant and potentially significant. | |
|  | 2Conditions which may reduce the risk of material misstatement, in terms of (1) reducing the risk that a misstatement has occurred, and/or (2) reducing the risk that users will perceive a misstatement to be material if it has occurred. | |

550 – Perform Other Reporting Phase Audit Procedures

1. The auditor should perform procedures to

* obtain legal representations (see FAM 550.02 through .04);
* identify material subsequent events and subsequently discovered facts (see FAM 550.05 through .09);
* obtain management representations (see FAM 550.10 through .14);
* assess related party relationships and transactions (see FAM 550.15);
* communicate with those charged with governance (see FAM 550.16 through .19);
* assess RSI and other information (see FAM 550.20); and
* consider the entity’s ability to continue as a going concern (see FAM 550.21).

Obtain Legal Representations

As discussed in FAM 280, the auditor should design and perform audit procedures to identify litigation, claims, and assessments involving the entity that may give rise to a risk of material misstatement required by AU-C 501.16 through .23 and the supplement in FAM 1002. In considering any liabilities, contingencies, or uncertainties that may affect the federal entity or its financial statements, the auditor shouldseek direct communication with and obtain representations from the entity’s in-house and external legal counsel regarding litigation, claims, and assessments that may give rise to a risk of material misstatement (AU-C 501.16 through .19). The auditor should do so through a letter of inquiry, prepared by management, and sent by the auditor requesting the entity’s legal counsel to communicate directly with the auditor (AU-C 501.18). Further guidance on these inquiries, as well as on interpreting and using responses received from legal counsel, is provided in AU-C 501, FAM 1002, Office of Management and Budget (OMB) audit guidance, and FAM 280. See FAM 1002 for an example letter of inquiry.

The Department of Justice (Justice) may be involved as the legal counsel of the federal entity under audit; Justice’s level of involvement as an external legal counsel may vary. In considering whether to obtain legal representations from Justice, the auditor should consider Justice’s level of involvement in litigation affecting the entity. If the auditor determines not to obtain legal representations directly from Justice, the auditor should document such determinations in accordance with AU-C 501.18 through .20.

The inquiries and responses should cover the entire period (or as close as practicable) under audit and the subsequent period through the date of the auditor’s report. It is preferable that the entity’s legal counsel’s response be as close to the date of the auditor’s report as practicable in the circumstances (AU-C 501.A53). The auditor may specify the earliest acceptable effective date of a response and the latest date by which it is to be sent to the auditor. If a long period elapses from the date of the legal counsel’s response to the date of the auditor’s report or to the report release date, the auditor should obtain an update, either written or oral (and include in audit documentation), to identify whether there have been any significant changes in legal representation letter matters occurring up to the audit report date or report release date.

Identify Material Subsequent Events and Subsequently Discovered Facts

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

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

The auditor should follow AU-C 560.13 and AU-C 700 on dating the auditor’s report if management appropriately revises the financial statements for subsequent events and should obtain updated or additional representations from management, as appropriate. See AU-C 560.13. If management does not appropriately revise the financial statements for a subsequent event, the auditor should modify the opinion (express a qualified or an adverse opinion), as discussed in AU-C 705, FAM 580, and AU-C 560.14.

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

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

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

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

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

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

Obtain Management Representations

As discussed in FAM 280.03, the auditor should request written representations from entity management with appropriate responsibilities for the financial statements and knowledge of the related matters (AU-C 580.09) (this may include those charged with governance when appropriate). These representations should be in the form of a representation letter addressed to the auditor (AU-C 580.21). These representations supplement the other audit procedures performed by the auditor but are not a substitute for them. Written representations help avoid any misunderstandings that could arise if only oral representations were received from management. In some circumstances, corroborating evidence for representations may not be readily available, such as for those involving management’s intent concerning a future transaction or business decision.

The auditor should request that entity management provide the representations required by AU-C 580.10 through .19, including that management has fulfilled its responsibilities, as set out in the terms of the engagement. If the auditor is engaged to express an opinion on the effectiveness of internal control over financial reporting, the auditor should request that management provide the representations required by AU-C 940.57. These representations are discussed further in FAM 1001 and included in the example representation letter in FAM 1001 A.

Additionally, the auditor generally should determine whether to request representations on other matters unique to the entity under audit. If the auditor determines that it is necessary to obtain specific representations to support other audit evidence, the auditor should request such representations (AU-C 580.19). Examples of written representations obtained from management are provided in AU-C 580.A35 and .A36. Additional guidance for these representations is provided in FAM 1001 and the example representation letter provided at FAM 1001 A.

Auditors should obtain further representations from management in addition to those required by U.S. generally accepted auditing standards. Such further management representations concern management’s assessment of the effectiveness of internal control and assumptions regarding the statement of social insurance, as applicable. For CFO Act agencies, auditors also should obtain management representations about substantial compliance of the entity’s financial management systems with the three requirements of FFMIA. Additionally, OMB audit guidance includes representations regarding the consistency of budget data in the statement of budgetary resources and specific budget data submitted for preparing the annual budget of the U.S. government.

If the auditor has concerns about the competence, integrity, ethical values, or diligence of management or about management’s commitment to, or enforcement of, these, the auditor should determine the effect that such concerns may have on the reliability of representations (oral and written) and audit evidence in general (AU-C 580.22).

If a representation is inconsistent with other audit evidence, the auditor should perform audit procedures, such as identifying and understanding the circumstances to attempt to resolve the matter. If the matter remains unresolved, or if management does not provide one or more of the requested representations, the auditor should (a) discuss the matter with management; (b) reconsider the assessment of the competence, integrity, ethical values, or diligence of management or of management’s commitment to, or enforcement of, these; and (c) determine the effect that these may have on the reliability of representations and audit evidence in general (AU-C 580.23 and .26). The auditor should also determine whether this may indicate a scope limitation sufficient to preclude an unmodified opinion (AU-C 580.24 and .26). If the auditor concludes that management’s written representations are not reliable or complete, the auditor should consider the effects on the assessment of risk and the integrity of management. Further, the auditor should determine its ability to complete the audit and/or the effects on the auditor’s report. See FAM 580 for additional reporting guidance (AU-C 580.25). For example, in the case of identified inconsistencies between one or more written representations and audit evidence obtained from another source, the auditor may consider whether the risk assessment remains appropriate and, if not, may revise the risk assessment and determine the nature, timing, and extent of further audit procedures to respond to the assessed risks.

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

The auditor may find it useful to discuss representations with management early in the audit to identify and resolve any difficulties related to obtaining these representations at the completion of the audit. This is particularly true for first year audits, when standards change, and when management changes (see FAM 280.03).

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

Entity management should date the representation letter as of the date of the auditor’s report. Typically, senior management will review the final financial statements and disclosures to take responsibility for them before signing the representation letter. Although the auditor is not required to perform audit procedures regarding the financial statements after the date of the auditor’s report, the auditor may determine that an updated management representation letter is necessary to provide evidence concerning events subsequent to the report date. For example, the auditor may determine that updated management representations are needed to (1) support a determination that subsequent events identified after the report date do not require revisions to the financial statements; (2) support a revised report date due to revisions to the financial statements as a result of a subsequent event; or (3) provide evidence that no subsequent events have occurred, particularly where the financial statements are not issued shortly after the audit report release date.

Assess Related Party Relationships and Transactions

The auditor should evaluate whether the identified related party relationships and transactions have been appropriately accounted for and disclosed. The auditor should also evaluate whether the effects of the related party relationships and transactions prevent the financial statements from achieving fair presentation (AU-C 550.26). FAM 280, FAM 904, and AU-C 550 provide guidance on related party relationships and transactions. Such related party relationships and transactions may include, as defined by FASAB, disclosure entities, related parties, and public-private partnerships (FAM 904.03). SFFAS 47 provides the definitions of related parties and disclosure entities and related disclosure requirements for federal entities. SFFAS 49 provides the criteria for public-private partnerships and related disclosure requirements for federal entities.

**Communicate with Those Charged with Governance**

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

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

* Explain to those charged with governance why the auditor considers a significant accounting practice that is acceptable under the applicable financial reporting framework not to be the most appropriate to the particular circumstances.
* Determine that those charged with governance are informed about the process used by management in formulating particularly sensitive accounting estimates, including fair value estimates, and about the basis for the auditor’s conclusion regarding the reasonableness of those estimates (AU-C 260.12.a). See AU-C 260.A24 through .A25 for items the auditor may consider communicating related to accounting practices.

1. Significant difficulties, if any, that the auditor encountered during the audit (AU-C 260.12.b). See AU-C 260.A26 and AU-C 730.06 for examples of difficulties, such as significant delays in receiving required information, extensive unexpected effort necessary to obtain sufficient appropriate audit evidence, an unnecessarily brief time within which to complete the audit, and inability to complete procedures related to RSI.
2. Uncorrected misstatements, other than those the auditor believes are clearly trivial, if any, and the effect that they, individually or in the aggregate, may have on the auditor’s opinion on the financial statements (see FAM 595 C, example 2). The auditor should request correction of these misstatements and should communicate the material uncorrected misstatements individually. When there are a large number of individually immaterial uncorrected misstatements, the auditor may communicate the number and overall monetary effect of the uncorrected misstatements, rather than the details of each uncorrected misstatement. The auditor should also communicate the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements taken as a whole (AU-C 260.13). The auditor generally should discuss the reasons for, and the implications of, failing to correct misstatements, taking into account the size and nature of a misstatement judged in the surrounding circumstances, and possible implications with regard to future financial statements (AU-C 260.A30).
3. Any disagreements with management, regardless of whether they were satisfactorily resolved, about matters that individually or in the aggregate could be significant to the entity’s financial statements or the auditor’s report (AU-C 260.12.c). Examples of disagreements are included in AU-C 260.A28. For this purpose, disagreements do not include differences of opinion based on incomplete facts or preliminary information that are later resolved.
4. Other findings or issues, if any, arising from the audit that are, in the auditor’s professional judgment, significant and relevant to those charged with governance regarding their responsibility to oversee the financial reporting process (AU-C 260.12.d).
5. Unless all of those charged with governance are involved in managing the entity, the auditor also should communicate

* Material corrected misstatements that were brought to the attention of management as a result of audit procedures (see FAM 595 C, example 3) (AU-C 260.14.a).
* Management representations requested by the auditor (AU-C 260.14.d). The auditor may provide those charged with governance a copy of management’s written representations (AU-C 260.A33).
* The auditor’s views about significant matters that were the subject of management’s consultations with other accountants, if any, on accounting and auditing matters when the auditor is aware that such consultation has occurred (AU-C 260.14.c).
* Any significant findings or issues arising from the audit that were discussed with management or that were the subject of correspondence with management (AU-C 260.14.b). AU-C 260.A32 includes examples of significant matters that the auditor may communicate.

1. Identified or suspected fraud involving (1) management, (2) employees who have significant roles in internal control, and (3) others when the fraud results in a material misstatement in the financial statements. If the auditor suspects fraud involving management, the auditor should discuss the nature, timing, and extent of audit procedures necessary to complete the audit. Also, the auditor should discuss any other matters involving fraud that are, in the auditor’s professional judgment, relevant to those charged with governance’s responsibility (AU-C 240.40 through .41).
2. Suspected noncompliance with laws and regulations, when the auditor determines it is appropriate to discuss with those charged with governance (AU-C 250.18).
3. Procedures performed relating to other information included in documents containing the audited financial statements and the results of these procedures (AU-C 720.08).
4. Matters involving identified or suspected noncompliance with laws and regulations that come to the auditor’s attention during the audit, unless clearly inconsequential (AU-C 250.21). If, in the auditor’s professional judgment, the matter is believed to be intentional and material, the auditor should communicate the matter as soon as practicable (AU-C 250.22).
5. Significant deficiencies and material weaknesses identified during the audit, including those that were remediated during the audit (AU-C 265.11). For an integrated audit, the auditor should communicate in writing to management and those charged with governance significant deficiencies and material weaknesses identified during the integrated audit, including those that were remediated during the integrated audit and those that were previously communicated but have not yet been remediated (AU-C 940.59).
6. Significant findings and issues in connection with the entity’s related parties, unless all those charged with governance are involved in managing the entity (AU-C 550.27).
7. If management has imposed a limitation on the scope of the audit and refuses to remove the limitation, the auditor should communicate the matter to those charged with governance, unless all of those charged with governance are involved in managing the entity (AU-C 705.11 and .12).
8. A material misstatement of the financial statements that relates to the omission of information required to be presented or disclosed (AU-C 705.20).
9. If the auditor expects to modify the opinion, the circumstances that led to the expected modification of the opinion and the proposed wording of the modification (AU-C 705.29).
10. If the auditor expects to include an emphasis-of-matter and/or other-matter paragraph in the auditor’s report, this expectation and the proposed wording of this paragraph (AU-C 706.09).
11. A material inconsistency or material misstatement of fact that requires revision to other information and management refuses to make the revision (AU-C 720.12, .15, and .18).
12. Matters that arose during the audit that were communicated to those charged with governance and satisfactorily resolved do not need to be included in the communication.

AU-C 260.A23 through .A33 provide further guidance on these matters.

As discussed in FAM 215.31, the auditor should communicate significant findings and issues in writing if, in the auditor’s professional judgment, oral communication would not be adequate (AU-C 260.16). Factors that may affect whether to communicate orally or in writing, the extent of detail or summarization in the communication, and the formality of the communication are discussed in AU-C 260.A39 through .A41. Effective communication may involve formal presentations and written reports as well as less formal communications, including discussions (AU-C 260.A39 through .A41).

As discussed in FAM 215.35 and .36, the auditor should communicate with those charged with governance on a timely basis and should document all communications, including when and to whom they were made (AU-C 260.18 and .20).

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

* The appropriateness and timeliness of actions taken by those charged with governance in response to matters communicated by the auditor.
* The apparent openness of those charged with governance in their communications with the auditor.
* The willingness and capacity of those charged with governance to meet with the auditor without management present.
* The apparent ability of those charged with governance to fully comprehend matters communicated by the auditor, such as the extent to which those charged with governance probe issues and question recommendations made to them.
* Difficulty in establishing with those charged with governance a mutual understanding of the form, timing, and expected general content of communications.
* When all or some of those charged with governance are involved in managing the entity, their apparent awareness of how matters discussed with the auditor affect their broader governance responsibilities, as well as their management responsibilities. (AU-C 260.19, .A44, .A45)

If the two-way communication between the auditor and those charged with governance is not adequate, the auditor should evaluate the effect, if any, on the auditor’s assessment of the risks of material misstatement and ability to obtain sufficient appropriate audit evidence, and should take appropriate action. If the situation cannot be resolved, the auditor may take actions as discussed in AU-C 260.A46, including modifying the auditor’s opinion for a limitation on the scope of the audit (AU-C 260.19 and .A46).

Assess RSI and Other Information

The auditor should conclude on procedures performed for RSI and other information. For RSI, the auditor should determine whether there are any omissions or material departures from FASAB guidance based on the procedures performed in FAM 280.05. For other information, the auditor should determine whether there are any material inconsistencies with the audited financial statements based on the procedures performed in FAM 280.06. Further, if the auditor finds a misstatement of fact, the auditor should consult AU-C 720. See FAM 580 regarding how the auditor reports on the work performed in these areas.

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

The auditor should evaluate whether there is substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time based on the results of the audit procedures performed pursuant to AU-C 570.

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

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

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

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

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

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

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

The auditor should perform audit procedures to evaluate whether the overall presentation of the financial statements, including the related disclosures, is in accordance with U.S. GAAP or other applicable financial reporting framework (AU-C 330.26). (See FAM 215.14 for discussion of financial reporting framework.) This evaluation should include consideration of the qualitative aspects of the entity’s accounting practices, including indicators or possible bias in management’s judgments (AU-C 700.15). This evaluation should include the following:

1. Whether, in view of the requirements of the applicable financial reporting framework,

* the financial statements adequately disclose the significant accounting policies selected and applied;
* the accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;
* the accounting estimates made by management are reasonable;
* the information presented in the financial statements is relevant, reliable, comparable, and understandable;
* the financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements; and
* the terminology used in the financial statements, including the title of each financial statement, is appropriate (AU-C 700.16).

1. Whether the financial statements achieve fair presentation should also include consideration of the following:

* the overall presentation, structure, and content of the financial statements and
* whether the financial statements, including the related notes, represent the underlying transactions and events in a manner that achieves fair presentation (AU-C 700.17).

1. Whether the financial statements adequately refer to or describe the applicable financial reporting framework (AU-C 700.18).

The auditor can meet the requirement for the above evaluations by completing the Federal Financial Reporting Checklist.[[5]](#footnote-5) This checklist also can assist the entity in preparing federal entity financial statements with appropriate and adequate disclosure in accordance with U.S. GAAP.

For accounting estimates with significant risks, the auditor should evaluate the adequacy of the disclosure of estimation uncertainty in the financial statements (AU-C 540.20). Even when the disclosures are in accordance with U.S. GAAP, the auditor may conclude that the disclosure of estimation uncertainty is inadequate in light of the circumstances and facts involved. The auditor’s evaluation of adequacy increases in importance the greater the range of possible outcomes of the estimate. (AU-C 540.A130)

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

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

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

580 – Draft Reports

1. At the conclusion of the audit, the auditor should draft written reports, which include the auditor’s conclusions on

* the financial statements (see FAM 580.02 through .42);
* internal control over financial reporting (see FAM 580.43 through .73);
* for CFO Act agencies, whether the financial management systems comply substantially with the requirements of FFMIA—federal financial management systems requirements, federal accounting standards (U.S. GAAP), and the *U.S. Government Standard General Ledger* (SGL) at the transaction level (see FAM 580.74 through .78);[[6]](#footnote-6) and
* compliance with applicable laws, regulations, contracts, and grant agreements (see FAM 580.79 through .86).

The auditor should also include in the draft written reports a description of the procedures performed (FAM 280.05 through .06) on

* RSI, including MD&A (see FAM 580.16 and 580.37), and
* other information included in documents containing the audited financial statements (see FAM 580.16 and 580.37).

Financial Statement Reporting

The auditor should form an opinion on whether the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework (AU-C 700.13).

Audit Scope

To express an opinion, first the auditor should determine if the audit has been conducted in accordance with GAGAS and, if applicable, OMB audit guidance. The auditor should conclude whether the auditor has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error (AU-C 700.14a), as discussed in FAM 560 and 570. If the auditor is not able to perform all procedures considered necessary, the scope of the audit is restricted, and the auditor should consider whether to modify the GAGAS compliance statement in the report, as discussed in GAGAS (2018) 2.17b, 2.18 and 2.20, and determine whether to qualify or disclaim an opinion.

Limitations on the scope of the auditor’s work resulting in the auditor’s inability to obtain sufficient, appropriate audit evidence may be imposed by the entity, may be caused by circumstances beyond the entity’s control, or may result from circumstances related to the nature or the timing of the audit work. Examples of scope limitations are included in AU-C 705.A8 through .A12. Limitations imposed by the entity may have other implications for the audit, such as the auditor’s assessment of risk of material misstatement due to fraud.

The auditor should conclude whether sufficient, appropriate audit evidence has been obtained to reduce the risk of undetected material misstatements to an appropriately low level in the financial statements. When forming this conclusion, the auditor should consider all relevant audit evidence regardless of whether it appears to corroborate or contradict the assertions in the financial statements (AU-C 330.28). AU-C 330.A75 presents factors that may influence this conclusion on the sufficiency and appropriateness of audit evidence.

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

If the auditor has not obtained sufficient appropriate audit evidence about a relevant assertion, the auditor should attempt to obtain further audit evidence (AU-C 330.29). If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor should consider whether to express a qualified opinion or to disclaim an opinion and include the reasons for that inability in the basis for the modification paragraph (AU-C 705.21).

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

Departure from U.S. GAAP (Misstatements)

The auditor should evaluate whether the financial statements as a whole, including the related disclosures, are materially misstated based on a departure from U.S. GAAP, as discussed in FAM 560. If such a departure exists, the auditor should determine the effects of the departure on the financial statements, considering both quantitative and qualitative aspects. The auditor should conclude whether the effects of the misstatements, individually or in the aggregate, are (1) material and (2) pervasive to the financial statements. See FAM 580.29 for further discussion.

In rare cases when the auditor can demonstrate that compliance with U.S. GAAP would result in misleading financial statements, the auditor may issue an unmodified opinion that includes a description of the nature of the departure; the effects, if practicable; and why compliance with U.S. GAAP would result in misleading financial statements. The reviewer should approve the auditor’s conclusion in these circumstances.

Uncertainties

Uncertainties are matters affecting the financial statements whose outcome is expected to be resolved at a future date when conclusive evidence becomes available and that could result in a modified opinion. Uncertainties may be related to the resolution of litigation or the valuation of assets, such as real estate owned, and include the contingencies discussed in SFFAS 5, as amended by SFFAS 12, as well as other matters (see FAM 905 for discussion of auditing accounting estimates). In these circumstances, management is responsible for estimating the effect of future events on the financial statements or determining that a reasonable estimate cannot be made and making the required disclosures, based on management’s analysis of existing conditions. An audit includes an assessment of whether the audit evidence is sufficient to support management’s analysis. Absence of information related to the outcome of an uncertainty does not necessarily indicate that the audit evidence supporting management’s assessment is not sufficient. Rather, the auditor’s professional judgment regarding the sufficiency of the audit evidence is based on the audit evidence that is, or should be, available. If, after considering the existing conditions and available evidence, the auditor concludes that sufficient appropriate audit evidence supports management’s assessments about the nature of a matter involving an uncertainty and its presentation or disclosure in the financial statements, an unmodified opinion ordinarily is appropriate (AU-C 705.A13).

In cases involving multiple uncertainties, the auditor may conclude that it is not possible to form an opinion on the financial statements as a whole due to the interaction and possible cumulative effects of the uncertainties (AU-C 705.A14).

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

Comparative Information and Inconsistencies with Financial Statements

Comparative information is defined as prior period information presented for purposes of comparison with current period amounts or disclosures that is not in the form of a complete set of financial statements. Comparative information includes prior period information presented as condensed financial statements or summarized financial information (AU-C 700.11).

The auditor should evaluate whether the comparability of the financial statements between periods has been materially affected by a change in accounting principle or by adjustments to correct a material misstatement in previously issued financial statements (AU-C 708.05, AU-C 700.48 through .51). The auditor’s evaluation should include all periods covered by the auditor’s opinion or the prior period if the auditor’s opinion only covers the current period, regardless of whether the prior period’s financial statements are presented. The auditor should also evaluate whether the financial statements for the periods being reported on are consistent with previously issued financial statements for the relevant periods (AU-C 708.06).

If the auditor identifies material inconsistencies between the comparative financial statements, the auditor will need to determine the effect on the auditor’s opinion and include an emphasis-of-matter paragraph. The auditor should see AU-C 705 and AU-C 708 for further guidance. If the auditor becomes aware of a material misstatement in the prior period financial statements, the auditor should see FAM 580.91 and AU-C 700 .51 through .53 and .55.

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

If comparative information is presented but not covered by the auditor’s opinion, the auditor should clearly indicate in the auditor’s report the character of the auditor’s work, if any, and the degree of responsibility the auditor is taking (AU-C 700.47).

If comparative information is presented and the auditor has been engaged to express an opinion on all periods presented, the auditor should consider whether the information included for the prior period(s) contains sufficient detail to constitute a fair presentation in accordance with the applicable reporting framework (AU-C 700.48).

Report Format

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

Information that is not required by the applicable financial reporting framework but is nevertheless presented as part of the basic financial statements should be covered by the auditor’s opinion if it cannot be clearly differentiated, such as being identified as “unaudited” (AU-C 700.59).

The auditor’s report should be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor’s opinion on the financial statements, including evidence that

* the audit documentation has been reviewed;
* all the statements that the financial statements comprise, including the related notes, have been prepared; and
* management has asserted that they have taken responsibility for those financial statements (AU-C 700.41).

If the auditor identifies a material subsequent event for disclosure in the report, as discussed in FAM 550, the auditor should follow guidance in AU-C 560 with respect to report dating.

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

Types of Reports

If the auditor can express an opinion, the auditor may issue one of the following opinion types: (1) unmodified or (2) modified, which may be a qualified opinion or an adverse opinion. If an opinion cannot be expressed, the auditor should issue a disclaimer of opinion report. Additionally, the auditor may be required or may choose to include an emphasis-of-matter and/or other-matter paragraph as discussed below.

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

If the auditor expresses an opinion only on a single financial statement, or specific elements, accounts, or items of a financial statement, the auditor should follow AU-C 805.

Unmodified Opinion

In an unmodified opinion on the financial statements, the auditor concludes that the financial statements and accompanying notes are presented fairly, in all material respects, as of the specified date in accordance with U.S. GAAP (AU-C 700.19).[[7]](#footnote-7) The auditor should follow the requirements of AU-C 700.23 through .40 regarding specific wording and structure of the auditor’s report, as specified in FAM 595 A. Additionally, the auditor should include an emphasis-of-matter and/or other-matter paragraph to the unmodified report in certain circumstances, as discussed below.

Types of Modified Opinions

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

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

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

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

1. the auditor’s conclusions on whether uncorrected misstatements are material, individually or in the aggregate, to the financial statements, as discussed in FAM 540 and AU-C 450.11 (AU-C 700.14b);
2. the auditor’s conclusions on whether the financial statements are prepared, in all material respects, in accordance with the requirements of the applicable reporting framework, including consideration of the qualitative aspects of the entity’s accounting practices, including indicators of possible bias in management’s judgments, as discussed in FAM 560.05 (AU-C 700.15);
3. the results of the auditor’s evaluation of the financial statement disclosure of accounting policies, the selection of accounting policies, and other items specified in AU-C 700.16a through .16f, as discussed in FAM 560;
4. the results of the auditor’s evaluation about whether the financial statements achieve fair presentation considering the factors in AU-C 700 .17a and .17b, as discussed in FAM 560; and
5. the results of the auditor’s evaluation about whether the financial statements adequately refer to or describe the applicable reporting framework per AU-C 700.18 and as discussed in FAM 560.

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

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

The auditor should modify the opinion in the auditor’s report if the auditor concludes that based on the audit evidence obtained, the financial statements as a whole are materially misstated or the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement (AU-C 700.20, AU-C 705.07).

When the auditor modifies the opinion on the financial statements, the auditor should include a paragraph in the auditor’s report that provides a description of the matter giving rise to the modification (using a heading that includes Basis for Qualified Opinion, Basis for Adverse Opinion, or Basis for Disclaimer of Opinion) (AU-C 705.17 and .22).

1. If the auditor concludes that it is necessary to express an adverse opinion or disclaim an opinion on the entity’s complete set of financial statements as a whole, an unmodified opinion on a specific element in the same auditor’s report would contradict the adverse opinion or disclaimer of opinion on the entity’s complete set of financial statements as a whole and would be tantamount to expressing a piecemeal opinion (which is prohibited). In the context of a separate audit of a specific element that is included in those financial statements, when the auditor nevertheless considers it appropriate to express an unmodified opinion on that specific element, the auditor should only do so if that opinion is expressed in an auditor’s report that is neither published with nor otherwise accompanies the auditor’s report containing the adverse opinion or disclaimer of opinion and
2. the specific element does not constitute a major portion of the entity’s complete set of financial statements or the specific element is not, or is not based upon, the entity's stockholders’ equity or net income or the equivalent.

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

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

If there is a predecessor auditor’s opinion regarding the prior period’s financial statements, the objective of the successor auditor still includes obtaining sufficient appropriate audit evidence regarding opening balances about whether

1. opening balances contain misstatements that materially affect the current period’s financial statements and
2. appropriate accounting policies reflected in the opening balances have been consistently applied in the current period’s financial statements or changes thereto are appropriately accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework (see AU-C 510 for further guidance).

If the auditor concludes that the opinion on the financial statements should be modified, the auditor should revise the auditor’s report to reflect the specific wording changes required by AU-C 705 .17 through .28. Specific wording is provided for qualified opinions, adverse opinions, and disclaimers of opinion.

Qualified Opinion

The auditor should express a qualified opinion, as discussed in AU-C 705.08, when conditions exist as follows:

* the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material but not pervasive to the financial statements (see FAM 580.09) or
* the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive. (See FAM 580.27 through .33.)

AU-C 705 provides guidance on qualified opinions.

Adverse Opinion

An adverse opinion is expressed on the financial statements **taken as a whole** when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements (AU-C 705.09).

Guidance on adverse opinions is provided in AU-C 705.

Disclaimer of Opinion

In a disclaimer of opinion, the auditor does not express an opinion on the financial statements. The auditor should disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive (AU-C 705.10). Guidance on a disclaimer of opinion is provided in AU-C 705.

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

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

| Situation | FAM paragraph and further guidance |
| --- | --- |
| **Relating to the financial statements** | |
| 1. Insufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement (also referred to as limitations on the scope of the audit). (AU-C 705.07.a and .b) | FAM 580.27–.33  AU-C 705 Illustration 4 (qualified)  AU-C 705 Illustrations 5 and 6 (disclaimer) |
| 1. Effects of uncertainties on an audit opinion. | FAM 580.36 |
| 1. Inconsistencies of comparability between the financial statements for all periods presented, including changes in accounting principles. (AU-C 708) | FAM 580.41 |
| 1. Material departures from U.S. GAAP resulting in a qualified or adverse opinion. (AU-C 705.07.a) | FAM 580.34–.35  AU-C 705 Illustrations 1 and 2 (qualified)  AU-C 705 Illustration 3 (adverse) |
| 1. Procedures performed on RSI (which includes MD&A (AU-C 730)) and other information included in documents containing the audited financial statements (AU-C 720) and any issues identified by the auditor based on applied procedures. | FAM 580.16 and FAM 595A |
| **Relating to internal control** | |
| 1. Scope limitation resulting in a disclaimer of opinion on internal control. | FAM 580.52–.54 |
| 1. Material weaknesses and significant deficiencies in a report or opinion on internal control or other control deficiencies that the auditor has decided to describe in the audit report. | FAM 580.56–.58  FAM 595 B Example 1 (material weakness in internal control)  FAM 595 B Example 2 (significant deficiency in internal control) |
| 1. Material inconsistencies between the Summary of Management’s Report on Internal Controls prepared under FMFIA and the results of the auditor’s evaluation of internal control. | FAM 580.73 |
| 1. Purpose of audit was not to give an opinion on internal control, and significant deficiencies or material weaknesses were found. | FAM 580.61–.62  AU-C 265 |
| **Relating to financial management systems’ substantial compliance with FFMIA requirements (for CFO Act agencies)** | |
| 1. Instances of lack of entity financial management systems’ substantial compliance with the three requirements of FFMIA for CFO Act agencies. | FAM 580.74–.77 |
| **Relating to compliance with applicable laws, regulations, contracts, and grant agreements** | |
| 1. Scope limitation—some significant provisions of applicable laws, regulations, contracts, and grant agreements could not be tested. | FAM 580.84–.86 |
| 1. Scope limitation—all significant provisions of applicable laws, regulations, contracts, and grant agreements could not be tested—disclaimer. | FAM 580.84–.86 |
| 1. Reportable noncompliance—instances of noncompliance with significant provisions of laws, regulations, contracts, and grant agreements that are reportable under GAGAS (which incorporates U.S. GAAS) or OMB audit guidance that are not clearly inconsequential. | FAM 580.82–.83 |
| 1. Material noncompliance with significant provisions of applicable laws, regulations, contracts, and grants agreements. | FAM 580.82–.83 |

As discussed in AU-C 706, the auditor should add an emphasis-of-matter and/or other-matter paragraph when certain conditions exist. Additionally, the auditor may include emphasis-of-matter and/or other-matter paragraphs in the report based on the auditor’s professional judgment. Inclusion of an emphasis-of-matter paragraph does not affect the auditor’s opinion, including an unmodified opinion (AU-C 706.A5).

***Emphasis-of-Matter Paragraph***

If the auditor considers it necessary to draw users’ attention to a matter appropriately presented or disclosed in the financial statements that in the auditor’s professional judgment, is of such importance that it is fundamental to users’ understanding of the financial statements, the auditor should include an emphasis-of-matter paragraph in the auditor’s report, provided that the auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated in the financial statements. Such a paragraph should refer only to information presented or disclosed in the financial statements (AU-C 706.06).

The auditor should follow the requirements of AU-C 706.07 for specific wording and placement of emphasis-of-matter paragraphs in the auditor’s report.

***Other-Matter Paragraph***

If the auditor considers it necessary to communicate a matter other than those presented or disclosed in the financial statements that in the auditor’s professional judgment, is relevant to users’ understanding of the audit, the auditor’s responsibilities, or the auditor’s report, the auditor should do so in an other-matter paragraph in the auditor’s report (AU-C 706.08). See AU-C 706.A6 through .A11 for additional guidance on other-matter paragraphs.

The auditor should follow the requirements of AU-C 706.08 for specific wording and placement of other-matter paragraphs in the auditor’s report.

The following is a list of conditions that may require the auditor to include an emphasis-of-matter and/or other-matter paragraph. This is not an all-inclusive list. The auditor should refer to the related AU-C section for further requirements and guidance. (See FAM 580.37.)

1. Subsequently discovered facts that become known to the auditor after the report release date. See FAM 580.91, AU-C 560.16c, and AU-C 700.53 for further guidance.
2. The auditor has substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time based on the results of the audit procedures performed (see AU-C 570.15 through .16).
3. The accounting principles or their method of application changes between periods and the effect on the financial statements is material. For a discussion of consistency, see FAM 580.14.
4. Certain situations related to prior period financial statements that are audited by a predecessor auditor or are not audited (AU-C 700.54 through .57, AU-C 510).
5. When the auditor identifies a material inconsistency prior to the report release date that requires revision of the other information and management refuses to make the revision, the auditor should communicate this matter to those charged with governance and include in the auditor’s report an other-matter paragraph describing the material inconsistency, in accordance with AU-C 706.
6. Procedures performed on RSI (including MD&A) and other information included in documents containing the audited financial statements and any issues identified by the auditor based on applied procedures, as discussed in FAM 280.05 and FAM 280.06 (AU-C 730.07, AU-C 720.12). If the auditor finds that management’s representations about internal control in the MD&A are inappropriate, the auditor should describe the issue of the inconsistency in an Other Matters section of the auditor’s report.
7. There is a departure from U.S. GAAP that has a material effect on the financial statements, and the auditor can demonstrate that the financial statements would be misleading without this departure (see the Code of Professional Conduct of the AICPA such as 1.320.001 Accounting Principles Rule).

GAGAS (2018) 6.57 requires the auditor to obtain and report the views of entity management concerning the findings, conclusions, and recommendations in the audit report, as well as any planned corrective actions. The entity comments and (auditor) evaluation section of the report discusses the extent to which the entity agrees with the facts and conclusions presented by the auditor and the reasons for any disagreements. The auditor should evaluate any disagreements that the entity expresses and present the auditor’s view. The auditor may also outline in the report entity’s description of the efforts it is taking to correct or mitigate matters. The auditor should disclaim an opinion on this information. (See FAM 580.87 through .89.)

Internal Control

Federal financial auditors may take one of two different approaches to reporting on internal control: (1) management provides an assessment about the effectiveness of its internal control and the auditor expresses an opinion on internal control or on management’s assessment following the guidance in AU-C 940 (see FAM 580.51 through .60)[[8]](#footnote-8) or (2) the auditor reports material weaknesses and significant deficiencies found but does not give an opinion on internal control (see FAM 580.61 through .62). OMB reporting guidance requires management to include representations about internal control in the management representation letter and requires CFO Act agencies to include these representations in the MD&A in the annual financial statement. OMB audit guidance does not require auditors to express an opinion on internal control; however, the terms of the engagement may include a requirement for an auditor to express an opinion on the effectiveness of the entity’s internal control over financial reporting. In either case, the auditor should evaluate whether the design and implementation of internal control is sufficient to meet the control objectives insofar as those objectives pertain to providing reasonable assurance that a misstatement or omission in the relevant assertion is prevented, or detected and corrected, on a timely basis. These control objectives are as follows:

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

Classifying Control Weaknesses

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

* A **significant deficiency** is a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness yet important enough to merit attention by those charged with governance.
* A **material weakness** is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility[[9]](#footnote-9) that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected, on a timely basis (AU-C 265.07).[[10]](#footnote-10)

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

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

* The likelihood and magnitude of potential misstatement that would not be prevented or detected because of the control deficiencies. AU-C 265.A6 through .A9 provide examples of factors for evaluating the likelihood and magnitude of misstatement.
* Whether individual control deficiencies that affect the same account balance, disclosure, relevant assertion, or component of internal control collectively result in an internal control deficiency.
* The possible mitigating effects of effective compensating controls that have been tested and evaluated as part of the financial statement audit.[[11]](#footnote-11)

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

Additional guidance on evaluating identified deficiencies in internal control is provided in AU-C 265.A5. through A11. AU-C 265.A11 includes indicators of control deficiencies that the auditor should regard as indicators of a material weakness, such as the auditor’s identification of a material misstatement of the financial statements under audit that was not initially identified by the entity’s internal control. Additionally, circumstances that may be considered control deficiencies, significant deficiencies, or material weaknesses are described in AU-C 265.A37. Guidance on concluding on the effectiveness of internal control and reporting findings is provided in FAM 580.55 through .60 and FAM 580.64 through 67.

OMB Circular No. A-123 provides guidance for management to report control weaknesses under the Federal Managers’ Financial Integrity Act (FMFIA). The term material weakness as used by OMB (FMFIA material weakness) is different from the above definition and includes matters of an operational nature. Management and the auditor should evaluate the material weaknesses reported under FMFIA to determine whether they meet the auditor’s definitions of material weakness and significant deficiency for reporting as part of management’s assessment of the effectiveness of internal control (see FAM 580.43).

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

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

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Opinion on Internal Control

Although not required by OMB audit guidance, if the auditor plans to express an opinion on internal control, the auditor’s evaluation of the entity’s internal control and the results of other audit procedures form the basis for this opinion. The opinion may be (1) unmodified, (2) unmodified with reference to significant deficiencies, (3) disclaimer, or (4) adverse (one or more material weaknesses). Additionally, there may be restrictions on the scope of the procedures that result in a disclaimer of opinion (see FAM 580.52 through .55). The auditor should communicate any identified internal control deficiencies (including weaknesses in operations controls), as discussed in FAM 580.64 through .71, and consider the effects of these deficiencies on other entity-prepared reports (see FAM 580.72).

Scope of Procedures

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

1. Obtain the agreement of management that it acknowledges and understands its responsibility for the following:

* Designing, implementing, and maintaining effective internal control over financial reporting.
* Evaluating the effectiveness of the entity’s internal control over financial reporting using suitable and available criteria.
* Providing management’s assessment about internal control over financial reporting in a report that accompanies the auditor’s report.
* Supporting its assessment about the effectiveness of the entity’s internal control over financial reporting with sufficient evaluations and documentation.
* Providing the auditor with (1) access to all information of which management is aware that is relevant to management’s assessment of internal control over financial reporting, such as records, documentation, and other matters; (2) additional information that the auditor may request from management for the purpose of the audit of internal control over financial reporting; and (3) unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

1. Determine that the as of date corresponds to the balance sheet date (or period ending date) of the period covered by the financial statements (AU-C 940.06).

The auditor should evaluate the effectiveness of the entity’s internal control over financial reporting using the same suitable and available criteria used by management for its assessment (AU-C 940.07). The date specified in management’s assessment (the as of date of the audit) should correspond to the balance sheet date (or period ending date) of the period covered by the financial statements.

In accordance with FAM 580.52.a.iii above, the auditor should request from management a written assessment about the effectiveness of the entity’s internal control over financial reporting. Management’s refusal to provide a written assessment represents a scope limitation, and the auditor should apply the requirements in AU-C 940.74 through .77 (AU-C 940.08).The auditor should perform all necessary procedures, as described in FAM 300 and FAM 450 on the written assessment from management. The auditor should evaluate whether management has a reasonable basis for its assessment. For example, the assessment may be based on management’s monitoring procedures (see AU-C 940.A9 through .A12 for evidence that management can use to support its assessment). The audit results alone cannot be the basis for management’s assessment. When a scope limitation arises because management refuses to furnish a written assessment about the effectiveness of internal control over financial reporting, the auditor should withdraw from the integrated audit engagement. When withdrawal is not possible under applicable law or regulation, the auditor should disclaim an opinion on internal control over financial reporting and consider the implications on the financial statement audit (AU-C 940.74).

If there is a restriction on the scope of the audit, such that not all of these procedures can be performed, the auditor should evaluate whether or not to disclaim the opinion on internal control over financial reporting and determine whether or not to modify the GAGAS compliance statement in the report, as discussed in GAGAS (2018) 2.17b, 2.18, and 2.20. Scope restrictions may be imposed by the entity or may be due to other circumstances. The auditor should consult with the reviewer on this decision.

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

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

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

Based on the types of deficiencies noted, the auditor should conclude on the effectiveness of internal control over financial reporting as of the end of the audit period, as discussed in FAM 580.56 through .59. Management also should conclude on the effectiveness of internal control in deciding what assessment to make. After forming an opinion on the effectiveness of the entity’s internal control, the auditor should evaluate management’s report to determine whether it appropriately contains the following:

* A statement regarding management’s responsibility for internal control over financial reporting
* A description of the subject matter of the examination (for example, controls over the preparation of the entity’s financial statements in accordance with U.S. GAAP)
* An identification of the criteria against which internal control over financial reporting is measured (for example, criteria established in the GAO’s *Standards for Internal Control in the Federal Government* or the Committee of Sponsoring Organizations of the Treadway Commission’s *Internal Control-Integrated Framework*)
* Management’s assessment of the effectiveness of internal control over financial reporting
* A description of the material weaknesses, if any
* The date as of which management’s assessment of internal control over financial reporting is made (AU-C 940.55)

If the auditor determines that any required element of management’s report is incomplete or improperly presented, the auditor should request management to revise its report (AU-C 940.56). If management does not revise its report, the auditor should modify the auditor’s report to include an explanatory paragraph describing the reasons for this determination (AU-C 940.72).

Material Weaknesses

If one or more material weaknesses exist at the end of the audit period, the auditor should conclude that the entity’s internal control is ineffective, which would result in an adverse opinion (AU-C 940.68). The existence of a material weakness precludes a conclusion that internal control is effective, which would result in a modified opinion. If one or more material weaknesses have not been included in management’s report accompanying the auditor’s report, the auditor’s report should be modified to state that one or more material weaknesses have been identified but not included in management’s report. Additionally, the auditor’s report should include a description of each material weakness not included in management’s report. The auditor’s description should include specific information about the nature of each material weakness and its actual and potential effect on the presentation of the entity’s financial statements issued during the existence of the weakness. In this case, the auditor also should communicate, in writing, to those charged with governance that one or more material weaknesses were not disclosed or identified as a material weakness in management’s report. If one or more material weaknesses have been included in management’s report but the auditor concludes that the disclosure of such material weaknesses is not fairly presented in all material respects, the auditor’s report should describe this conclusion as well as the information necessary to fairly describe each material weakness (AU-C 940.70).

The auditor should determine the effect an adverse opinion on internal control over financial reporting has on the auditor’s opinion on the financial statements. Additionally, the auditor should disclose, in an other-matter paragraph or as part of the paragraph that identifies the material weakness, whether the auditor’s opinion on the financial statements was affected by the material weakness (AU-C 940.71). If a material weakness is presented in a report that also includes an unmodified opinion on the financial statements, the auditor should add a statement to the unmodified opinion to indicate that as a result of a material weakness, material misstatements may nevertheless occur in other financial information reported by the entity. Example report modifications for material weaknesses are provided in FAM 595 B.

Significant Deficiencies

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

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

Control deficiencies that do not meet the criteria for material weaknesses or significant deficiencies in FAM 580.44 do not affect the auditor’s conclusion on the effectiveness of internal control. The auditor also should communicate to management at an appropriate level of responsibility—on a timely basis either in writing (e.g., in a separate management letter, a write-up of the deficiency to management for its concurrence with the facts, etc.) or orally—these deficiencies in internal control identified during the audit that have not been communicated to management by other parties and that in the auditor’s professional judgment, are of sufficient importance to merit management’s attention. If these deficiencies in internal control are communicated orally, the auditor should document the communication (AU-C 265.12b). This communication should be made no later than 60 days following the report release date (AU-C 265.13). The auditor should document any oral communication of these deficiencies. When performing an integrated audit, the auditor should communicate these deficiencies in writing and inform those charged with governance when such communication was made. The auditor is not required to communicate those deficiencies that are not material weaknesses or significant deficiencies that were included in previous written communications, regardless of whether those communications were made by the auditor, internal auditors, or others within the organization (AU-C 940.62).

Type of Opinion

As described in FAM 580.51 through .55, if the auditor is unable to apply all the audit procedures considered necessary in the circumstances, a scope limitation exists and the auditor should issue a disclaimer of opinion on internal control over financial reporting. If all the procedures considered necessary were performed, the auditor should issue one of the following opinions:

* If the auditor and management agree on the effectiveness of internal control and there are no material weaknesses, the auditor should issue an unmodified opinion on internal control (see FAM 595 A).
* If the auditor and management agree on the effectiveness of internal control and there are no material weaknesses in internal control, but there are significant deficiencies, the auditor should issue an unmodified opinion, including a statement that internal control is effective but could be improved and referring to the significant deficiencies (see FAM 595 B).
* If the auditor and management agree on the effectiveness of internal control and there *are* material weaknesses in internal control, the auditor should modify the opinion on internal control by (1) referring to the material weakness(es) noted in management’s assessment (which states that internal control over financial reporting is ineffective (adverse opinion)) and (2) describing the material weakness(es) (see FAM 595 B). OMB Circular No. A-123 guidance for FMFIA allows management to provide a qualified assessment of internal control effectiveness even if material weaknesses exist.
* If the auditor and management disagree on the effectiveness of internal control, either because (1) management does not agree that material weakness(es) exist or (2) management does not appropriately modify its assessment of the effectiveness of internal control in light of the material weakness(es), the auditor should issue an adverse opinion. The existence of a material weakness precludes management from asserting that its internal control is effective. Thus, an adverse opinion is appropriate if management states that internal control is effective “except for” the material weakness when, in the auditor’s professional judgment, the material weakness indicates that internal control is ineffective (see FAM 580.56).

Nonopinion Report

If the purpose of the audit is not to express an opinion on internal control, the auditor should still report any identified material weaknesses and significant deficiencies in internal control. If no material weaknesses were identified, the auditor may state in its report that no material weaknesses were found, if such reporting was agreed to as part of the terms of the engagement (see FAM 595 A). The auditor should not issue a written communication stating that no significant deficiencies were identified during the audit because of the potential for users to misinterpret the amount of assurance provided by such communication (AU-C 265.16). If there are one or more material weaknesses, the auditor may state in its report that internal control was ineffective for one or more objectives. Further, the auditor should conclude whether the scope of the work and the related audit evidence are sufficient to meet the audit objectives described in the OMB audit guidance. If the work is not sufficient, the auditor should report a scope limitation.

Under AU-C 905.06, a report on internal control in which no opinion is issued is considered a by-product report. When no opinion is issued, the report provides only a limited degree of assurance about internal control, as internal control is not the primary objective of the engagement. The auditor should indicate the intended use of the internal control report because of the potential for users to misunderstand a by-product report’s limited degree of assurance. Because the distribution of government audit reports is not restricted, the reports should explain their limitations. See FAM 595 A, Example 2, for an example of a report when the auditor does not provide an opinion on internal control and cautions the reader that the internal control testing performed may not be sufficient for other purposes (AU-C 905.11).

Where and When to Report Control Deficiencies for Nonopinion Report

The means of communicating deficiencies in internal control depends on the type of weakness, as discussed in FAM 580.44. The auditor should communicate in writing to those charged with governance on a timely basis significant deficiencies and material weaknesses identified during the audit, including those that were remediated during the audit (AU-C 265.11). The auditor also should communicate to management at an appropriate level of responsibility, on a timely basis in writing, significant deficiencies and material weaknesses that the auditor has communicated or intends to communicate to those charged with governance, unless it would be inappropriate to communicate directly to management in the circumstances (AU-C 265.12a). Under GAGAS, this communication is part of the auditor’s report on financial statements. For other deficiencies, the auditor should communicate no later than 60 days following the report release date. However, the auditor may issue other written communication containing further details on the deficiencies. The auditor should include any material weaknesses or other significant deficiencies that were communicated in previous financial statement audits that have not yet been corrected. The auditor may do this by referring to the previously issued written communication and the date of the communication. Communicating each type of deficiency is discussed in FAM 580.68 through .72.

Material Weaknesses and Significant Deficiencies

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

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

If more complete information concerning control deficiencies is provided in other reports issued prior to or at the same time as the auditor’s report, the auditor generally should refer to such other reports (such as date and title or report number) in the auditor’s report. The auditor may also subsequently report significant deficiencies in more detail in a separate management report or other written communication that includes other elements of the findings, as discussed in FAM 580.68.

Other Control Deficiencies

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

What to Report about Control Deficiencies

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

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

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

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

In discussing each material weakness that meets FMFIA reporting criteria, the auditor should determine whether the material weakness was identified in the entity’s FMFIA report or in the FMFIA report of the organization of which the entity is a part (see FAM 580.73).

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

Other Considerations

To communicate findings promptly, the auditor may issue written communications during the audit. For example, GAO issued a report to a federal entity where on an interim basis some installations were reporting in millions of dollars and others in billions of dollars, causing materially inaccurate consolidations of amounts. GAO issued this report to provide information so that the entity could improve the consistency and accuracy of amounts in time for year-end reporting. In such instances, the auditor may describe the control deficiency and see the reports as discussed in FAM 580.67.

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

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

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

If the auditor found material weaknesses or systems’ nonconformance that should have been reported under FMFIA (see FAM 580.47 through .51), the auditor should refer to such findings as indicated at FAM 580.70, and determine whether management’s FMFIA process has deficiencies that the auditor should report. Such deficiencies might result from the following:

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

The auditor may refer to the assessment of management’s FMFIA process performed during planning, as discussed at FAM 260.65 through .70, when concluding as to how to report these matters.

### Financial Management Systems

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

* Federal financial management systems requirements, including those found in the Treasury Financial Manual, Volume 1, Part 6, Chapter 9500, *Revised Federal Financial Management System Requirements*.
* Applicable federal accounting standards
* The SGL at the transaction level.

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

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

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

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

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

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

#### **Scope of Procedures**

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

Compliance with Applicable Laws, Regulations, Contracts, and Grant Agreements

The auditor should report on the results of compliance testing and on compliance matters (including fraud, as discussed in FAM 540) that come to the auditor’s attention during procedures other than compliance tests.

If the auditor concludes that the noncompliance has a material effect on the financial statements, and it has not been adequately reflected in the financial statements, the auditor should, in accordance AU-C 705, *Modifications to the Opinion in the Independent Auditor's Report*, express a qualified or adverse opinion on the financial statements (AU-C 250.24). If the auditor is precluded by management or those charged with governance from obtaining sufficient appropriate audit evidence to evaluate whether noncompliance that may be material to the financial statements has, or is likely to have, occurred, the auditor should express a qualified opinion or disclaim an opinion on the financial statements on the basis of a limitation on the scope of the audit, in accordance with AU-C 705 (AU-C 250.25).

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

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

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

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

Reporting on Compliance Tests

The auditor should state directly whether any reportable noncompliance was detected during compliance tests. This type of direct statement is illustrated in FAM 595 A for a situation in which the compliance tests disclosed no reportable noncompliance. If the auditor identifies any reportable noncompliance, the auditor should modify the statement, and the auditor should discuss the reportable noncompliance in the auditor’s report as described in FAM 580.79 through .81.

Under AU-C 905, a report on compliance with applicable laws, regulations, contracts, and grant agreements in which no opinion is issued is a by-product of a financial statement audit that provides a limited degree of assurance about compliance. When no opinion is issued, the report on compliance is not the primary objective of the engagement. The auditor should indicate the intended use of the compliance report because of the potential for users to misunderstand a by-product report’s limited degree of assurance. Because the distribution of government audit reports is not restricted, the auditor’s report should explain this limitation as follows (AU-C 905.11): “However, the objective of our tests was not to provide an opinion on compliance with laws, regulations, contracts, and grant agreements applicable to [entity]. Accordingly, we do not express such an opinion.”

#### **Scope of Procedures**

The auditor should perform all of the procedures that the auditor determines necessary for obtaining sufficient appropriate evidence for reporting on compliance with applicable laws, regulations, contracts, and grant agreements. If the auditor is unable to perform all of the procedures for each of the significant provisions of applicable laws, regulations, contracts, and grant agreements, the auditor may be able to report solely on the applicable laws, regulations, contracts, and grant agreements tested. However, the auditor should modify the report to alert the reader that not all of the laws, regulations, contracts, and grant agreements that the auditor believed were necessary were tested.

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

If deficiencies in compliance controls are identified but no instances of noncompliance are found during compliance testing, the auditor should determine whether controls or other mitigating factors prevented or detected instances of noncompliance. If sufficient additional controls or other mitigating factors are not identified, the auditor should consult with the reviewer and OGC concerning the appropriate reporting of such deficiencies and compliance tests.

Entity Comments

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

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

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

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

Dating the Auditor’s Report

1. The auditor should date the report no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor’s opinion, as discussed in AU-C 700.41. When expressing an opinion on all periods presented, a continuing auditor should update the report on the financial statements of one or more prior periods, presented on a comparative basis, with those of the current period. The auditor's report on comparative financial statements should not be dated earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to support the opinion for the most recent audit (AU-C 700.45).

Among other things, sufficient appropriate audit evidence includes evidence that supervisors, first partners, and the reviewer have completed their reviews; the entity’s financial statements, including disclosures, have been prepared; management has asserted that it has taken responsibility for them by signing the representation letter; and any significant issues have been resolved.

However, if additional evidence is needed, the auditor should determine whether to change the date of the auditor’s report. This will ordinarily result in a report date that is close to the date on which the auditor permits the entity to use the auditor’s report in connection with the financial statements (report release date). If there are delays in releasing the report, the auditor should perform additional procedures to comply with AU-C 560 and AU-C 700. There are three important dates to consider.

* **Auditor’s report date.** This is the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the opinion.
* **Report release date.** This is the date on which the auditor permits the entity to use the auditor’s report in connection with the financial statements. Often, the report release date will be the date that the auditor delivers the audit report to the entity. The report release date will ordinarily be a date that is close to the auditor’s report date. The report release date is important because it starts the period when the auditor should complete the audit documentation.
* **Documentation completion date.** This is the date that the auditor determines that the audit documentation is assembled, final, and complete. The auditor should complete final audit documentation within 60 days following the report release date.

Restatement of Audited Financial Statements

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

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1. The auditor should prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand (1) the nature, timing, and extent of work performed in the reporting phase to comply with GAGAS; (2) the results of the audit procedures performed and the audit evidence obtained; and (3) the significant findings or issues arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions (AU-C 230.08). The audit documentation should include, but is not limited to
2. audit summary memorandum (FAM 590.02 through .03);
3. overall analytical procedures (FAM 590.04);
4. deficiencies in internal control (FAM 590.05);
5. evaluation and communication of misstatements (FAM 540);
6. letters from legal counsel (FAM 1002);
7. subsequent events (FAM 1005);
8. management representations (FAM 1001);
9. names of identified related parties and the nature of the related party relationships (AU-C 550.28);
10. procedures performed to determine consistency of the other information in the annual financial statement with the financial statements and in accordance with U.S. GAAP or OMB financial reporting guidance, currently OMB Circular No. A-136 (FAM 280.05 through .06);
11. evidences of exit conference(s) (FAM 590.12); and
12. applicable audit completion checklists (FAM 1003).

Specific Documentation Considerations

Audit Summary Memorandum

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

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

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

1. any significant changes from the auditor’s original assessment of the risk of material misstatement;
2. any additional fraud risks or other conditions beyond those considered in planning (FAM 260), including analytical relationships identified during the audit that caused the auditor to believe that additional audit procedures or any other response was required, as well as any further response the auditor concluded was appropriate;
3. the results of the procedures performed to specifically address the risk of management override of controls, including the consideration of the qualitative aspects of the entity’s accounting practices, including indicators of possible bias in management’s judgments (AU-C 240.44.b and 700.15);
4. information that demonstrates that the financial statements agree or reconcile with the underlying accounting records (AU-C 330.33);
5. the auditor’s evaluation of misstatements that the auditor believes are or might be the result of fraud;
6. the nature of any communications about fraud or possible fraud (and any significant abuse) made to management, those charged with governance, the Special Investigator Unit, the Office of Inspector General, or others (AU-C 240.45);
7. the auditor’s summary conclusions related to the consideration of fraud;
8. significant accounting, auditing, or reporting issues;
9. if the auditor identified information that is inconsistent with the auditor’s final conclusion regarding a significant finding or issue, the auditor should document how the auditor addressed the inconsistency (AU-C 230.12);
10. any limitations on the audit scope and the auditor’s assessment of whether the audit procedures were adequate to support conclusions on the financial statements, internal control, the systems’ substantial compliance with FFMIA requirements (for CFO Act agencies), compliance with applicable laws, regulations, contracts, and grant agreements, and MD&A, RSI, and other accompanying information;
11. the auditor’s conclusions on whether the audit evidence obtained is sufficient, is appropriate, and supports the conclusions on the financial statements, internal control, the systems’ substantial compliance with FFMIA requirements, compliance with significant provisions of applicable laws, regulations, contracts, and grant agreements, and MD&A, RSI, and other accompanying information;
12. the auditor’s conclusions on whether sufficient appropriate audit evidence was obtained to reduce audit risk to an appropriately low level;
13. the auditor’s conclusion on whether the audit was performed in compliance with GAGAS, OMB audit guidance, and, if used, the FAM, and whether the report is appropriate;
14. the auditor’s conclusion on whether the entity’s financial statements are in accordance with U.S. GAAP;
15. significant subsequent events, if any;
16. findings with respect to related party transactions and complex or unusual transactions (AU-C 940.54c.);
17. the Summary of Uncorrected Misstatements (FAM 595 C) and communication of the misstatements to management and those charged with governance;
18. a summary of internal control weaknesses classified as material weaknesses, other significant deficiencies, and other control deficiencies, and a comparison of material weaknesses the auditor found to the weaknesses reported in management’s assessment of the effectiveness of internal control;
19. a summary of instances of the systems’ lack of substantial compliance with FFMIA requirements, as well as areas in which there is substantial but not full compliance (for CFO Act agencies);
20. a summary of instances of noncompliance with applicable laws, regulations, contracts, and grant agreements;
21. documentation of overall analytical procedures;
22. documentation of oral or written communication required to be communicated with management, those charged with governance (see FAM 550.20 through .21), and others, including the nature of the significant findings or issues discussed, and when and with whom the discussions took place (AU-C 230.11 and 260.20); and
23. the auditor’s conclusion on the adequacy of two-way communication with those charged with governance (see FAM 550.22 through .23).

Overall Analytical Procedures

The auditor should document the following:

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

Deficiencies in Internal Control

The auditor should document

* the basis for considering internal control deficiencies as material weaknesses, significant deficiencies, or other control deficiencies;
* any oral communications of control deficiencies that are not included in a written report; and
* procedures performed to determine the effects of deficiencies in internal control on other reports that the entity uses.

Lack of Systems’ Substantial Compliance with FFMIA Requirements

The auditor should document the basis for deciding whether systems’ noncompliance with FFMIA requirements (for CFO Act agencies) represents a lack of substantial compliance with the three FFMIA requirements for financial management systems (FAM 580.74 through .78 and FAM 701).[[12]](#footnote-12)

Instances of Noncompliance or Suspected Noncompliance

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

The auditor should document the basis for classifying instances of noncompliance as material noncompliance, other reportable noncompliance, or not reportable. The auditor should also document any oral communications of noncompliance that are not included in a written report (FAM 580.80 through .83 and FAM 800).

Other Reporting Matters

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

The auditor should document procedures performed with respect to any subsequent discovery of facts that could have affected a previously issued audit report on the financial statements (FAM 580.92).

The auditor should document procedures performed with respect to the issuance of condensed financial statements or selected financial data (FAM 580.93).

Exit Conference(s)

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

595 A – Example Unmodified Auditor’s Reports

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

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

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

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

**[Auditor’s Address]**

**Independent Auditor’s Report**

To **[appropriate addressee]**

In our audits of the fiscal years **[20XX and 20XX]** financial statements of **[entity[[13]](#footnote-13)]**, we found

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

The following sections discuss in more detail (1) our report on the financial statements and on internal control over financial reporting, which includes **[if applicable insert “an emphasis-of-matter paragraph related to (include brief description), and”]** required supplementary information (RSI)[[14]](#footnote-14) and other information included with the financial statements; [[15]](#footnote-15) (2) our report on compliance with laws, regulations, contracts, and grant agreements; and (3) agency comments **[if applicable, add “and our evaluation” and revise related heading on page 595 A-6 for consistency]**.

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

In accordance with **[cite audit authority],** we have audited **[entity’s]** financial statements. **[Entity’s]** financial statements comprise the balance sheets as of **[September 30, 20XX, and 20XX]**; the related statements of net cost **[if included in statement title, insert “of operations”]**, changes in net position, and budgetary resources for the fiscal years then ended; and the related notes to the financial statements. We also have audited **[entity’s]** internal control over financial reporting as of **[September 30, 20XX]**, based on criteria established under 31 U.S.C. § 3512(c), (d), commonly known as the Federal Managers’ Financial Integrity Act (FMFIA).

We conducted our audits in accordance with U.S. generally accepted government auditing standards. We believe that the audit evidence we obtained is sufficient and appropriate to provide a basis for our audit opinions.

Management’s Responsibility

**[Entity]** management is responsible for (1) the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; (2) preparing, measuring, and presenting the RSI in accordance with U.S. generally accepted accounting principles; (3) preparing and presenting other information included in documents containing the audited financial statements and auditor’s report, and ensuring the consistency of that information with the audited financial statements and the RSI; (4) maintaining effective internal control over financial reporting, including the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; (5) evaluating the effectiveness of internal control over financial reporting based on the criteria established under FMFIA; and (6) its assessment about the effectiveness of internal control over financial reporting as of **[September 30, 20XX]**, included in the accompanying Management’s Report on Internal Control over[[16]](#footnote-16) Financial Reporting **[or other title of management’s report]** in appendix I.

Auditor’s Responsibility

Our responsibility is to express an opinion on these financial statements and an opinion on **[entity’s]** internal control over financial reporting based on our audits. U.S. generally accepted government auditing standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement, and whether effective internal control over financial reporting was maintained in all material respects. We are also responsible for applying certain limited procedures to RSI and other information included with the financial statements.

An audit of financial statements involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgment, including the auditor’s assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances. An audit of financial statements also involves evaluating the appropriateness of the accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

An audit of internal control over financial reporting involves performing procedures to obtain evidence about whether a material weakness exists.[[17]](#footnote-17) The procedures selected depend on the auditor’s judgment, including the assessment of the risk that a material weakness exists. An audit of internal control over financial reporting also includes obtaining an understanding of internal control over financial reporting, and evaluating and testing the design and operating effectiveness of internal control over financial reporting based on the assessed risk. Our audit of internal control also considered **[entity’s]** process for evaluating and reporting on internal control over financial reporting based on criteria established under FMFIA. Our audits also included performing such other procedures as we considered necessary in the circumstances.

We did not evaluate all internal controls relevant to operating objectives as broadly established under FMFIA, such as those controls relevant to preparing performance information and ensuring efficient operations. We limited our internal control testing to testing controls over financial reporting. Our internal control testing was for the purpose of expressing an opinion on whether effective internal control over financial reporting was maintained, in all material respects. Consequently, our audit may not identify all deficiencies in internal control over financial reporting that are less severe than a material weakness.

Definition and Inherent Limitations of Internal Control over Financial Reporting

An entity’s internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, the objectives of which are to provide reasonable assurance that (1) transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in accordance with U.S. generally accepted accounting principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition, and (2) transactions are executed in accordance with provisions of applicable laws, including those governing the use of budget authority, regulations, contracts, and grant agreements, noncompliance with which could have a material effect on the financial statements.

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

Opinion on Financial Statements

In our opinion, **[entity’s]** financial statements present fairly, in all material respects, **[entity’s]** financial position as of **[September 30, 20XX, and 20XX]**, and its net cost of operations, changes in net position, and budgetary resources for the fiscal years then ended in accordance with U.S. generally accepted accounting principles.

**[Note: If applicable, insert emphasis-of-matter paragraph in accordance with AU-C 706 and include related heading. Conclude with “Our opinion on [entity’s] financial statements is not modified with respect to this matter.”]**

Opinion on Internal Control over Financial Reporting

In our opinion, **[entity]** maintained, in all material respects, effective internal control over financial reporting as of **[September 30, 20XX]**, based on criteria established under FMFIA.

**[If applicable]** During our **[20XX]** audit, we identified deficiencies in **[entity’s]** internal control over financial reporting that we do not consider to be material weaknesses or significant deficiencies.[[18]](#footnote-18) Nonetheless, these deficiencies warrant **[entity]** management’s attention. We have communicated these matters to **[entity]** management and, where appropriate, will report on them separately.

Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles issued by the Federal Accounting Standards Advisory Board (FASAB) require that the RSI be presented to supplement the financial statements. Although the RSI is not a part of the financial statements, FASAB considers this information to be an essential part of financial reporting for placing the financial statements in appropriate operational, economic, or historical context. We have applied certain limited procedures to the RSI in accordance with U.S. generally accepted government auditing standards, which consisted of inquiries of management about the methods of preparing the RSI and comparing the information for consistency with management’s responses to the auditor’s inquiries, the financial statements, and other knowledge we obtained during the audit of the financial statements, in order to report omissions or material departures from FASAB guidelines, if any, identified by these limited procedures. We did not audit and we do not express an opinion or provide any assurance on the RSI because the limited procedures we applied do not provide sufficient evidence to express an opinion or provide any assurance.

Other Information

**[Entity’s]** other information contains a wide range of information, some of which is not directly related to the financial statements. This information is presented for purposes of additional analysis and is not a required part of the financial statements or the RSI. We read the other information included with the financial statements in order to identify material inconsistencies, if any, with the audited financial statements. Our audit was conducted for the purpose of forming an opinion on **[entity’s]** financial statements. We did not audit and do not express an opinion or provide any assurance on the other information.

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

In connection with our audits of **[entity’s]** financial statements, we tested compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements consistent with our auditor’s responsibility discussed below. We caution that noncompliance may occur and not be detected by these tests. We performed our tests of compliance in accordance with U.S. generally accepted government auditing standards.

Management’s Responsibility

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

Auditor’s Responsibility

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

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

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

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

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

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

In commenting on a draft of this report, **[entity[[19]](#footnote-19)]** ………………………The complete text of **[entity’s]** response is reprinted in appendix II.

**[Signature]**

**[Title]**

**[Date of auditor’s report]**

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

**[Auditor’s Address]**

**Independent Auditor’s Report**

To **[appropriate addressee]**

In our audits of the fiscal years **[20XX and 20XX]** financial statements of **[entity[[20]](#footnote-20)]**, we found

* **[entity’s]** financial statements as of and for the fiscal years ended **[September 30, 20XX, and 20XX]**, are presented fairly, in all material respects, in accordance with U.S. generally accepted accounting principles;
* no material weaknesses in internal control over financial reporting based on the limited procedures we performed; [[21]](#footnote-21) and
* no reportable noncompliance for **[fiscal year 20XX]** with provisions of applicable laws, regulations, contracts, and grant agreements we tested.

The following sections discuss in more detail (1) our report on the financial statements, which includes **[if applicable insert “an emphasis-of-matter paragraph related to (include brief description), and”]** required supplementary information (RSI)[[22]](#footnote-22) and other information included with the financial statements; [[23]](#footnote-23) (2) our report on internal control over financial reporting; (3) our report on compliance with laws, regulations, contracts, and grant agreements; and (4) agency comments **[if applicable, add “and our evaluation” and revise related heading on page 595 A-11 for consistency]**.

**Report on the Financial Statements**

In accordance with [**cite audit authority**], we have audited **[entity’s]** financial statements. **[Entity’s]** financial statements comprise the balance sheets as of **[September 30, 20XX, and 20XX]**; the related statements of net cost **[if included in the statement title, insert “of operations”]**, changes in net position, and budgetary resources for the fiscal years then ended; and the related notes to the financial statements.

We conducted our audits in accordance with U.S. generally accepted government auditing standards. We believe that the audit evidence we obtained is sufficient and appropriate to provide a basis for our audit opinions.

Management’s Responsibility

**[Entity]** management is responsible for (1) the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; (2) preparing, measuring, and presenting the RSI in accordance with U.S. generally accepted accounting principles; (3) preparing and presenting other information included in documents containing the audited financial statements and auditor’s report, and ensuring the consistency of that information with the audited financial statements and the RSI; and (4) maintaining effective internal control over financial reporting, including the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor’s Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. U.S. generally accepted government auditing standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. We are also responsible for applying certain limited procedures to RSI and other information included with the financial statements.

An audit of financial statements involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgment, including the auditor’s assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control. Accordingly, we express no such opinion. An audit of financial statements also involves evaluating the appropriateness of the accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. Our audits also included performing such other procedures as we considered necessary in the circumstances.

Opinion on Financial Statements

In our opinion, **[entity’s]** financial statements present fairly, in all material respects, **[entity’s]** financial position as of **[September 30, 20XX, and 20XX]**, and its net cost of operations, changes in net position, and budgetary resources for the fiscal years then ended in accordance with U.S. generally accepted accounting principles.

**[Note: If applicable, insert emphasis-of-matter paragraph in accordance with AU-C 706, and include related heading. Conclude with “Our opinion on [entity’s] financial statements is not modified with respect to this matter.”]**

Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles issued by the Federal Accounting Standards Advisory Board (FASAB) require that the RSI be presented to supplement the financial statements. Although the RSI is not a part of the financial statements, FASAB considers this information to be an essential part of financial reporting for placing the financial statements in appropriate operational, economic, or historical context. We have applied certain limited procedures to the RSI in accordance with U.S. generally accepted government auditing standards, which consisted of inquiries of management about the methods of preparing the RSI and comparing the information for consistency with management’s responses to the auditor’s inquiries, the financial statements, and other knowledge we obtained during the audit of the financial statements, in order to report omissions or material departures from FASAB guidelines, if any, identified by these limited procedures. We did not audit and we do not express an opinion or provide any assurance on the RSI because the limited procedures we applied do not provide sufficient evidence to express an opinion or provide any assurance.

Other Information

**[Entity’s]** other information contains a wide range of information, some of which is not directly related to the financial statements. This information is presented for purposes of additional analysis and is not a required part of the financial statements or the RSI. We read the other information included with the financial statements in order to identify material inconsistencies, if any, with the audited financial statements. Our audit was conducted for the purpose of forming an opinion on **[entity’s]** financial statements. We did not audit and do not express an opinion or provide any assurance on the other information.

**Report on Internal Control over Financial Reporting**

In connection with our audits of the **[entity’s]** financial statements, we considered the **[entity’s]** internal control over financial reporting, consistent with our auditor’s responsibility discussed below. We performed our procedures related to the **[entity’s]** internal control over financial reporting in accordance with U.S. generally accepted government auditing standards.

Management’s Responsibility

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

Auditor’s Responsibility

In planning and performing our audit of **[entity’s]** financial statements as of and for the year ended **[September 30, 20XX]**, in accordance with U.S. generally accepted government auditing standards, we considered the **[entity’s]** internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the **[entity’s]** internal control over financial reporting. Accordingly, we do not express an opinion on the **[entity’s]** internal control over financial reporting. We are required to report all deficiencies that are considered to be significant deficiencies[[24]](#footnote-24) or material weaknesses. We did not consider all internal controls relevant to operating objectives, such as those controls relevant to preparing performance information and ensuring efficient operations.

Definition and Inherent Limitations of Internal Control over Financial Reporting

An entity’s internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, the objectives of which are to provide reasonable assurance that (1) transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in accordance with U.S. generally accepted accounting principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition, and (2) transactions are executed in accordance with provisions of applicable laws, including those governing the use of budget authority, regulations, contracts, and grant agreements, noncompliance with which could have a material effect on the financial statements.

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

Results of Our Consideration of Internal Control over Financial Reporting

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

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

Intended Purpose of Report on Internal Control over Financial Reporting

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

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

In connection with our audits of **[entity’s]** financial statements, we tested compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements consistent with our auditor’s responsibility discussed below. We caution that noncompliance may occur and not be detected by these tests. We performed our tests of compliance in accordance with U.S. generally accepted government auditing standards.

Management’s Responsibility

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

Auditor’s Responsibility

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

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

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

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

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

**Agency Comments [if applicable, add “and Our Evaluation.” Heading should be consistent with related wording on page 595 A-7.]**

In commenting on a draft of this report, **[entity[[25]](#footnote-25)]** ………………………The complete text of **[entity’s]** response is reprinted in appendix II.

Signature

Title

Date of auditor’s report

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

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

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

In both examples, the auditor’s opinion on the financial statements is unmodified, and no reportable noncompliance with applicable laws, regulations, contracts, and grant agreements is identified.

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

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

**[Auditor’s Address]**

**Independent Auditor’s Report**

To **[appropriate addressee]**

In our audits of the fiscal years **[20XX and 20XX]** financial statements of **[entity[[26]](#footnote-26)]**, we found

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

The following sections discuss in more detail (1) our report on the financial statements and on internal control over financial reporting, which includes **[if applicable insert “a matter of emphasis paragraph related to (include brief description), and”]** required supplementary information (RSI)[[27]](#footnote-27) and other information included with the financial statements; [[28]](#footnote-28) (2) our report on compliance with laws, regulations, contracts, and grant agreements; and (3) agency comments **[if applicable, add “and our evaluation” and revise related heading on page 595 B-7 for consistency]**.

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

In accordance with **[cite audit authority],** we have audited **[entity’s]** financial statements. **[Entity’s]** financial statements comprise the balance sheets as of **[September 30, 20XX and 20XX]**; the related statements of net cost **[if included in statement title, insert “of operations”]**, changes in net position, and budgetary resources for the fiscal years then ended; and the related notes to the financial statements. We also have audited **[entity’s]** internal control over financial reporting as of **[September 30, 20XX]**, based on criteria established under 31 U.S.C. § 3512(c), (d), commonly known as the Federal Managers’ Financial Integrity Act (FMFIA).

We conducted our audits in accordance with U.S. generally accepted government auditing standards. We believe that the audit evidence we obtained is sufficient and appropriate to provide a basis for our audit opinions.

Management’s Responsibility

**[Entity]** management is responsible for (1) the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; (2) preparing, measuring, and presenting the RSI in accordance with U.S. generally accepted accounting principles; (3) preparing and presenting other information included in documents containing the audited financial statements and auditor’s report, and ensuring the consistency of that information with the audited financial statements and the RSI; (4) maintaining effective internal control over financial reporting, including the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; (5) evaluating the effectiveness of internal control over financial reporting based on the criteria established under FMFIA; and (6) its assessment about the effectiveness of internal control over financial reporting as of **[September 30, 20XX]**, included in the accompanying Management’s Report on Internal Control over[[29]](#footnote-29) Financial Reporting **[or other title of management’s report]** in appendix I.

Auditor’s Responsibility

Our responsibility is to express an opinion on these financial statements and an opinion on **[entity’s]** internal control over financial reporting based on our audits. U.S. generally accepted government auditing standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement, and whether effective internal control over financial reporting was maintained in all material respects. We are also responsible for applying certain limited procedures to RSI and other information included with the financial statements.

An audit of financial statements involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgment, including the auditor’s assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances. An audit of financial statements also involves evaluating the appropriateness of the accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

An audit of internal control over financial reporting involves performing procedures to obtain evidence about whether a material weakness exists. [[30]](#footnote-30) The procedures selected depend on the auditor’s judgment, including the assessment of the risk that a material weakness exists. An audit of internal control over financial reporting also includes obtaining an understanding of internal control over financial reporting, and evaluating and testing the design and operating effectiveness of internal control over financial reporting based on the assessed risk. Our audit of internal control also considered **[entity’s]** process for evaluating and reporting on internal control over financial reporting based on criteria established under FMFIA. Our audits also included performing such other procedures as we considered necessary in the circumstances.

We did not evaluate all internal controls relevant to operating objectives as broadly established under FMFIA, such as those controls relevant to preparing performance information and ensuring efficient operations. We limited our internal control testing to testing controls over financial reporting. Our internal control testing was for the purpose of expressing an opinion on whether effective internal control over financial reporting was maintained, in all material respects. Consequently, our audit may not identify all deficiencies in internal control over financial reporting that are less severe than a material weakness.

Definition and Inherent Limitations of Internal Control over Financial Reporting

An entity’s internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, the objectives of which are to provide reasonable assurance that (1) transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in accordance with U.S. generally accepted accounting principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition, and (2) transactions are executed in accordance with provisions of applicable laws, including those governing the use of budget authority, regulations, contracts, and grant agreements, noncompliance with which could have a material effect on the financial statements.

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

Opinion on Financial Statements

In our opinion, **[entity’s]** financial statements present fairly, in all material respects, **[entity’s]** financial position as of **[September 30, 20XX, and 20XX]**, and its net cost of operations, changes in net position, and budgetary resources for the fiscal years then ended in accordance with U.S. generally accepted accounting principles.

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

**[Note: If applicable, insert matter of emphasis paragraph in accordance with AU-C 706 and include related heading. Conclude with “Our opinion on [entity’s] financial statements is not modified with respect to this matter.”]**

Opinion on Internal Control over Financial Reporting

In our opinion, because of a material weakness in internal control over **[briefly name the deficiency]**, **[entity]** did not maintain, in all material respects, effective internal control over financial reporting as of **[September 30, 20XX]**, based on criteria established under FMFIA.

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

**[If applicable]** In addition to thematerial weakness in internal control over **[insert description of material weakness from above]**, we also identified other deficiencies in **[entity’s]** internal control over financial reporting that we do not consider to be material weaknesses or significant deficiencies.[[31]](#footnote-31) Nonetheless, these deficiencies warrant **[entity]** management’s attention. We have communicated these matters to **[entity]** management and, where appropriate, will report on them separately. [[32]](#footnote-32)

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

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

Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles issued by the Federal Accounting Standards Advisory Board (FASAB) require that the RSI be presented to supplement the financial statements. Although the RSI is not a part of the financial statements, FASAB considers this information to be an essential part of financial reporting for placing the financial statements in appropriate operational, economic, or historical context. We have applied certain limited procedures to the RSI in accordance with U.S. generally accepted government auditing standards, which consisted of inquiries of management about the methods of preparing the RSI and comparing the information for consistency with management’s responses to the auditor’s inquiries, the financial statements, and other knowledge we obtained during the audit of the financial statements, in order to report omissions or material departures from FASAB guidelines, if any, identified by these limited procedures. We did not audit and we do not express an opinion or provide any assurance on the RSI because the limited procedures we applied do not provide sufficient evidence to express an opinion or provide any assurance.

Other Information

**[Entity’s]** other information contains a wide range of information, some of which is not directly related to the financial statements. This information is presented for purposes of additional analysis and is not a required part of the financial statements or the RSI. We read the other information included with the financial statements in order to identify material inconsistencies, if any, with the audited financial statements. Our audit was conducted for the purpose of forming an opinion on **[entity’s]** financial statements. We did not audit and do not express an opinion or provide any assurance on the other information.

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

In connection with our audits of **[entity’s]** financial statements, we tested compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements consistent with our auditor’s responsibility discussed below. We caution that noncompliance may occur and not be detected by these tests. We performed our tests of compliance in accordance with U.S. generally accepted government auditing standards.

Management’s Responsibility

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

Auditor’s Responsibility

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

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

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

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

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

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

In commenting on a draft of this report, **[entity[[33]](#footnote-33)]** ………………………The complete text of **[entity’s]** response is reprinted in appendix II.

**[Signature]**

**[Title]**

**[Date of auditor’s report]**

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

**[Auditor’s Address]**

**Independent Auditor’s Report**

To **[appropriate addressee]**

In our audits of the fiscal years **[20XX and 20XX]** financial statements of **[entity[[34]](#footnote-34)]**, we found

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

The following sections discuss in more detail (1) our report on the financial statements and on internal control over financial reporting, which includes **[if applicable insert “a matter of emphasis paragraph related to (include brief description), and”]** required supplementary information (RSI)[[35]](#footnote-35) and other information included with the financial statements;[[36]](#footnote-36) (2) our report on compliance with laws, regulations, contracts, and grant agreements; and (3) agency comments **[if applicable, add “and our evaluation” and revise related heading on page 595 B-13 for consistency]**.

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

In accordance with **[cite audit authority],** we have audited **[entity’s]** financial statements. **[Entity’s]** financial statements comprise the balance sheets as of **[September 30, 20XX and 20XX]**; the related statements of net cost **[if included in statement title, insert “of operations”]**, changes in net position, and budgetary resources for the fiscal years then ended; and the related notes to the financial statements. We also have audited **[entity’s]** internal control over financial reporting as of **[September 30, 20XX]**, based on criteria established under 31 U.S.C. § 3512(c), (d), commonly known as the Federal Managers’ Financial Integrity Act (FMFIA).

We conducted our audits in accordance with U.S. generally accepted government auditing standards. We believe that the audit evidence we obtained is sufficient and appropriate to provide a basis for our audit opinions.

Management’s Responsibility

**[Entity]** management is responsible for (1) the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; (2) preparing, measuring, and presenting the RSI in accordance with U.S. generally accepted accounting principles; (3) preparing and presenting other information included in documents containing the audited financial statements and auditor’s report, and ensuring the consistency of that information with the audited financial statements and the RSI; (4) maintaining effective internal control over financial reporting, including the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; (5) evaluating the effectiveness of internal control over financial reporting based on the criteria established under FMFIA; and (6) its assessment about the effectiveness of internal control over financial reporting as of **[September 30, 20XX]**, included in the accompanying Management’s Report on Internal Control over[[37]](#footnote-37) Financial Reporting **[or other title of management’s report]** in appendix I.

Auditor’s Responsibility

Our responsibility is to express an opinion on these financial statements and an opinion on **[entity’s]** internal control over financial reporting based on our audits. U.S. generally accepted government auditing standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement, and whether effective internal control over financial reporting was maintained in all material respects. We are also responsible for applying certain limited procedures to RSI and other information included with the financial statements.

An audit of financial statements involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgment, including the auditor’s assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances. An audit of financial statements also involves evaluating the appropriateness of the accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

An audit of internal control over financial reporting involves performing procedures to obtain evidence about whether a material weakness exists.[[38]](#footnote-38) The procedures selected depend on the auditor’s judgment, including the assessment of the risk that a material weakness exists. An audit of internal control over financial reporting also includes obtaining an understanding of internal control over financial reporting, and evaluating and testing the design and operating effectiveness of internal control over financial reporting based on the assessed risk. Our audit of internal control also considered **[entity’s]** process for evaluating and reporting on internal control over financial reporting based on criteria established under FMFIA. Our audits also included performing such other procedures as we considered necessary in the circumstances.

We did not evaluate all internal controls relevant to operating objectives as broadly established under FMFIA, such as those controls relevant to preparing performance information and ensuring efficient operations. We limited our internal control testing to testing controls over financial reporting. Our internal control testing was for the purpose of expressing an opinion on whether effective internal control over financial reporting was maintained, in all material respects. Consequently, our audit may not identify all deficiencies in internal control over financial reporting that are less severe than a material weakness.

Definition and Inherent Limitations of Internal Control over Financial Reporting

An entity’s internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, the objectives of which are to provide reasonable assurance that (1) transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in accordance with U.S. generally accepted accounting principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition, and (2) transactions are executed in accordance with provisions of applicable laws, including those governing the use of budget authority, regulations, contracts, and grant agreements, noncompliance with which could have a material effect on the financial statements.

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

Opinion on Financial Statements

In our opinion, **[entity’s]** financial statements present fairly, in all material respects, **[entity’s]** financial position as of **[September 30, 20XX, and 20XX]**, and its net cost of operations, changes in net position, and budgetary resources for the fiscal years then ended in accordance with U.S. generally accepted accounting principles.

**[Note: If applicable, insert matter of emphasis paragraph in accordance with AU-C 706 and include related heading. Conclude with “Our opinion on [entity’s] financial statements is not modified with respect to this matter.”]**

Opinion on Internal Control over Financial Reporting

In our opinion, although certain internal controls could be improved, **[entity]** maintained, in all material respects, effective internal control over financial reporting as of **[September 30, 20XX]**, based on criteria established under FMFIA. As discussed below in more detail, our **[20XX]** audit identified deficiencies in **[entity’s]** controls over **[describe account or process where significant deficiency identified, for example, accounts receivable process]** that collectively represent a significant deficiency in **[entity’s]** internal control over financial reporting.[[39]](#footnote-39) We considered this significant deficiency in determining the nature, timing, and extent of our audit procedures on **[entity’s]** fiscal year **[20XX]** financial statements.

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

**[If applicable]** In addition to the significant deficiency in internal control over **[insert description of significant deficiency from above]**, we also identified other deficiencies in **[entity’s]** internal control over financial reporting that we do not consider to be material weaknesses or significant deficiencies. Nonetheless, these deficiencies warrant **[entity]** management’s attention. We have communicated these matters to **[entity]** management and, where appropriate, will report on them separately. [[40]](#footnote-40)

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

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

Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles issued by the Federal Accounting Standards Advisory Board (FASAB) require that the RSI be presented to supplement the financial statements. Although the RSI is not a part of the financial statements, FASAB considers this information to be an essential part of financial reporting for placing the financial statements in appropriate operational, economic, or historical context. We have applied certain limited procedures to the RSI in accordance with U.S. generally accepted government auditing standards, which consisted of inquiries of management about the methods of preparing the RSI and comparing the information for consistency with management’s responses to the auditor’s inquiries, the financial statements, and other knowledge we obtained during the audit of the financial statements, in order to report omissions or material departures from FASAB guidelines, if any, identified by these limited procedures. We did not audit and we do not express an opinion or provide any assurance on the RSI because the limited procedures we applied do not provide sufficient evidence to express an opinion or provide any assurance.

Other Information

**[Entity’s]** other information contains a wide range of information, some of which is not directly related to the financial statements. This information is presented for purposes of additional analysis and is not a required part of the financial statements or the RSI. We read the other information included with the financial statements in order to identify material inconsistencies, if any, with the audited financial statements. Our audit was conducted for the purpose of forming an opinion on **[entity’s]** financial statements. We did not audit and do not express an opinion or provide any assurance on the other information.

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

In connection with our audits of **[entity’s]** financial statements, we tested compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements consistent with our auditor’s responsibility discussed below. We caution that noncompliance may occur and not be detected by these tests. We performed our tests of compliance in accordance with U.S. generally accepted government auditing standards.

Management’s Responsibility

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

Auditor’s Responsibility

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

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

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

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

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

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

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

**[Signature]**

**[Title]**

**[Date of auditor’s report]**

595 C – Uncorrected Misstatements and Adjusting Entries

1. As discussed in FAM 540.04, the auditor should accumulate factual, judgmental, and projected misstatements that the auditor identified during the audit but have not yet corrected by the entity. The auditor may do this on a Schedule of Uncorrected Misstatements that includes related adjusting entries (see FAM 595 C, example 1). Because the entity is responsible for its financial statements, as discussed in FAM 540.06 through .07, management has to decide which misstatements to correct in the financial statements and which amounts will remain uncorrected misstatements. The auditor should communicate misstatements to those charged with governance.

**Schedule of Uncorrected Misstatements (before Discussion with Management) (FAM 595 C – Example 1)**

The auditor should include the effect of uncorrected misstatements on the entity’s financial statements and provide the related adjusting entries to entity management. Because this information follows the entity’s financial statements, the specific line items may differ for each entity. The auditor should list all uncorrected misstatements other than those below a clearly trivial amount (see FAM 540.04).

As discussed in FAM 540.05, the auditor should quantify and evaluate misstatements under both the rollover and iron curtain approaches. Subsequently, the auditor generally should propose an adjusting entry when either approach results in quantifying a misstatement that is above clearly trivial, after considering all relevant quantitative and qualitative factors.

The auditor should also include the effect of uncorrected misstatements from the prior year on the current year’s financial statements (the carryover effect) or note that there were no prior-year misstatements.

Typical information related to adjusting entries information would include the following:

1. Reference to an adjustment number or documentation reference.
2. Whether the misstatement is factual, judgmental, or projected.
3. Whether the misstatement is the carryover effect from a prior year (PY) or a misstatement arising in the current year (CY).
4. Description of the adjustment.
5. Indication of whether each account affected is a federal intragovernmental (F) or a nonfederal public account (N).
6. SGL account number and account description.
7. Amount of the debit and credit.
8. Line items affected in the entity’s financial statements. (For entities required to submit misstatements for use in the preparation and audit of the U.S. government’s consolidated financial statements (CFS), the auditor generally should indicate the CFS line item affected.)

**Discuss Uncorrected Misstatements with Management and Those Charged with Governance**

The auditor should communicate factual, judgmental, and projected misstatements identified during the audit to the appropriate level of management and those charged with governance, as required by AU-C 450 and AU-C 260*.* The auditor should request that management correct all misstatements, as discussed in FAM 540.06 through .07. If management investigates and challenges assumptions or methods used in developing an estimate for judgmental and projected misstatements, the auditor should reevaluate the misstatement and determine whether to perform additional audit procedures. The auditor should document discussions with management on misstatements and any additional audit procedures performed.

The auditor also may communicate to those charged with governance other corrected immaterial misstatements, such as frequently recurring immaterial misstatements that may indicate a particular bias in the preparation of the financial statements. An example would be recurring cutoff errors for liabilities at year-end.

If there are a large number of small uncorrected misstatements, the auditor may communicate to those charged with governance the number and overall monetary effect of the misstatements, rather than the details of each misstatement.

The auditor should discuss with those charged with governance the implications of management’s failure to correct factual, judgmental, and projected misstatements, considering qualitative as well as quantitative considerations, including possible implications in relation to future financial statements.

**Schedule of Uncorrected Misstatements (after Discussion with Management) (FAM 595 C – Example 2)**

If management corrects one or more of the identified misstatements to the financial statements, the auditor should use the Schedule of Uncorrected Misstatements (before Discussion with Management) – Example 1 to create a new Summary of Uncorrected Misstatements (after Discussion with Management) for any uncorrected misstatements, as indicated in example 2 of this FAM section. The example summary includes a last column of final account balances to assist the auditor in calculating, evaluating, and concluding the effect of uncorrected misstatements on the final financial statements. In example 2, management has declined to correct misstatements 1 through 5 in the financial statements as management has determined them immaterial.

The auditor generally should transfer any corrected misstatement to a Summary of Misstatements Corrected as indicated in example 3 of this FAM section. In example 3, management has agreed to correct misstatement 6 in the financial statements as management has determined it to be material.

The auditor should attach the Summary of Uncorrected Misstatements (from example 2) without the auditor’s calculations, evaluation, and conclusion (or a listing of uncorrected misstatements if the number and amount of the misstatements are insignificant) to the management representation letter, as discussed in FAM 1001.

**Final Evaluation**

The auditor should evaluate the effect of the uncorrected misstatements and determine whether the financial statements taken as a whole are materially misstated from a quantitative or qualitative viewpoint (FAM 540).

The auditor should also conclude (in consultation with the reviewer, as discussed in FAM 540.04 and FAM 545) on the adequacy of the scope of procedures performed in light of the total uncorrected misstatements identified above.

**Example 1 – Schedule of Uncorrected Misstatements (before Discussion with Management), Including a Prior Period Misstatement**

(This schedule lists the uncorrected misstatements and the effects identified by the auditor. See FAM 595 C.02 through .05. In this example, one of the proposed adjustments relates to an expense cut-off error in which $200 of expenses related to the following year were recorded in the current year, thereby overstating other liabilities by $200 at the end of the current year. In addition, a similar cut-off error existed at the end of the prior year, in which $300 of expenses related to the current year were included in the prior year. For the purpose of evaluating misstatements under the rollover approach in the current year, the entity quantifies the misstatement as a $200 overstatement of expenses, offset by the effect of the reversal of the $300 understatement of expenses included in the prior year that should have been incurred in the current year. The schedule also includes the misstatements and related adjustment quantified under the iron curtain approach. The adjustment consists of a $300 debit to beginning net position and a $300 credit to operating expenses to reverse the effects of prior year misstatements recorded under the rollover approach, resulting in a $200 overstatement of other liabilities and total net cost as of the end of the current year.)

| (Dollars in thousands)  (1) | Adjustment number  (2) | Factual, judgmental, or projected misstatement  (3) | Line item balance  (4) | Total misstatements  (5) | | | Effect of prior year misstatements  (6) | Adjusted line item balance – effect of misstatements originating in the current year  (7) = (4) + (5) + (6) | Misstatement as percentage of reported line item - effect of misstatements originating in the current year  (8) | Adjustments for the effect of misstatements on the balance sheet as of the end of the current year  (9) | Adjusted line item balance – effect of misstatements on the balance sheet as of the end of the current year  (10) = (7) + (9) | Misstatement as percentage of reported line item - effect of misstatements as of the end of the current year  (11) |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Debit/(Credit) | Debit | (Credit) | Net Debit/(Credit) | Debit/(Credit) | Debit/(Credit) | Debit/(Credit) |
| Balance Sheet[[42]](#footnote-42) |  |  |  |  |  |  |  |  |  |  |  |  |
| Assets |  |  |  |  |  |  |  |  |  |  |  |  |
| Fund balance with Treasury | 5 | F | 50,000 |  | (10,000) | (10,000) |  | 40,000 | -20.00% |  | 40,000 | -20.00% |
| Accounts receivable, net | 3 | F | 125 |  | (25) | (105) |  | 20 | -84.00% |  | 20 | -84.00% |
| 4 | P |  |  | (80) |  |  |
| Loans receivable, net |  |  | 1,000 |  |  |  |  | 1,000 | 0.00% |  | 1,000 | 0.00% |
| PPE, net |  |  | 40,000 |  |  |  |  | 40,000 | 0.00% |  | 40,000 | 0.00% |
| Inventory |  |  | 8,000 |  |  |  |  | 8,000 | 0.00% |  | 8,000 | 0.00% |
| Total assets |  |  | 99,125 |  | (10,105) | (10,105) |  | 89,020 |  |  | 89,020 |  |
| Liabilities |  |  |  |  |  |  |  |  |  |  |  |  |
| Accounts payable - nonfederal public | 1 | J | (2,000) |  | (230) | (230) |  | (2,230) | 11.50% |  | (2,230) | 11.50% |
| Other liabilities | 2 | F | (5,250) | 200 |  | 200 |  | (5,050) | -3.81% |  | (5,050) | -3.81% |
| Total liabilities |  |  | (7,250) | 200 | (230) | (30) |  | (7,280) |  |  | (7,280) |  |
| Net Position |  |  |  |  |  |  |  |  |  |  |  |  |
| Beginning Net Position |  |  | (104,675) |  |  |  | (300) | (104,975) | 0.29% | 300 | (104,675) | 0.00% |
| Net current year (surplus) deficit | 1 | J | 12,800 | 230 |  | 10,135 |  | 23,235 | 81.52% | (300) | 22,935 | 79.18% |
| 2 | F |  |  | (200) | 300 |
| 3 | F |  | 25 |  |  |
| 4 | P |  | 80 |  |  |
| 5 | F |  | 10,000 |  |  |
| Total net position |  |  | (91,875) | 10,335 | (200) | 10,135 |  | (81,740) |  |  | (81,740) |  |
| Total liabilities and net position |  |  | (99,125) | 10,510 | (430) | 10,105 |  | (89,020) |  |  | (89,020) |  |
| Total uncorrected misstatements |  |  |  | 10,535 | (10,535) |  | 300 |  |  | 300 |  |  |
| Statement of Net Cost |  |  |  |  |  |  |  |  |  |  |  |  |
| Net cost of operations: |  |  |  |  |  |  |  |  |  |  |  |  |
| Program A: |  |  |  |  |  |  |  |  |  |  |  |  |
| Gross cost - nonfederal public | 1 | J | 19,800 | 230 |  | 30 |  | 20,130 | 1.67% | (300) | 19,830 | 0.15% |
| 2 | F |  | (200) | 300 |
| Less: earned revenue |  |  | (23,000) |  |  |  |  | (23,000) | 0.00% |  | (23,000) | 0.00% |
| Net cost Program A |  |  | (3,200) | 230 | (200) | 30 | 300 | (2,870) | -10.31% | (300) | (3,170) | -0.94% |
| Program B: |  |  |  |  |  |  |  |  |  |  |  |  |
| Gross cost - nonfederal public |  |  | 31,000 |  |  |  |  | 31,000 | 0.00% |  | 31,000 | 0.00% |
| Gross cost - intragovernmental | 3 | F | 500 | 25 |  | 105 |  | 605 | 21.00% |  | 605 | 21.00% |
| 4 | P |  | 80 |  |  |  |  |  |  |  |
| Less: earned revenue | 5 | F | (15,500) | 10,000 |  | 10,000 |  | (5,500) | -64.52% |  | (5,500) | -64.52% |
| Net cost Program B |  |  | 16,000 | 10,105 |  | 10,105 |  | 26,105 | 63.16% |  | 26,105 | 63.16% |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| Total net cost of operations | 12,800 | 10,335 | (200) | 10,135 | 300 | 23,235 | 81.52% | (300) | 22,935 | 79.18% |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| Note: The line items presented mirror those in the entity’s financial statements. Also, for illustration purposes, only the balance sheet and net cost misstatements are presented. When presented to management, the effect on all entity financial statements is presented | | | | | | | | | | | | |
| Legend:  Total misstatements – All misstatements arising in the current year are included in this column. This does not include misstatements arising in prior years (e.g., included in the prior year Summary of Uncorrected Misstatements or misstatements identified in the current year that should be included in the prior year Summary of Uncorrected Misstatements.) Misstatements in this column correspond to adjusting entries included below.  Effect of prior year misstatements – Current year misstatements as a result of misstatements arising in prior years (e.g., reversal of items included in the prior year Summary of Uncorrected Misstatements are included in this column.) Misstatements in this column correspond to adjusting entries included below.  Adjusted line item balance – effect of misstatements originating in the current year – This column shows the adjusted line item balance after accounting for the effect of total misstatements originating in the current year.  Misstatement as percentage of reported line item (effect of misstatements originating in the current year) – The effect of misstatements originating in the current year as a percentage of the reported line item balance is displayed in this column to help assess the materiality of the misstatement on each line item.  Adjustments for the effect of misstatements on the balance sheet as of the end of the current year – This column includes any adjustments to misstatements as a result of switching approaches from quantifying misstatements originating in the current year to quantifying all misstatements as of the end of the current year, regardless of the period in which the misstatement arose. This column can include reversals of misstatements that were included when only considering the effect of misstatements originating in the current year. Misstatements in this column correspond to adjusting entries included below.  Adjusted line item balance - effect of misstatements on the balance sheet as of the end of the current year – This column shows the adjusted line item balance after accounting for any adjustments needed to consider the effect of all misstatements as of the end of the current year.  Misstatement as percentage of reported line item (effect of misstatements as of the end of the current year) - Misstatements as of the end of the current year are displayed in this column as a percentage of the reported line item balance to help assess the materiality of the misstatement on each line item. | | | | | | | | | | | | |

Example 1 – Adjusting Entries to Correct Misstatements (before Discussion with Management)

| Adj. # | Management will record? | | | |  |  | | | (Dollars in thousands) | | Corresponding U.S. government's CFS line item |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | Factual, judgmental or projected? | | |  | Federal governmental (F) or nonfederal public (N) | | |
|  |  | Prior year (PY) or current year (CY) | |  |  | SGL account number | |
|  |  |  | Description |  |  |  | SGL Description | Debit | Credit |
| 1 |  | Judgmental | CY | To accrue accounts payable for Program A. |  | N | 6100 | Operating expenses – Program A | $230 |  | Gross costs |
|  |  |  |  |  | N | 2110 | Accounts payable |  | $230 | Accounts payable |
| 2 |  | Factual | CY | To decrease operating expenses arising in the current year from the current year cut-off error. |  | N | 2990 | Other liabilities | $200 |  | Other liabilities |
|  |  |  |  | N | 6100 | Operating expenses – Program A |  | $200 | Gross costs |
|  | Factual | PY | To increase current year operating expenses arising from the prior year cut-off error (from prior year Summary of Uncorrected Misstatements). |  | N | 6100 | Operating expenses – Program A | $300 |  | Gross costs |
|  |  |  |  | N | 3000 | Beginning net position |  | $300 | Net Position, beginning of period |
| 3 |  | Factual | CY | To increase current year loan bad debt expense in Program B. [Actual error amount of an intragovernmental sample item.] |  | F | 6720 | Bad debt expense – Program B | $25 |  | Intragovernmental amounts are eliminated in consolidation |
|  |  |  |  | F | 1319 | Allowance for accounts receivable |  | $25 |
| 4 |  | Projected | CY | To increase current year loan bad debt expense in Program B. [Additional projected misstatement as a result of actual error amount of sample item from Adj #3 above projected to the population. Total projected misstatement of $105 less $25 actual misstatement] |  | F | 6720 | Bad debt expense – Program B | $80 |  | Intragovernmental amounts are eliminated in consolidation |
|  |  |  |  |  | F | 1319 | Allowance for accounts receivable |  | $80 |
| 5 |  | Factual | CY | To adjust FBWT for receipts after cutoff date. |  | N | 5100 | Earned revenue - Program B | $10,000 |  | Earned revenue |
|  |  |  |  |  | F | 1010 | FBWT |  | $10,000 | FBWT eliminates in consolidation |
|  | | | | | | | |  |  |  |  |
| Adjustments for the effect of misstatements as of the end of the current year: | | | | | | | | | | | |
|  |  | Factual | CY | To decrease current year operating expenses as a result of the reversal of the correcting entry for the prior year cut-off error of operating expenses (adjustment number 2), which does not affect misstatements on the balance sheet as of the end of the current year. |  | N | 3000 | Beginning net position | $300 |  | Net position, beginning of period |
|  |  |  |  |  | N | 6100 | Operating expenses – Program A |  | $300 | Gross costs |

Note: The line items presented mirror those in the entity’s financial statements.

Example 2 – Summary of Uncorrected Misstatements (after Discussions with Management)

(After discussions with management (FAM 595 C.06 through .09), a summary of uncorrected misstatements is created from Example 1 that management has declined to correct. See FAM 595 C.10 and .12)

| (Dollars in thousands)  (1) | Adjustment number  (2) | Factual, judgmental, or projected misstatement  (3) | Line item balance  (4) | Total misstatements  (5) | | | Effect of prior year misstatements  (6) | Adjusted line item balance – effect of misstatements originating in the current year  (7) = (4) + (5) + (6) | Misstatement as percentage of reported line item - effect of misstatements originating in the current year  (8) | Adjustments for the effect of misstatements on the balance sheet as of the end of the current year  (9) | Adjusted line item balance – effect of misstatements on the balance sheet as of the end of the current year  (10) = (7) + (9) | Misstatement as percentage of reported line item - effect of misstatements as of the end of the current year  (11) |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Debit/(Credit) | Debit | (Credit) | Net Debit/(Credit) | Debit/(Credit) | Debit/(Credit) | Debit/(Credit) |
| Balance Sheet[[43]](#footnote-43) |  |  |  |  |  |  |  |  |  |  |  |  |
| Assets |  |  |  |  |  |  |  |  |  |  |  |  |
| Fund balance with Treasury |  |  | 50,000 |  |  |  |  | 50,000 | 0.00% |  | 50,000 | 0.00% |
| Accounts receivable, net | 3 | F | 125 |  | (25) | (105) |  | 20 | -84.00% |  | 20 | -84.00% |
| 4 | P |  |  | (80) |  |  |
| Loans receivable, net |  |  | 1,000 |  |  |  |  | 1,000 | 0.00% |  | 1,000 | 0.00% |
| PPE, net |  |  | 40,000 |  |  |  |  | 40,000 | 0.00% |  | 40,000 | 0.00% |
| Inventory |  |  | 8,000 |  |  |  |  | 8,000 | 0.00% |  | 8,000 | 0.00% |
| Total assets |  |  | 99,125 |  | (105) | (105) |  | 99,020 |  |  | 99,020 |  |
| Liabilities |  |  |  |  |  |  |  |  |  |  |  |  |
| Accounts payable - nonfederal public | 1 | J | (2,000) |  | (230) | (230) |  | (2,230) | 11.50% |  | (2,230) | 11.50% |
| Other liabilities | 2 | F | (5,250) | 200 |  | 200 |  | (5,050) | -3.81% |  | (5,050) | -3.81% |
| Total liabilities |  |  | (7,250) | 200 | (230) | (30) |  | (7,280) |  |  | (7,280) |  |
| Net Position |  |  |  |  |  |  |  |  |  |  |  |  |
| Beginning Net Position |  |  | (104,675) |  |  |  | (300) | (104,975) | 0.29% | 300 | (104,675) | 0.00% |
| Net current year (surplus) deficit | 1 | J | 12,800 | 230 |  | 135 |  | 13,235 | 3.40% | (300) | 12,935 | 1.05% |
| 2 | F |  |  | (200) | 300 |
| 3 | F |  | 25 |  |  |
| 4 | P |  | 80 |  |  |
|  |  |  |  |  |  |
| Total net position |  |  | (91,875) | 335 | (200) | 135 |  | (91,740) |  |  | (91,740) |  |
| Total liabilities and net position |  |  | (99,125) | 535 | (430) | 105 |  | (99,020) |  |  | (99,020) |  |
| Total uncorrected misstatements |  |  |  | 535 | (535) |  | 300 |  |  | 300 |  |  |
| Statement of Net Cost |  |  |  |  |  |  |  |  |  |  |  |  |
| Net cost of operations: |  |  |  |  |  |  |  |  |  |  |  |  |
| Program A: |  |  |  |  |  |  |  |  |  |  |  |  |
| Gross cost - nonfederal public | 1 | J | 19,800 | 230 |  | 30 |  | 20,130 | 1.16% | (300) | 19,830 | -3.89% |
| 2 | F |  | (200) | 300 |
| Less: earned revenue |  |  | (23,000) |  |  |  |  | (23,000) | 0.00% |  | (23,000) | 0.00% |
| Net cost Program A |  |  | (3,200) | 230 | (200) | 30 | 300 | (2,870) | -10.31% | (300) | (3,170) | -0.94% |
| Program B: |  |  |  |  |  |  |  |  |  |  |  |  |
| Gross cost - nonfederal public |  |  | 31,000 |  |  |  |  | 31,000 | 0.00% |  | 31,000 | 0.00% |
| Gross cost - intragovernmental | 3 | F | 500 | 25 |  | 105 |  | 605 | 21.00% |  | 605 | 21.00% |
| 4 | P |  | 80 |  |  |  |  |  |  |  |
| Less: earned revenue |  |  | (15,500) |  |  |  |  | (15,500) | 0.00% |  | (15,500) | 0.00% |
| Net cost Program B |  |  | 16,000 | 105 |  | 105 |  | 16,105 | 0.66% |  | 16,105 | 0.66% |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| Total net cost of operations | 12,800 | 335 | (200) | 135 | 300 | 13,235 | 3.40% | (300) | 12,935 | 1.05% |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| Legend:  Total misstatements – All misstatements arising in the current year are included in this column. This does not include misstatements arising in prior years (e.g., included in the prior year Summary of Uncorrected Misstatements or misstatements identified in the current year that should be included in the prior year Summary of Uncorrected Misstatements.) Misstatements in this column correspond to adjusting entries included below.  Effect of prior year misstatements – Current year misstatements as a result of misstatements arising in prior years (e.g., reversal of items included in the prior year Summary of Uncorrected Misstatements are included in this column.) Misstatements in this column correspond to adjusting entries included below.  Adjusted line item balance – effect of misstatements originating in the current year – This column shows the adjusted line item balance after accounting for the effect of total misstatements originating in the current year.  Misstatement as percentage of reported line item (effect of misstatements originating in the current year) – The effect of misstatements originating in the current year as a percentage of the reported line item balance is displayed in this column to help assess the materiality of the misstatement on each line item.  Adjustments for the effect of misstatements on the balance sheet as of the end of the current year – This column includes any adjustments to misstatements as a result of switching approaches from quantifying misstatements originating in the current year to quantifying all misstatements as of the end of the current year, regardless of the period in which the misstatement arose. This column can include reversals of misstatements that were included when only considering the effect of misstatements originating in the current year. Misstatements in this column correspond to adjusting entries included below.  Adjusted line item balance - effect of misstatements on the balance sheet as of the end of the current year – This column shows the adjusted line item balance after accounting for any adjustments needed to consider the effect of all misstatements as of the end of the current year.  Misstatement as percentage of reported line item (effect of misstatements as of the end of the current year) - Misstatements as of the end of the current year are displayed in this column as a percentage of the reported line item balance to help assess the materiality of the misstatement on each line item. | | | | | | | | | | | | |
| We discussed the Summary of Uncorrected Misstatements with Joe Jones, CFO, and Sandra Hawkins, COO, on 11/1/XX. We encouraged them to make adjustments for all of the factual misstatements and investigate the judgmental and projected misstatements. They corrected misstatement #5 in the financial statements because they believed it was material. When considering the effect of misstatements originating in the current year and the effect of misstatements as of the end of the current year, management concluded that the other misstatements were not material, but that after the audit they would consider whether internal control needed strengthening in these areas. On 11/4/xx, we discussed misstatements with the entity’s Executive Committee, including the entity’s head Jane Green. The Executive Committee agreed with the actions taken by management. | | | | | | | | | | | | |
| Conclusion: The effect of uncorrected misstatements originating in the current year excluding the effects of misstatements arising in prior years ($135,000) and the effect of all uncorrected misstatements originating in the current year ($435,000) on total net cost are each less than our materiality for the financial statements as a whole of $1,524,000 (3% of gross cost with the public of $50.8 million— our materiality benchmark). In addition, we found that the effect of the uncorrected misstatements originating in the current year excluding the effects of misstatements arising in prior years ($30,000) and the effect of all uncorrected misstatements originating in the current year ($330,000) on total gross cost with the public are each less than our materiality for the financial statements as a whole. Further, the effect of all uncorrected prior period misstatements on the balance sheet as of the end of the current year ($135,000) on both total net cost and total gross cost with the public is also less than materiality for the financial statements as a whole. We also considered the effect of the uncorrected misstatements on other line items on the financial statements. We also considered whether these misstatements were qualitatively material. Based on this analysis, we concur with management that the uncorrected misstatements are not material to the financial statements.  In addition, we have obtained sufficient appropriate audit evidence to conclude that there is an acceptably low risk that projected misstatement plus an allowance for further misstatement would be material. | | | | | | | | | | | | |
| Note: For illustration purposes, only the balance sheet and net cost misstatements are presented. When presented to management, the effect of misstatements on all entity financial statements is presented. | | | | | | | | | | | | |

Example 2 – Adjusting Entries to Correct Misstatements (after Discussion with Management)

| Adj. # | Management will record? | | | |  | | | (Dollars in thousands) | | Corresponding U.S. government's CFS line item |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | Factual, judgmental or projected? | | | Federal governmental (F) or nonfederal public (N) | | |
|  |  | Prior year (PY) or current year (CY) | |  | SGL account number | |
|  |  |  | Description |  |  | SGL Description | Debit | Credit |
| 1 | No | Judgmental | CY | To accrue accounts payable for Program A. | N | 6100 | Operating expenses – Program A | $230 |  | Gross costs |
|  |  |  |  | N | 2110 | Accounts payable |  | $230 | Accounts payable |
|  | No | Factual | CY | To decrease operating expenses arising in the current year from the current year cut-off error. | N | 2990 | Other liabilities | $200 |  | Other liabilities |
| 2 |  |  |  | N | 6100 | Operating expenses – Program A |  | $200 | Gross costs |
| No | Factual | PY | To increase current year operating expenses arising from the prior year cut-off error (from prior year Summary of Uncorrected Misstatements). | N | 6100 | Operating expenses – Program A | $300 |  | Gross costs |
|  |  |  |  | N | 3000 | Beginning net position |  | $300 | Net position, beginning of period |
| 3 | No | Factual | CY | To increase current year loan bad debt expense in Program B. [Actual error amount of an intragovernmental sample item.] | F | 6720 | Bad debt expense – Program B | $25 |  | Intragovernmental amounts are eliminated in consolidation |
|  |  |  | F | 1319 | Allowance for accounts receivable |  | $25 |
| 4 | No | Projected | CY | To increase current year loan bad debt expense in Program B. [Additional projected misstatement as a result of actual error amount of sample item from Adj #3 above projected to the population. Total projected misstatement of $105 less $25 actual misstatement] | F | 6720 | Bad debt expense – Program B | $80 |  | Intragovernmental amounts are eliminated in consolidation |
|  |  |  |  | F | 1319 | Allowance for accounts receivable |  | $80 |
| Adjustments for the effect of misstatements as of the end of the current year: | | | | | | | | | | |
|  | No | Factual | CY | To decrease current year operating expenses as a result of the reversal of the correcting entry for the prior year cut-off error of operating expenses (adjustment number 2), which does not affect misstatements on the balance sheet as of the end of the current year. | N | 3000 | Beginning net position | $300 |  | Net position, beginning of period |
|  |  |  |  | N | 6100 | Operating expenses – Program A |  | $300 | Gross costs |

**Example 3 – Summary of Corrected Misstatements (after Discussion with Management)**

(This summary schedule shows the misstatement from example 2 that management has agreed to correct. See FAM 595 C.11.)

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Adj. # | Management will record? | | | |  |  | | | (Dollars in thousands) | | Corresponding U.S. government's CFS line item |
|  | Factual, judgmental or projected? | | |  | Federal governmental (F) or nonfederal public (N) | | |
|  |  | Prior year (PY) or current year (CY) | |  |  | SGL account number | |
|  |  |  | Description |  |  |  | SGL Description | Debit | Credit |
| 5 | Yes | Factual | CY | To reconcile FBWT for receipts after cutoff date. |  | N | 5100 | Earned revenue - Program B | $10,000 |  | FBWT eliminates in consolidation |
|  |  |  |  |  | F | 1010 | FBWT |  | $10,000 |

1. For example, if assets have been materially overstated, the financial statements as a whole will be materially misstated, even if the effect of the misstatement on net position is completely offset by an equivalent overstatement of liabilities. It may be appropriate to offset misstatements within the same account balance or class of transactions; however, the risk that further undetected misstatements may exist is considered before concluding that offsetting even immaterial misstatements is appropriate. (See AU-C 450.A21.) [↑](#footnote-ref-1)
2. Generally, entities resist booking projected misstatements citing no supporting transactions. However, the amount can be booked through a general journal entry and reversed the following year. [↑](#footnote-ref-2)
3. An audit sampling specialist may perform or be consulted on all statistical calculations. [↑](#footnote-ref-3)
4. GASB establishes U.S. GAAP for units of state and local governments. [↑](#footnote-ref-4)
5. Auditors may obtain the Federal Financial Reporting Checklist by contacting FAM@gao.gov. [↑](#footnote-ref-5)
6. Non-GAO auditors may combine bullets 3 and 4. [↑](#footnote-ref-6)
7. These are usually comparative statements for the current and prior years unless it is the entity’s initial audit. [↑](#footnote-ref-7)
8. If the auditor finds no material weaknesses in internal control, the auditor may express an opinion on management’s assessment or directly on internal control. [↑](#footnote-ref-8)
9. A reasonable possibility exists when the likelihood of an event occurring is either reasonably possible or probable. Reasonably possible is defined as the chance of the future event or events occurring is more than remote but less than likely. Probable is defined as the future event or events are likely to occur (AU-C 265.07). [↑](#footnote-ref-9)
10. This definition is used to determine whether a material weakness exists. [↑](#footnote-ref-10)
11. A compensating control is a control that limits the severity of a control deficiency and prevents it from rising to the level of a significant deficiency or, in some cases, a material weakness. Compensating controls operate at a level of precision, considering the possibility of further undetected misstatements that would prevent or detect a misstatement that is more than inconsequential or material to the financial statements. Although compensating controls mitigate the effects of a control deficiency, they do not eliminate the control deficiency. [↑](#footnote-ref-11)
12. OMB’s Bulletin on *Audit Requirements for Federal Financial Statements* contains additional information regarding FFMIA audit requirements and is updated periodically. The current version of the OMB Bulletin can be found at <https://www.whitehouse.gov/omb/information-for-agencies/bulletins>. [↑](#footnote-ref-12)
13. This example assumes the acronym of the agency does not include the word “the” in front of it as part of its common usage (example: CFPB). If “the” is part of the common usage of the acronym (example: the FBI), apply throughout the example. [↑](#footnote-ref-13)
14. The RSI consists of [insert description of the RSI, such as “Management’s Discussion and Analysis” and the “Combined Statement of Budgetary Resources”], which are included with the financial statements. [↑](#footnote-ref-14)
15. Other information consists of information included with the financial statements, other than the RSI **[if applicable]** and the auditor’s report. [↑](#footnote-ref-15)
16. Note: GAO does not capitalize the “o” in “over” in “internal control over financial reporting” when used in a heading or title. However, when referring to the title of management’s report included with the auditor’s report, the wording and capitalization should be consistent with management’s presentation. [↑](#footnote-ref-16)
17. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected, on a timely basis. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. [↑](#footnote-ref-17)
18. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. [↑](#footnote-ref-18)
19. For GAO reports, only the agency name is cited in this section if the entity provides written comments. Do not include the name or title of the commenting official. If the entity provides an email or oral comments, the title of the commenting official is included. See Words@Work on the GAO intranet. [↑](#footnote-ref-19)
20. This example assumes the acronym of the agency does not include the word “the” in front of it as part of its common usage (example: CFPB). If “the” is part of the common usage of the acronym (example: the FBI), apply throughout the example. [↑](#footnote-ref-20)
21. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected, on a timely basis. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. [↑](#footnote-ref-21)
22. The RSI consists of [insert description of the RSI, such as “Management’s Discussion and Analysis” and the “Combined Statement of Budgetary Resources”], which are included with the financial statements. [↑](#footnote-ref-22)
23. Other information consists of information included with the financial statements, other than the RSI **[if applicable]** and the auditor’s report. [↑](#footnote-ref-23)
24. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. [↑](#footnote-ref-24)
25. For GAO reports, only the agency name is cited in this section if the entity provides written comments. Do not include the name or title of the commenting official. If the entity provides an email or oral comments, the title of the commenting official is included. See Words@Work on the GAO intranet. [↑](#footnote-ref-25)
26. This example assumes the acronym of the agency does not include the word “the” in front of it as part of its common usage (example: CFPB). If “the” is part of the common usage of the acronym (example: the FBI), apply throughout the example. [↑](#footnote-ref-26)
27. The RSI consists of [insert description of the RSI, such as “Management’s Discussion and Analysis” and the “Combined Statement of Budgetary Resources”], which are included with the financial statements. [↑](#footnote-ref-27)
28. Other information consists of information included with the financial statements, other than the RSI **[if applicable]** and the auditor’s report. [↑](#footnote-ref-28)
29. Note: GAO does not capitalize the “o” in “over” in “internal control over financial reporting” when used in a heading or title. However, when referring to the title of management’s report included with the auditor’s report, the wording and capitalization should be consistent with management’s presentation. [↑](#footnote-ref-29)
30. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected, on a timely basis. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. [↑](#footnote-ref-30)
31. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. [↑](#footnote-ref-31)
32. If applicable, consider adding the following sentence to the beginning of the paragraph “We will be reporting additional details concerning this material weakness separately to **[entity]** management, along with recommendations for corrective actions.” [↑](#footnote-ref-32)
33. For GAO reports, only the agency name is cited in this section if the entity provides written comments. Do not include the name or title of the commenting official. If the entity provides an email or oral comments, the title of the commenting official is included. See Words@Work on the GAO intranet. [↑](#footnote-ref-33)
34. This example assumes the acronym of the agency does not include the word “the” in front of it as part of its common usage (example: CFPB). If “the” is part of the common usage of the acronym (example: the FBI), apply throughout the example. [↑](#footnote-ref-34)
35. The RSI consists of [insert description of the RSI, such as “Management’s Discussion and Analysis” and the “Combined Statement of Budgetary Resources”], which are included with the financial statements. [↑](#footnote-ref-35)
36. Other information consists of information included with the financial statements, other than the RSI **[if applicable]** and the auditor’s report. [↑](#footnote-ref-36)
37. Note: GAO does not capitalize the “o” in “over” in the phrase “internal control over financial reporting” when used in a heading or title. However, when referring to the title of management’s report included with the auditor’s report, the wording and capitalization should be consistent with management’s presentation. [↑](#footnote-ref-37)
38. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected, on a timely basis. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. [↑](#footnote-ref-38)
39. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. [↑](#footnote-ref-39)
40. If applicable, consider adding the following sentence to the beginning of the paragraph “We will be reporting additional details concerning this significant deficiency separately to **[entity]** management, along with recommendations for corrective actions.” [↑](#footnote-ref-40)
41. For GAO reports, only the agency name is cited in this section if the entity provides written comments. Do not include the name or title of the commenting official. If the entity provides an email or oral comments, the title of the commenting official is included. See Words@Work on the GAO intranet. [↑](#footnote-ref-41)
42. As needed, create additional schedules for other financial statements that have adjustments. [↑](#footnote-ref-42)
43. As needed, create additional schedules for other financial statements that have adjustments. [↑](#footnote-ref-43)